

**KAUPTHING BANK HF.**  
(incorporated in Iceland as a public limited company)

**ISK 200,000,000,000**  
**Covered Bond Programme**

**unconditionally and irrevocably guaranteed as to payments by**  
**KAUPTHING MORTGAGES INSTITUTIONAL INVESTOR FUND**  
(established in Iceland as an institutional investment fund pursuant to Act No. 30/2003 on UCITS and Investment Funds)

Under this ISK 200,000,000,000 covered bond programme (the **Programme**), Kaupthing Bank hf. (the **Issuer**) may from time to time issue bonds (the **Covered Bonds**) denominated in any currency agreed between the Issuer and the relevant Dealer (as defined below).

The payments of all amounts due in respect of the Covered Bonds have been unconditionally and irrevocably guaranteed by Kaupthing Mortgages Institutional Investor Fund (the **Fund**).

The maximum aggregate nominal amount of all Covered Bonds from time to time outstanding under the Programme will not exceed ISK 200,000,000,000 (or its equivalent in other currencies calculated as described in the Programme Agreement described herein), subject to increase as described herein.

The Covered Bonds 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 Prospectus to the **relevant Dealer** shall, in the case of an issue of Covered Bonds which are to be subscribed to by one or more Dealers, be to all Dealers agreeing to subscribe to such Covered Bonds.

Application was made to the OMX Nordic Exchange Iceland hf. (**OMX ICE**) for Covered Bonds issued under the Programme during the 12 months from the date of this Prospectus to be admitted to trading on the regulated market of the OMX ICE. References in this Prospectus to Covered Bonds being **listed** (and all related references) shall mean that such Covered Bonds have been admitted to trading on the regulated market of the OMX ICE. The regulated market of the OMX ICE is a regulated market for the purposes of Directive 2004/39/EC (the **Markets in Financial Instruments Directive**).

Notice of the aggregate nominal amount of Covered Bonds, interest (if any) payable in respect of Covered Bonds, the issue price of Covered Bonds and any other terms and conditions not contained herein which are applicable to each Tranche (as defined under *Terms and Conditions of the Covered Bonds*) of Covered Bonds will be set out in a final terms document (the **Final Terms**) which, with respect to Covered Bonds to be listed on the OMX ICE, will be delivered to the OMX ICE.

The Programme provides that Covered Bonds 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, the Fund, the Representative (as defined herein) and the relevant Dealer. The Issuer may also issue unlisted Covered Bonds and/or Covered Bonds not admitted to trading on any market.

The Covered Bonds may be held in a manner which will allow Eurosystem eligibility. This simply means that the Covered Bonds may upon issue be deposited with Clearstream Banking, *société anonyme* (**Clearstream, Luxembourg**) or Euroclear Bank S.A./N.V. (**Euroclear**) as one of the international central securities depositories as common safekeeper and does not necessarily mean that the Covered Bonds will be recognised as eligible collateral for Eurosystem monetary policy and intra-day credit operations by the Eurosystem either upon issue or at any or all times during their life. Such recognition will depend upon satisfaction of the Eurosystem eligibility criteria.

**Potential Investors should note that, as stated in Condition 19, by subscribing for or purchasing any Covered Bond, the holder of a Covered Bond shall be deemed to have acknowledged and agreed to the appointment of the Representative as its representative to act for the benefit of the holders for the time being of the Covered Bonds in accordance with the terms of the Representative and Agency Agreement (as defined below).**

**See *Risk Factors* for a discussion of certain factors to be considered in connection with an investment in the Covered Bonds.**

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

The Issuer and the Fund may agree with any Dealer and the Representative that Covered Bonds may be issued in a form not contemplated by the Terms and Conditions of the Covered Bonds described herein, in which event a supplemental prospectus, if appropriate, will be made available which will describe the effect of the agreement reached in relation to such Covered Bonds.

The Covered Bonds issued under the Programme are expected on issue to be assigned a rating of "Aaa" by Moody's Investors Service Limited (**Moody's**). A credit rating is not a recommendation to buy, sell or hold securities and may be subject to revision, suspension or withdrawal at any time at the absolute discretion of the assigning rating organisation. The ratings assigned by Moody's to a Series of Covered Bonds address the expected loss posed to investors by the legal final maturity date. Moody's ratings address only the credit risks associated with the transaction. Other non-credit risks have not been addressed, but may have a significant effect on yield to investors.

**Arranger and Dealer**  
**Kaupthing Bank hf.**

The date of this Prospectus is February 29, 2008.

This Prospectus comprises a base prospectus for the purposes of the Prospectus Directive.

Copies of Final Terms will be available from the registered office of the Issuer and from the specified office of each of the Paying Agents (as defined below).

This Prospectus is to be read in conjunction with all documents which are deemed to be incorporated herein by reference; see *Documents Incorporated by Reference* below. This Prospectus shall be read and construed on the basis that such documents are incorporated in and form part of this Prospectus.

Neither the Dealers, the Arranger nor the Representative have 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, the Arranger or the Representative as to the accuracy or completeness of the information contained or incorporated in this Prospectus or any other information provided by the Issuer and the Fund in connection with the Programme. Neither the Arranger, any of the Dealers or the Representative accepts any liability in relation to the information contained or incorporated by reference in this Prospectus or any other information provided by the Issuer or the Fund in connection with the Programme.

No person is or has been authorised by the Issuer, the Fund, the Arranger, any of the Dealers or the Representative to give any information or to make any representation not contained in or not consistent with this Prospectus or any other information supplied in connection with the Programme or the Covered Bonds and, if given or made, such information or representation must not be relied upon as having been authorised by the Issuer, the Fund, the Arranger, any of the Dealers or the Representative.

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

Neither the delivery of this Prospectus nor the offering, sale or delivery of any Covered Bonds shall in any circumstances imply that the information contained herein concerning the Issuer and the Fund 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, the Arranger and the Representative expressly do not undertake to review the financial condition or affairs of the Issuer or the Fund during the life of the Programme or to advise any investor in the Covered Bonds of any information coming to their attention. This Prospectus does not constitute an offer to sell or the solicitation of an offer to buy any Covered Bonds in any jurisdiction to any person to whom it is unlawful to make the offer or solicitation in such jurisdiction. The distribution of this Prospectus and the offer or sale of Covered Bonds may be restricted by law in certain jurisdictions. The Issuer, the Fund, the Arranger, the Dealers and the Representative do not represent that this Prospectus may be lawfully distributed, or that any Covered Bonds 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, unless specifically indicated to the contrary in the applicable Final Terms, no action has been taken by the Issuer, the Fund, the Arranger, the Dealers or the Representative which is intended to permit a public offering of any Covered Bonds outside Iceland or distribution of this Prospectus in any jurisdiction where action for that purpose is required. Accordingly, no Covered Bonds may be offered or sold, directly or indirectly, and neither this 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 Prospectus or any Covered Bonds may come must inform themselves about, and observe, any such restrictions on the distribution of this Prospectus and the offering and sale of Covered Bonds. In particular, there are restrictions on the distribution of this Prospectus and the offer or sale of Covered Bonds in the United States, the European Economic Area (including the United Kingdom and Iceland) and Japan; see *Subscription and Sale*.

This Prospectus has been prepared on the basis that, except to the extent subparagraph (ii) below may apply, any offer of Covered Bonds in any Member State of the European Economic Area which has implemented the Prospectus Directive (each, a **Relevant Member State**) will be made pursuant to an exemption under the Prospectus Directive, as implemented in that Relevant Member State, from the requirement to publish a prospectus for offers of Covered Bonds. Accordingly any person making or intending to make an offer in that Relevant Member State of Covered Bonds which are the subject of an offering contemplated in this Prospectus as completed by final terms in relation to the offer of those Covered Bonds may only do so (i) in circumstances in which no obligation arises for the Issuer or any Dealer to publish a prospectus pursuant to Article 3 of the Prospectus Directive or supplement a prospectus pursuant to Article 16 of the Prospectus Directive, in each case, in relation to such offer, or (ii) if a prospectus for such offer 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 and (in either case) published, all in accordance with the Prospectus Directive, provided that any such prospectus has subsequently been completed by final terms which specify that offers may be made other than pursuant to Article 3(2) of the Prospectus Directive in that Relevant Member State and such offer is made in the period beginning and ending on the dates specified for such purpose in such prospectus or final terms, as applicable. Except to the extent subparagraph (ii) above may apply, neither the Issuer nor any Dealer has authorised, nor do they authorise, the making of any offer of Covered Bonds in circumstances in which an obligation arises for the Issuer or any Dealer to publish or supplement a prospectus for such offer.

**All references in this document to "U.S. dollars", " U.S.\$" and "\$" refer to United States dollars, to "ISK", "króna" and "krónur" refer to the currency of Iceland, to "Japanese Yen" and "Yen" refer to the currency of Japan, 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.**

All references to "we", "us" and "our" in this Prospectus are references to the Issuer together with its subsidiaries.

## TABLE OF CONTENTS

Summary of the Programme.....	5
Risk Factors .....	12
Documents Incorporated by Reference .....	35
Structure Overview .....	36
Form of the Covered Bonds .....	39
Applicable Final Terms .....	41
Terms and Conditions of the Covered Bonds.....	74
Use of Proceeds .....	101
Description of Kaupthing Bank.....	102
Sources of Funds .....	108
Principal Shareholders.....	114
Risk Management .....	116
Board of Directors of the Issuer .....	127
Summary Consolidated Financial Information.....	130
Description of the Fund .....	132
Summary of the Principal Documents.....	134
Credit Structure .....	150
Cashflows .....	152
Description of Investment Funds in Iceland.....	156
Taxation.....	158
Subscription and Sale .....	160
General Information .....	163
Glossary.....	165

**In connection with the issue and distribution of any Tranche of Covered Bonds, 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 Covered Bonds or effect transactions with a view to supporting the market price of the Covered Bonds 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 terms of the offer of the relevant Tranche of Covered Bonds 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 Covered Bonds and 60 days after the date of the allotment of the relevant Tranche of Covered Bonds. Any stabilisation action or over-allotment must be conducted by the relevant Stabilising Manager(s) (or persons acting on behalf of any Stabilising Manager(s)) in accordance with all applicable laws and rules.**

## SUMMARY OF THE PROGRAMME

This summary must be read as an introduction to this Prospectus and any decision to invest in any Covered Bonds should be based on a consideration of this 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 and the Fund (together the Responsible Persons) 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 Prospectus. Where a claim relating to information contained in this Prospectus is brought before a court in a Member State of the European Economic Area, the plaintiff may, under the national legislation of the Member State where the claim is brought, be required to bear the costs of translating the Prospectus before the legal proceedings are initiated.

*Words and expressions defined elsewhere in this Prospectus shall have the same meanings in this summary. A glossary of certain defined terms is contained at the end of this Prospectus.*

### **Issuer:**

Kaupthing Bank hf. (**Kaupthing Bank**)

Kaupthing Bank, ID no. 560882-0419, is a Nordic bank with shares listed on the OMX Nordic Exchanges in Iceland hf. (**OMX ICE**) and Sweden (**OMX STO**). It has the highest market capitalisation on the OMX ICE. Kaupthing Bank has operations in twelve countries, including all of the Nordic countries and two of the world's main business centres, London and New York. It holds banking licences in eight countries: Iceland, the United Kingdom, Denmark, Sweden, Finland, the Faroe Islands, Norway and Luxembourg. In the United States, it operates through its subsidiary Kaupthing Securities Inc., a licensed broker-dealer, and in Dubai International Financial Centre and Qatar Financial Centre the Issuer has been granted a licence to operate a branch. Iceland, Scandinavia and the United Kingdom currently are the Issuer's most important markets, generating 33 per cent., 25.8 per cent. and 31.3 per cent., respectively, of group operating income in 2007.

Kaupthing Bank and its subsidiaries (together, the **Group**) offer integrated financial services to companies, institutional investors and individuals. Its services include investment banking, corporate banking, capital markets services and asset management, and comprehensive wealth management for private banking clients.

Kaupthing Bank has five core business areas: Banking; Asset Management and Private Banking; Investment Banking; Capital Markets and Treasury. It also has ancillary divisions such as risk management, information technology, finance and legal, compliance and human resources. We also operate a retail banking franchise in Iceland, where we have our headquarters and, to a lesser extent, in Norway and in Sweden.

For a more detailed description of the Issuer, see *Description of Kaupthing Bank* below.

### **Fund:**

Kaupthing Mortgages Institutional Investor Fund, ID no. 570106-9610, an institutional investment fund established in Iceland pursuant to Act No. 30/2003 on Undertaking for Collective Investment in Transferable Securities (**UCITS**) and Investment Funds. The day-to-day operations of the Fund are managed by Kaupthing Bank Asset Management Company hf. (the **Management Company**). The business of the Fund is to acquire, *inter alia*, Loans and their Related Security from the Seller pursuant to the terms of the Mortgage Sale Agreement and to guarantee the Covered Bonds.

The Fund has provided a guarantee covering all Guaranteed Amounts when the same shall become Due for Payment, but only following service of a

Notice to Pay or a Fund Acceleration Notice.

For a more detailed description of the Fund, see *Description of the Fund* below.

**Seller:**

Kaupthing Bank hf.

For a more detailed description of the Seller, see *Description of Kaupthing Bank* below.

**Servicer:**

Kaupthing Bank hf. has been appointed to service, on behalf of the Fund, the Loans and Related Security in the Portfolio pursuant to the terms of the Servicing and Custody Agreement.

**Management Company:**

Kaupthing Bank Asset Management Company hf., ID no. 700996-2479, has been appointed pursuant to the Fund's Articles of Association to manage the day-to-day operations of the Fund in accordance with the Articles of Association of the Fund and the Transaction Documents.

**Custody Agent:**

Arion Custody Services hf., ID no. 470502-4520, has been appointed pursuant to the Fund's Articles of Association to provide certain administration and depository services to the Fund in accordance with the Servicing and Custody Agreement entered into by, *inter alios*, it and the Management Company on behalf of the Fund.

**Cash Manager:**

Kaupthing Bank hf. has also been appointed, *inter alia*, to provide cash management services to the Fund and to monitor compliance by the Fund with the Asset Coverage Test pursuant to the Cash Management Agreement.

**Principal Paying Agent:**

Deutsche Bank AG, London Branch, acting through its office at Winchester House, 1 Great Winchester Street, London EC2N 2DB, has been appointed pursuant to the Representative and Agency Agreement as issuing and principal paying agent and agent bank.

**Representative:**

Deutsche Trustee Company Limited, acting through its office at Winchester House, 1 Great Winchester Street, London EC2N 2DB, has been appointed to act as the representative of the Covered Bondholders in respect of the Covered Bonds.

**Asset Monitor:**

A reputable institution appointed pursuant to the Asset Monitor Agreement as an independent monitor to perform tests in respect of the Asset Coverage Test when required. The Asset Monitor, as at the Programme Date, will be KPMG hf.

**GIC Provider:**

Kaupthing Bank hf. has agreed to act as GIC Provider to the Fund pursuant to the Guaranteed Investment Contract.

**Account Bank:**

Kaupthing Bank hf. has agreed to act as an Account Bank to the Fund pursuant to the Bank Account Agreement.

**Risk Factors:**

There are certain factors that may affect the Issuer's ability to fulfil its obligations under Covered Bonds issued under the Programme. These are set out under *Risk Factors* below and include 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 Covered Bonds issued under the Programme. These are set out under *Risk Factors* below and include the fact that the Covered Bonds may not be a suitable investment for all investors and the risks related to the structure of a particular issue of Covered Bonds.

In addition, prospective investors in Reference Item Linked Covered Bonds (as defined under *Risks related to the structure of a particular issue of Covered Bonds* in *Risk Factors*) should understand the risks of transactions involving Reference Item Linked Covered Bonds and should reach an investment decision only after careful consideration, with their advisers, of the suitability of such Reference Item Linked Covered Bonds in light of their particular financial circumstances, the information set forth herein and the information regarding the relevant Reference Item Linked Covered Bonds and the particular Reference Item(s) to which the value of, or payments in respect of, the relevant Reference Item Linked Covered Bonds may relate, as specified in the applicable Final Terms.

Where the applicable Final Terms specify one or more Reference Item(s), the relevant Covered Bonds will represent an investment linked to the performance of such Reference Item(s) and prospective investors should note that the return (if any) on their investment in the Covered Bonds will depend upon the performance of the relevant Reference Item(s).

See *Risks related to the structure of a particular issue of Covered Bonds* in *Risk Factors*.

**PROSPECTIVE INVESTORS MUST REVIEW THE APPLICABLE FINAL TERMS TO ASCERTAIN WHAT THE RELEVANT REFERENCE ITEM(S) ARE AND TO SEE HOW BOTH ANY CASH AMOUNTS OR ASSET AMOUNTS ARE PAYABLE AND HOW ANY PERIODIC INTEREST PAYMENTS ARE DETERMINED AND WHEN ANY SUCH AMOUNTS ARE PAYABLE BEFORE MAKING ANY DECISION TO PURCHASE ANY REFERENCE ITEM LINKED COVERED BONDS.**

**Programme description:**

Covered Bond Programme.

**Arranger:**

Kaupthing Bank hf.

**Dealers:**

To be appointed from time to time in accordance with the terms of the Programme Agreement. As at the date of this Prospectus, Kaupthing Bank hf. is the only Dealer.

**Certain restrictions:**

Each issue of Covered Bonds 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. There are restrictions on the offer, sale and transfer of Covered Bonds in the United States, the European Economic Area (including the United Kingdom and Iceland) and Japan; see *Subscription and Sale*.

**Covered Bonds having a maturity of less than one year.**

Covered Bonds 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 (the **FSMA**) 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*.

**Programme size:**

Up to ISK 200,000,000,000 (or its equivalent in other currencies calculated

as described in the Programme Agreement) outstanding at any time as described herein. The Issuer and the Fund may increase the amount of the Programme in accordance with the terms of the Programme Agreement.

<b>Distribution:</b>	Covered Bonds may be distributed by way of private or public placement and in either case on a syndicated or non-syndicated basis.
<b>Currencies:</b>	Subject to any applicable legal or regulatory restrictions, such currency or currencies as may be agreed from time to time by the Issuer and the relevant Dealer.
<b>Redenomination:</b>	The applicable Final Terms may provide that certain Covered Bonds may be redenominated in euro. The relevant provisions applicable to any such redenomination are contained in Condition 4.
<b>Maturities:</b>	The Covered Bonds will have such maturities 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 any relevant central bank (or equivalent body) or any laws or regulations applicable to the Issuer or the relevant Specified Currency.
<b>Issue Price:</b>	Covered Bonds 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.
<b>Form of Covered Bonds:</b>	The Covered Bonds will be issued in bearer form as described in <i>Form of the Covered Bonds</i> .
<b>Inflation Linked Annuity Covered Bonds:</b>	Inflation Linked Annuity Covered Bonds will bear interest which will be payable on such date or dates as may be agreed between the Issuer and the relevant Dealer. Inflation Linked Annuity Covered Bonds will be redeemed by payment of one or more amounts, adjusted for indexation in accordance with the provisions set out in the applicable Final Terms, on such date or dates as may be agreed between the Issuer and the relevant Dealer.
<b>Fixed Rate Covered Bonds:</b>	Fixed Rate Covered Bonds will bear interest at a fixed rate, which 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.
<b>Floating Rate Covered Bonds:</b>	<p>Floating Rate Covered Bonds will bear interest at a rate determined:</p> <ul style="list-style-type: none"><li>(a) 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 ISDA Definitions; or</li><li>(b) on the basis of a reference rate appearing on the agreed screen page of a commercial quotation service; or</li><li>(c) on such other basis as may be agreed between the Issuer and the relevant Dealer,</li></ul> <p>as set out in the applicable Final Terms.</p> <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 Covered Bonds.</p>
<b>Index Linked Interest Covered Bonds:</b>	Payments of interest in respect of Index Linked Interest Covered Bonds 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.
<b>Credit Linked Interest Covered Bonds and Equity Linked Interest Covered Bonds:</b>	Payments of interest in respect of Credit Linked Interest Covered Bonds and Equity Linked Interest Covered Bonds will be calculated by reference to the price, value, performance or some other factor relating to one or more reference assets and/or the creditworthiness of, performance of obligations by or some other factor relating to one or more reference entities, as set out in the applicable Final Terms.
<b>Other provisions in relation to Floating Rate Covered Bonds and Variable Interest Covered Bonds:</b>	Floating Rate Covered Bonds and Variable Interest Covered Bonds may also have a Maximum Rate of Interest a Minimum Rate of Interest or both. Interest on Floating Rate Covered Bonds and Variable Interest Covered Bonds 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, in each case as may be agreed between the Issuer and the relevant Dealer.
<b>Dual Currency Interest Covered Bonds:</b>	Payments of interest, whether at maturity or otherwise, in respect of Dual Currency Interest Covered Bonds will be made in such currencies, and based on such rates of exchange, as the Issuer and the relevant Dealer may agree.
<b>Variable Interest Covered Bonds:</b>	Index Linked Interest Covered Bonds, Credit Linked Interest Covered Bonds, Equity Linked Interest Covered Bonds, Dual Currency Interest Covered Bonds and other Covered Bonds (excluding Inflation Linked Annuity Covered Bonds and Floating Rate Covered Bonds) where the rate of interest is variable are referred to as <b>Variable Interest Covered Bonds</b> .
<b>Zero Coupon Covered Bonds:</b>	Zero Coupon Covered Bonds may be offered and sold at a discount to their nominal amount and will not bear interest.
<b>Partly-Paid Covered Bonds:</b>	Covered Bonds may be issued on a partly-paid basis in which case interest will accrue on the paid-up amount of such Covered Bonds or on such other basis as may be agreed between the Issuer and the relevant Dealer.
<b>Redemption:</b>	<p>The applicable Final Terms will indicate either that the relevant Covered Bonds cannot be redeemed prior to their stated maturity (other than in specified amounts or instalments, if applicable, if it becomes unlawful for any Term Advance to remain outstanding or following an Issuer Event of Default or a Fund Event of Default) or that such Covered Bonds will be redeemable at the option of the Issuer upon giving notice to the Covered Bondholders, on one or more specified dates prior to their stated maturity and at a price or prices and on such other terms as may be agreed between the Issuer and the relevant Dealer.</p> <p>The applicable Final Terms may provide that Covered Bonds may be redeemable in two or more instalments of such amounts and on such dates as are indicated in the applicable Final Terms.</p> <p>Covered Bonds having a maturity of less than one year may be subject to restrictions on their denomination and distribution; see <i>Certain Restrictions - Covered Bonds having a maturity of less than one year</i> above.</p>
<b>Denomination of Covered Bonds:</b>	The Covered Bonds will be issued in such denominations as may be agreed between the Issuer and the relevant Dealer save that the minimum denomination of each Covered Bond 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 <i>Certain Restrictions - Covered Bonds having a maturity of less than one year</i> above. The minimum denomination of each Covered Bond

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 Covered Bonds are denominated in a currency other than euro, the equivalent amount in such currency).

**Taxation:**

All payments in respect of the Covered Bonds or, as the case may be, the Covered Bond Guarantee will be made subject to deduction for or on account of withholding taxes imposed by any Tax Jurisdiction.

**Negative Pledge:**

The terms of the Covered Bonds will contain a negative pledge provision as further described in Condition 3.

**Cross Default:**

If a Fund Acceleration Notice is served in respect of any one Series of Covered Bonds, then the obligation of the Fund to pay Guaranteed Amounts in respect of all Series of Covered Bonds then outstanding will be accelerated.

**Status of the Covered Bonds:**

The Covered Bonds will constitute direct, unconditional, unsubordinated and unsecured obligations of the Issuer and will rank *pari passu* without any preference among themselves and (save for any obligations required to be preferred by law) at least equally with all other present and future unsecured and unsubordinated obligations of the Issuer from time to time outstanding.

**Covered Bond Guarantee:**

Payment of Guaranteed Amounts in respect of the Covered Bonds when Due for Payment will be irrevocably guaranteed by the Fund. The obligations of the Fund to make payment in respect of the Guaranteed Amounts when Due for Payment are subject to the condition that a Notice to Pay or a Fund Acceleration Notice has been served on the Fund. The obligations of the Fund under the Covered Bond Guarantee will accelerate against the Fund upon service of a Fund Acceleration Notice. The obligations of the Fund under the Covered Bond Guarantee constitute direct and unsecured obligations of the Fund.

**Ratings:**

Covered Bonds to be issued under the Programme have, unless otherwise specified in the applicable Final Terms, been rated "Aaa" by Moody's. A credit rating is not a recommendation to buy, sell or hold securities and may be subject to revision, supervision or withdrawal at any time by the assigning rating organisation.

**Listing and admission to trading:**

Application has been made to the OMX Nordic Exchange Iceland hf. for Covered Bonds issued under the Programme to be admitted to trading on the regulated market of the OMX ICE.

Covered Bonds may be listed or admitted to trading, as the case may be, on such other or further stock exchanges or markets as agreed between the Issuer, the Fund, the Representative and the relevant Dealer in relation to the Series.

The applicable Final Terms will state whether or not the relevant Covered Bonds are to be listed and/or admitted to trading and, if so, on which stock exchanges and/or markets.

**Governing law:**

The Covered Bonds will be governed by, and construed in accordance with, Icelandic law.

**Selling Restrictions:**

There are restrictions on the offer, sale and transfer of the Covered Bonds in the United States, the European Economic Area (including the United Kingdom and Iceland) and Japan and such other restrictions as may be required in connection with the offering and sale of a particular Tranche of Covered Bonds; see *Subscription and Sale*.

## RISK FACTORS

*Each of the Issuer and the Fund believes that the following factors may affect its ability to fulfil its obligations under Covered Bonds issued under the Programme. Most of these factors are contingencies which may or may not occur and neither the Issuer nor the Fund is 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 Covered Bonds issued under the Programme are also described below.*

*Each of the Issuer and the Fund believes that the factors described below represent the principal risks inherent in investing in Covered Bonds issued under the Programme, but the inability of the Issuer or the Fund to pay interest, principal or other amounts on or in connection with any Covered Bonds 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 anticipate. Prospective investors should also read the detailed information set out elsewhere in this Prospectus and reach their own views prior to making any investment decision.*

*This section of the Prospectus is divided into four main sections: Risk Factors relating to the Issuer, Risk Factors relating to the Fund, Risk Factors relating to the Covered Bonds and General Risk Factors.*

**THE PURCHASE OF COVERED BONDS MAY INVOLVE SUBSTANTIAL RISKS AND MAY BE SUITABLE ONLY FOR INVESTORS WHO HAVE THE KNOWLEDGE AND EXPERIENCE IN FINANCIAL AND BUSINESS MATTERS NECESSARY TO ENABLE THEM TO EVALUATE THE RISKS AND THE MERITS OF AN INVESTMENT IN THE COVERED BONDS. PRIOR TO MAKING AN INVESTMENT DECISION, PROSPECTIVE INVESTORS SHOULD CONSIDER CAREFULLY, IN LIGHT OF THEIR OWN FINANCIAL CIRCUMSTANCES AND INVESTMENT OBJECTIVES, (I) ALL THE INFORMATION SET FORTH IN THIS BASE PROSPECTUS AND, IN PARTICULAR, THE CONSIDERATIONS SET FORTH BELOW AND (II) ALL THE INFORMATION SET FORTH IN THE APPLICABLE FINAL TERMS. PROSPECTIVE INVESTORS SHOULD MAKE SUCH ENQUIRIES AS THEY DEEM NECESSARY WITHOUT RELYING ON THE ISSUER OR ANY DEALER.**

**AN INVESTMENT IN COVERED BONDS LINKED TO ONE OR MORE REFERENCE ITEMS MAY ENTAIL SIGNIFICANT RISKS NOT ASSOCIATED WITH INVESTMENTS IN A CONVENTIONAL DEBT SECURITY, INCLUDING BUT NOT LIMITED TO THE RISKS SET OUT BELOW. THE AMOUNT PAID BY THE ISSUER ON REDEMPTION OF THE COVERED BONDS MAY BE LESS THAN THE NOMINAL AMOUNT OF THE COVERED BONDS, TOGETHER WITH ANY ACCRUED INTEREST, AND MAY IN CERTAIN CIRCUMSTANCES BE ZERO.**

**CERTAIN ISSUES OF COVERED BONDS INVOLVE A HIGH DEGREE OF RISK AND POTENTIAL INVESTORS SHOULD BE PREPARED TO SUSTAIN A LOSS OF ALL OR PART OF THEIR INVESTMENT.**

### **RISKS RELATED TO THE ISSUER'S BUSINESS**

#### **Our financial condition and results of operations may be adversely affected by movements in interest rates**

Interest rates are highly sensitive to many factors beyond our control, including interest rate and other monetary policies of governments and central banks in the jurisdictions in which we operate and changes to such policies. In particular, the policies of the Economic and Monetary Union of the European Union, the United Kingdom, Iceland, Denmark and Sweden are and will be significant for us and subject to change. Income from financial operations such as ours is particularly vulnerable to interest rate volatility.

The results of our banking operations are affected by our management of this interest rate sensitivity. Interest rate sensitivity refers to the relationship between changes in market interest rates and changes in net interest income. The composition of our banking assets and liabilities, and any gap position resulting from the composition, causes the banking operations' net interest income to vary with changes in interest rates. In recent years, our results of operations have been dependent to a great extent on earnings attributable to net interest income. Net interest income represented approximately 48 per cent. of our operating income for 2007, approximately 31 per cent. in 2006, approximately 32 per cent. in 2005 and approximately 37 per cent. in 2004.

A mismatch of interest-earning assets and interest-bearing liabilities in any given period may, in the event of changes in interest rates, have a material effect on the financial condition or results of operations of our banking businesses. In addition, variations in interest rate sensitivity may exist within the repricing periods or between the different currencies in which we hold interest rate positions.

We currently are operating in an environment of volatile interest rates. In particular, the London Inter-Bank Offered Rate (**LIBOR**) and Euro-zone inter-bank Offered Rate (**EURIBOR**) have been very volatile over recent months. As a significant portion of our liabilities are short to medium term, we may have to refinance these obligations at higher rates. See *"Liquidity risk may impair our ability to fund our operations and adversely affect our financial condition"*. If current spreads on our capital markets funding were to continue widening for an extended period of time, it could, in certain markets, affect our competitive position and adversely affect our net interest margin. At December 31, 2006, ISK 1,166,214 million or 32.9 per cent. of our total financial liabilities matured in one to five years while ISK 1,028,073 million of our financial assets matured in that period. Both the European Central Bank and the Central Bank of Iceland have raised interest rates several times over the last three years. Increases in interest rates may have a material adverse effect on our business, financial condition and results of operations.

#### **Our businesses are subject to the general economic conditions prevailing in Northern Europe and elsewhere**

An economic downturn in Northern Europe could affect our results and financial position by reducing demand for our products and services. Such a downturn could also affect the credit quality of our 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. See also *"Our business, results of operations and financial condition are affected by economic and political conditions in Iceland"*. The profitability of our businesses could also be adversely affected by a decline in general economic conditions in the European Economic Area, Northern Europe, Asia or the United States. These factors could have a material adverse effect on our business, financial condition and results of operations.

#### **Our loan portfolio is concentrated in certain currencies, industries and borrowers**

Our loan portfolio is exposed to a relatively high concentration in certain currencies and market sectors. As of December 31, 2007, 13.3 per cent. of our loans to customers were denominated in Icelandic króna, 18.8 per cent. were denominated in Danish krone, 22.5 per cent. were denominated in pounds sterling and 21.6 per cent. in euro. At December 31, 2007, loans to customers in the service sector (including financial services, public administration and technical services), loans to customers in industry (including manufacturing, food and beverage and construction) and loans to individuals comprised 18.3 per cent., 17.1 per cent. and 17.1 per cent., respectively, of our loan portfolio (excluding loans to banks and off-balance sheet credit related commitments). Furthermore, as of December 31, 2007, our ten largest borrowers represented 13.8 per cent. of our customer loans and our 20 largest borrowers represented 19.6 per cent. of our customer loans (in each case excluding loans to banks and off-balance sheet credit related commitments), and loans to our single largest borrower represented 2.8 per cent. of our customer loan portfolio.

Our financial condition will continue to be sensitive to downturns in certain industries and the consequent inability of clients to meet their obligations to us. Declines in the financial condition of our largest borrowers and adverse currency movements relative to the Icelandic króna also could have a material adverse effect on our business, financial condition and results of operations. In addition, as of December 31, 2007, 16.4 per cent. of our loans to customers, or ISK 541 billion, were attributable to our acquisition and leveraged finance portfolio; such loans inherently carry more risk than general corporate lending due to the higher levels of leverage. There can be no assurance that unanticipated provisions for non-performing loans through loan losses or write-offs will not be required in the future.

#### **We are exposed to the risk that third parties who owe us money will not meet, or will be unable to meet, their obligations to us**

The availability of accurate and comprehensive financial information and general credit information on which to base credit decisions is more limited for SMEs than is the case for large corporate clients, and is even more limited for individuals. SMEs and individuals form the majority of our client base. SMEs usually have less capital and business experience than large businesses and are hence more likely to default on their loans. Loans to SMEs and loans to individuals represented 39.7 per cent. and 17.1 per cent., respectively, of our total loan portfolio as of December 31, 2007. Therefore, we 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 our group to accurately assess the credit risk of prospective borrowers and lending to higher risk borrowers could have a material adverse effect on our business, financial condition and results of operations.

Our exposure to the credit risk of borrowers is higher in the case of acquisition finance loans, which typically involve higher levels of leverage than general corporate borrowing and make these borrowers more exposed to increases in interest rates and downturns in the economy. We have witnessed a number of key trends in acquisition and leveraged finance. The number of banks providing lead arranger services, the size of the private equity market, the amount of funds available to private equity firms and the amount of institutional funding provided through collateral debt obligations have all increased considerably in recent years. As a result of these factors and notwithstanding the recent disruptions in the credit markets, the acquisition and leveraged finance market is increasingly competitive. At December 31, 2007, our acquisition and leveraged finance portfolio amounted to approximately ISK 541.3 billion, or 16.4 per cent. of our total loan portfolio. In addition, we typically underwrite all or a substantial portion of acquisition finance loans, which are then sold or syndicated to other parties. Our ability to successfully reduce our exposure in these loans depends on market conditions at the time. If we are unable to syndicate or sell down our position in these acquisition finance loans, we may be left with undesirably high exposure to one or more highly-leveraged borrowers. A default by one or more highly-leveraged borrowers to which we have an undesirably high exposure could have a material adverse effect on our business, financial condition and results of operations.

Furthermore, we may from time to time co-invest with the borrowers under such loans, as the result of which we may also have an equity investment in the target companies in addition to our credit exposure, which could be completely lost if such companies encounter financial difficulties.

#### **Adverse price fluctuations in the securities in our investment portfolio could have a material adverse effect on our results of operations and financial condition**

We have a substantial investment portfolio that includes equity and debt securities of some of the largest issuers of securities in Iceland and Northern Europe. As of December 31, 2007, our equity and debt investment portfolios totalled ISK 160,797 million and ISK 367,350 million, respectively, and accounted for 3.0 per cent. and 6.8 per cent., respectively, of our total assets. A fall in the price of our Icelandic or Northern European securities could substantially reduce the value of our investment portfolio and the amount of our other operating income attributable to trading gains.

Under IFRS, we are required to classify our investment portfolio as either trading assets, financial assets designated at fair value through profit and loss, or available for sale securities. The securities in our trading portfolio and financial assets designated at fair value through profit and loss are measured at their fair value at the end of each financial period, with changes in value during the period recognised in our income statement under net gain on financial assets measured at fair value. As a result, declines in market value of our trading portfolio could adversely affect our profitability, even if those declines have not been realised through a sale of the relevant securities. Financial assets available-for-sale (principally unlisted equity securities held for long-term investment purposes) are also measured at their fair value at the end of each financial period. However, unrealised gains or losses of financial assets available-for-sale are recognised in equity. As a result, declines in the value of our financial assets available-for-sale can reduce our equity, adversely affecting our regulatory capital and the capital ratios (CAD and Tier I capital ratios) that we are required to maintain under applicable law. In 2007 financial loss in Treasury amounted to ISK 17.8 billion, primarily due to the decrease in the fair value of derivative contracts, bonds and asset-backed securities.

In addition, we maintain large positions in individual issues of securities or total claims (including but not limited to loans, bank overdrafts, equity holdings or other forms of financial exposure) on one individual company or group of financially connected counterparties, which have sometimes led to material losses, and there can be no assurance that future losses from these holdings will not occur. In certain instances we have also made loans to companies whose securities we hold, increasing our total exposure to them, including, in particular, in leveraged finance transactions. Further, market liquidity constraints can limit our ability to sell large blocks of these securities at attractive prices. Adverse developments affecting these issuers or liquidity for their shares could have a material adverse effect on our business, financial conditions and results of operations.

#### **A decline in the value or illiquidity of the collateral securing our loans may adversely affect our loan portfolios**

A substantial portion of our loans to customers are secured by collateral, including, in some cases, equity securities. In addition to equity securities such collateral includes real estate, securities, ships, and, in the case of fishing vessels, together with their non-transferable fishing quotas, receivables, raw materials and inventories. Downturns in the relevant markets or general deterioration of economic conditions in the industries in which these borrowers operate, or generally in Iceland, the United Kingdom, Denmark or Sweden, or other markets in which the collateral is located, may result in declines in the value of collateral securing loans to levels below the outstanding principal balance on those loans. In the case of equity securities, such securities are often unlisted and illiquid and the value of such securities is closely linked to the business performance of the borrowers compared to the other types of collateral described above. A decline in the value of collateral securing these loans or inability to obtain additional collateral may, in some cases, require us 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 us to losses which could have a material adverse effect on our business, financial condition and results of operations.

#### **Liquidity risk may impair our ability to fund our operations and adversely affect our financial condition**

Ready access to funds is essential to any banking business, including ours. We rely almost entirely on continuous access to financial markets for short and long-term financing. An inability on our part to access funds or to access the markets from which we raise funds may put our positions in liquid assets at risk and lead us to be unable to finance our operations adequately. A volatile interest rate environment, such as that seen during the third quarter of 2007, with significant changes in pricing compounds the risk that we will not be able to access funds at favourable rates or at all. These and other factors also could lead creditors and rating agencies to form a negative view of our liquidity, which could result in less favourable credit ratings, higher borrowing costs and less accessible funds. In addition, because we receive a portion of our funding from deposits, in particular wholesale deposits, we are 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.

We rely heavily on wholesale sources of funding, and until recently we had significant funding requirements in order to refund redemptions in 2008. As at December 31, 2007, we had ISK 875 billion of borrowings maturing in 2008 and ISK 2,302 billion of borrowings maturing in the next five years. Recently, events in the financial markets, in particular the default rates on sub-prime residential mortgages in the United States, have led to a disruptions in the credit markets and increased volatility in global credit and equity markets. This volatility may reduce the availability of credit or increase our borrowing costs.

Because we meet a significant portion of our funding requirements in the capital markets, we are exposed to conditions in the different markets in which we fund. We have previously raised funds principally in the Euromarkets, among other funding programmes, through our €12 billion European Medium-Term Note (EMTN) programme at Kaupthing and our €8 billion EMTN programme at FIH Erhvervsbank. We have also raised funds in the Euromarkets through our €2 billion European commercial paper programme for each of Kaupthing and FIH Erhvervsbank. Given the size of our issuances in the Euromarkets, we have diversified our sources of funding, including in the United States, Australia and Japan, where we raised funds for the first time in 2006. In 2007, we also raised funds in Switzerland and outside the Euromarket through our EMTN programme, including offerings in Canada, and Mexico. However, our access to funding may be more difficult in new markets and adverse economic conditions in Iceland and elsewhere may make it more difficult for us to access funds even in established markets.

In addition, our ability to raise or access funds may be impaired by factors that are not specific to our operations, such as general market conditions, the sovereign rating of Iceland, severe disruption of the financial markets or negative views about the prospects for the industries to which we provide a large proportion of our loans. For example, the tightening of liquidity in the global credit markets during recent months has increased the risk that we will not be able to access funding at favourable cost or at all. Recently, we were unable to "roll over" close to €1 billion of our outstanding FIH commercial paper, reducing our overall liquidity. Strains on our liquidity caused by any of these factors or otherwise could adversely affect our financial performance and competitive position. Furthermore, we believe that the other principal Icelandic banks have similar funding requirements and may be competing for funding from a similar class of investors. This also may adversely affect our access to funds and our cost of funding.

Unexpected events, unpredictable economic or market conditions, unforeseeable declines in our earnings or other situations beyond our control could cause either a short or a long-term liquidity crisis. Such a crisis might have an adverse material effect on our business, financial condition and results of operations.

#### **A reduction in our credit ratings could adversely affect our liquidity and businesses**

Our credit ratings are important to our liquidity. A reduction in our credit ratings could adversely affect our liquidity and competitive position, increase our borrowings costs, limit our access to the capital markets or trigger our obligations under certain bilateral provisions in some of our trading and collateralised financing contracts. Under these provisions, counterparties could be permitted to terminate contracts with us or require us to post additional collateral. Termination of our trading and collateralised financing contracts could cause us to sustain losses and impair our liquidity by requiring us to find other sources of financing or to make significant cash payments or securities movements.

On December 6, 2007, Fitch announced that Kaupthing Bank's ratings were affirmed at Long-term IDR 'A', Short-term IDR 'F1', Individual 'B/C', Support '2' and Support Rating Floor 'BBB'. Fitch changed the Outlook for Kaupthing's Long-term IDR

from Stable to Negative but changed it back to Stable on 31 January 2008 following our announcement that we will not acquire the Dutch merchant bank NIBC Holding N.V.(NIBC). On April 11, 2007, Moody's downgraded our long-term debt rating to 'Aa3' and at the same time affirmed our short-term debt ratings. On the same date, Moody's downgraded the long-term debt rating of FIH to 'A1'. The downgrades came in the wake of an upgrade for Kaupthing by four notches in February 2007, which was based on Moody's new joint default analysis methodology which takes into account potential sources of external support for banks. Following adjustments to the new methodology, Moody's credit ratings for both Kaupthing and FIH, along with many other banks, were revised with the aforementioned results. On September 19, 2007, following our announcement that we would acquire NIBC, Moody's affirmed that it had placed us on review for a possible downgrade which was reaffirmed on November 29, 2007 and on January 30, 2008. On February 28, 2008, Moody's downgraded our long term debt rating to A1 with stable outlook from Aa3, financial strength was downgraded to C- from C, subordinated debt was downgraded from A1 to A2 but P1 rating affirmed for short term and commercial paper.

On September 12, 2006, Moody's downgraded our bank financial strength rating from 'C+' to 'C', citing our high dependence on wholesale funding, the heightened risk profile of our assets due to the proportion of equities held relative to our Tier I capital, and the fact that proprietary trading and investment activities continue to account for a sizeable portion of our risk profile and revenues and contribute potential volatility to our earnings.

We are not currently rated by Standard & Poor's. On September 24, 2007, Standard & Poor's downgraded its foreign currency sovereign ratings for the Republic of Iceland to A+ long term and A-1 short term, and lowered the long-term local currency rating to AA, citing the loosening of fiscal policy prior to the 2007 elections at a time when the macroeconomic imbalances in the economy due to excessive domestic demand were in urgent need of readjustment. Although our ratings are not directly linked to the ratings assigned to the Republic of Iceland there can be no assurance that a downgrade in credit ratings assigned to the Republic of Iceland by any of the rating agencies would not have an adverse effect on our liquidity and competitive position or affect our access to capital markets, if only temporarily, without affecting the rating agencies' views on our credit rating. A worsening of our credit rating or the rating for the Republic of Iceland may have a material adverse effect on our business, financial condition and results of operations.

#### **Our income from investment banking activities and investments for our own account is subject to fluctuation**

We derive income from investment banking activities. In 2007 we derived approximately 15.5 per cent. of our operating income from our investment banking activities, compared to 29.5 per cent. in 2006 (16.4 per cent. excluding capital gains from the disposal of a substantial portion of our stake in Exista hf.) Our income from our investment banking activities consists of fee income and gains on investments. Our fee income is in part related to the number and size of the capital market and corporate advisory transactions in which we participate and to underlying market conditions. Fees generated by these transactions are typically not recurring and are subject to volatility. Accordingly, income from our investment banking business tends to be variable, and any reduction in the number and/or size of such transactions will affect our results of operations. In addition, our investment banking unit invests in unlisted and listed companies with a view towards exiting these investments in a limited time from the date of the acquisition. As of December 31, 2007, these investments amounted to ISK 160,797 million, of which 43 per cent. was in listed shares and equity instruments and 57 per cent. was in unlisted shares and equity instruments, compared to ISK 159,020 million at December 31, 2006, of which 72 per cent. was in listed shares and equity instruments and 28 per cent. in unlisted shares and equity instruments. We also engage in proprietary trading for our own account and market making, taking both medium- and short-term positions in debt and equity instruments. We could be adversely affected by a decline in the value of our holdings or the illiquid nature of certain holdings in our investment portfolio, which is subject to factors affecting the industries in which the companies in the portfolio operate as well as to general market fluctuations. See *"Adverse price fluctuations in the securities in our investment portfolio could have a material adverse effect on our results of operations and financial condition"*.

Furthermore, under IFRS, our financial assets available-for-sale are measured at their fair value at the end of each financial period, with gains and losses in value during the period being recognised in equity. Significant declines in the fair value of this portfolio in the future could adversely affect our equity.

#### **Our business, results of operations and financial condition are affected by economic and political conditions in Iceland**

Our business, results of operations and financial condition are affected directly by economic and political conditions in Iceland. There can be no assurance that the Icelandic economy will grow at the same rates experienced in the recent past or that there will not be a downturn in the Icelandic economy in the future. Recently, interest rates and the rate of inflation in Iceland have been rising. The Central Bank of Iceland has increased its policy interest rate from 8.25 per cent. at December 31, 2004 to 13.30 per cent. at December 31, 2006. Since June 2007, the Central Bank of Iceland's policy interest rate is



presented as a 13.30 per cent. nominal interest rate instead of 14.25 per cent., which is the corresponding annual rate of return. On November 1, 2007, the Central Bank of Iceland increased its policy interest rate by 0.45 per cent. to 13.75 per cent. The 12-month inflation rate was 6.9 per cent. in 2006, an increase from 4.4 per cent. for 2005, 3.95 per cent. in 2004 and 2.4 per cent. in 2003, while inflation in 2007 was 5.8 per cent. on an annualised basis. Higher interest rates might have an adverse impact on the growth rate of the economy. The consumer price index rose 3.94 per cent. from January 1, 2007 to October 1, 2007. In addition, Iceland's current account deficit at December 31, 2006 was 27.3 per cent. of gross domestic product for 2006, affecting the value of the Icelandic króna, which has fallen in value against the euro, the pound sterling and the U.S. dollar since reaching highs against these currencies. In 2007 the Icelandic króna appreciated against the major currencies and the Icelandic trade weighted index depreciated roughly 7 per cent. in the year. Since the beginning of 2008 the Icelandic króna has depreciated against the major currencies and the Icelandic trade weighted index appreciated around 5.6 per cent. in January 2008. These developments and others may have a material adverse effect on our business, financial condition and results of operations. In 2007 our operations in Iceland represented 31.9 per cent. of our total assets and contributed 33.0 per cent. of our operating income.

### **Trading and investment activities within our treasury unit are inherently exposed to significant risk**

Our 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 and interest rate movements relative to our 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. During 2007, our treasury activities recorded losses of net financial income of ISK 17,793 million, ISK 11,650 million of which was recorded in the fourth quarter of 2007 due to unfavourable market conditions.

At December 31, 2007, our Value-at-Risk (over ten trading days with a 99 per cent. degree of certainty) was ISK 5.4 billion (€59 million), or 1.4 per cent. of Tier I capital and 1.1 per cent. of CAD capital.

### **A mismatch of our positions in foreign currency could adversely affect our financial condition**

Our reporting currency is the Icelandic króna. Although, as of January 1, 2008, our reporting currency might be the euro, our full year results for 2007 will continue to be affected by fluctuations in the Icelandic króna. As of the end of 2007, approximately 86.5 per cent. of our total assets consisted of non-ISK-denominated assets and approximately 83.5 per cent. of our total liabilities were in currencies other than the Icelandic króna, particularly the euro (39.8 per cent.), the GBP (13.8 per cent.) and the U.S. dollar (12.4 per cent.). In addition, we trade currency on behalf of our clients and for our own account and maintain open currency positions in currencies other than the Icelandic króna and euro. We do not fully hedge our foreign currency exposure at all times. There can be no assurance that mismatches will not occur or that trading limits will not be breached. If our application, following an appeal to the Ministry of Finance<sup>1</sup>, to adopt the euro as our functional currency is approved, we will have a significant portion of our revenues and expenses as well as dividend payments we receive from our subsidiaries originating in currencies other than the euro, as is the case with the Icelandic króna, including the pound sterling, Danish krone and Swedish króna. Fluctuations in the exchange rate with these currencies will affect the translation of the results of these subsidiaries into Icelandic króna or, beginning in 2008, the euro, in our consolidated financial statements, where translation difference is recognised through equity. As a result, fluctuations in exchange rates could have a material adverse effect on our business, financial condition and results of operations.

### **We may be unable to continue to grow through acquisitions**

A significant proportion of our growth in recent years has been driven by acquisitions, including the acquisition of JP Nordiska AB in Sweden in 2002, the merger with Búnadarbanki in Iceland in 2003, the acquisition of FIH in Denmark in 2004, and the acquisition of Singer & Friedlander in the United Kingdom in 2005.

We continue to evaluate potential acquisition and investment opportunities that could further expand our international banking operations. These efforts will require significant financial resources and the attention of our board of directors and senior management, which could place a strain on management resources and adversely affect the management of our current operations. Further, no assurance can be given that we will be successful in identifying and acquiring appropriate candidates

---

<sup>1</sup> We applied to the Annual Account Registrar (Ársreikningsskrá) to change our functional currency into the euro as of January 2008, in accordance with IFRS. Our application as submitted was only approved with conditions which Kaupthing did not agree with and subsequently we have appealed to the Ministry of Finance. As at the date of this Prospectus, the Ministry of Finance has not yet rendered its decision.

in the key markets in which we operate, or that other businesses in the future will achieve the return on investments made by us in prior periods. As a result, the level of growth that the Group has experienced in the last three years may not be sustainable.

We have historically financed the majority of our acquisitions through the issuance of shares as well as subordinated bonds. There can be no assurance that we will be able to obtain such financing on favourable terms in the future, or at all. Our failure to successfully realise our acquisition strategy could have a material adverse effect on our business, financial condition and results of operations.

### **Our loan portfolio may not continue to grow at the historical rate**

In 2004, our customer loan portfolio grew by 203 per cent. to ISK 992,400 million, mainly due to the acquisition of FIH. In 2005, our customer loan portfolio grew by 57 per cent. to ISK 1,556,653 million, principally due to the acquisition of Singer & Friedlander as well as organic growth in Denmark and Iceland. In 2006, our customer loan portfolio grew by 64.2 per cent. to ISK 2,555,191 million. However, approximately half of this increase can be attributed to the weakening of the Icelandic króna in 2006, as approximately 14 per cent. of our loans to customers were denominated in Icelandic króna at December 31, 2006. When measured in euro, our customer loan portfolio increased by approximately 30 per cent. in 2006, due to organic growth, most significantly at Kaupthing. During 2007, our customer loan portfolio grew by 30.2 per cent. to ISK 3,304,408 million, due to an increase in operations in all our markets. Without future acquisitions we may not be able to achieve similar rates of loan portfolio growth. Furthermore, there are a limited number of high credit quality SME customers, our target clients, to whom banking services may be provided in our target markets. The pace of our loan portfolio growth may be constrained by, among other factors, our ability to increase lending volumes to customers that meet our credit quality standards. There can be no assurance that our strategy to continue to expand our banking network throughout Northern Europe and to target these SME customers will succeed. If we are unable to further expand our loan portfolio in general and our SME customer base in particular, we may not generate sufficient interest income to offset any decline in net interest margins, which could have a material adverse effect on our business, financial condition and results of operations.

### **The implementation of Basel II may adversely affect our results of operations and financial condition**

We may be adversely affected by the implementation of Basel II. We have applied to the Iceland Financial Supervisory Authority (**FME**) (Fjármálaeftirlitið) to use the Basel II Foundation Internal Ratings-Based **IRB** approach to determine our Pillar I capital requirements for credit risk. Under the Foundation IRB approach, we will use special purpose credit models to estimate the risk-related variables that serve as the input in the calculation of our capital requirements. The FME is currently carrying out its supervisory review of the credit models we propose to use for Pillar I, as well as various Pillar II requirements such as stress testing. Since the review has not yet been concluded we cannot at this time quantify how the revised guidelines will affect our requirements for capital and the impact these changes will have on our capital position. It is possible that our deployment and use of capital may have to be altered or additional capital may need to be raised to ensure that the revised capital adequacy requirements are satisfied. Such actions could have a material adverse effect on our business, financial condition and results of operations.

### **We face increasing competition in the markets in which we operate**

The financial services industry and all of our businesses are intensely competitive, and we expect them to remain so. We compete on the basis of a number of factors, including transaction execution, our products and services, innovation, reputation and price.

We face challenges from domestic and international competitors in the various markets in which we operate. Some of our competitors, including well-established domestic banks in each of the markets in which we operate, as well as international banks with operations in most of the markets in which we operate, may have better banking relationships with the SME clients that comprise our target customer bases and may have greater resources and better local market knowledge than we do. These and other factors related to competition could have a material adverse effect on our ability to compete effectively in these markets, and could adversely affect our business, financial condition and results of operations.

In addition, we face increased pressure to meet rising customer demands to provide new banking products that are developing rapidly in Northern Europe. There can be no guarantee that our 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 our ability to compete successfully in our primary markets.

Furthermore, the number of banking transactions conducted over the internet in the markets in which we operate has grown in recent years and is expected to grow further. We may be unable to compete with other banks that offer more extensive online services to their customers than we currently offer to our customers. There can be no assurance that some of our clients will not choose to transfer some or all of their business to competitors, which could adversely affect our business, financial condition and results of operations.

#### **The residential mortgage market in Iceland has lower margins than in other jurisdictions**

Historically, residential mortgages in Iceland have been provided principally by the Housing Finance Fund (the **HFF**), which had approximately a 50 per cent. share of the ISK 806 billion Icelandic mortgage market in 2006 compared to our 14.6 per cent. market share (according to our research department's calculations, based on information provided from the Central Bank of Iceland and HFF). Because it is a quasi-sovereign entity, the HFF has access to lower-cost funding than we do, which it can pass on to its customers in lower rate mortgages. As we believe that it is important to our overall retail business in Iceland to offer competitive market rates to our residential mortgage customers, to the extent we are required to match the mortgage rates of the HFF, our margins in our mortgage lending business in Iceland will be adversely affected.

#### **Our risk management policies, procedures, methods, assessments, techniques and strategies do not encompass all types of risk and may not be fully adequate to measure risk, in particular under extreme market conditions**

We devote significant resources to developing risk management policies, procedures and assessment methods for our banking, investment banking and asset management businesses. We, like other financial institutions, use a sophisticated value-at-risk model, duration analysis and sensitivity analysis as well as other risk assessment methods. Nonetheless, these risk management techniques and strategies may not be fully effective in mitigating risk exposure in all economic market environments or against all types of risk, including risks that we fail to identify or anticipate. In addition, we are in the process of developing additional risk assessment tools which we consider necessary to supplement our existing tools and to enable us to better consolidate risk that exists across the group. Some of our qualitative tools and metrics for managing risk are based upon use of observed historical market behaviour. We apply statistical and other tools to these observations to arrive at quantifications of risk exposures. These tools and metrics may fail to predict or predict incorrectly future risk exposures. As a result, our losses could be significantly greater than these measures would indicate. In addition, our quantified modelling takes into account credit, market, liquidity and operational risks, but does not take into account other risks which may be applicable to our business. Our more qualitative approach to managing risks takes into account a broader set of risks, but is less precise than quantified modelling and could prove insufficient. Unanticipated or incorrectly quantified risk exposures or failure to fully consolidate risks which exist across the group could result in material losses in our banking, investment banking and asset management businesses.

#### **Operational risks remain an inherent part of all of our businesses**

The operational risks that we face include the possibility of inadequate or failed internal or external processes or systems, human error, regulatory breaches, employee misconduct or external events such as fraud. Additionally, the loss of key personnel could adversely affect our operations and results.

Our business inherently generates operational risks. The business is dependent on processing a large number of complex transactions across numerous and diverse products, and is subject to a number of different legal and regulatory regimes. 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. Given our 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.

Controls we put in place to mitigate operational risks do not eliminate them and failures could subject us to regulatory scrutiny. These events could potentially result in financial loss as well as harm to our reputation and could in turn adversely affect our business, financial condition and results of operations.

#### **Mandatory physical settlement of derivative transactions may expose us to losses if we are unable to deliver the underlying security or obligation**

Like many participants in the derivatives marketplace we are party to a large number of derivative transactions, including credit derivatives that require that we deliver to the counterparty the underlying security or obligation in order to receive

payment. In a number of cases, we do not hold the underlying security or obligation and may have difficulty obtaining, or may be unable to obtain, the underlying security or obligation through the physical settlement of other transactions. As a result, we are subject to the risk that we may be unable to obtain the security or obligation within the required contractual timeframe for delivery. This could cause us to forfeit the payments due to us under these contracts or result in settlement delays with the attendant credit and operational risk as well as increased costs to the firm. The derivatives industry is working on various proposals to address this issue. A failure of the industry to address this issue could result in an unwillingness of counterparties to enter into certain types of derivative transactions, which could negatively affect our business.

**Unconfirmed derivative transactions and unauthorised assignments of derivatives by counterparties may expose us to unexpected risk and potential losses**

Derivative contracts and other transactions entered into with third parties are not always confirmed by the counterparties on a timely basis. While the transaction remains unconfirmed we are subject to heightened credit and operational risk and in the event of a default may find it more difficult to enforce the contract. The growth in the derivatives industry, including credit derivatives and other swap transactions, has also exposed us and other industry participants to an increasing incidence of counterparties seeking to unilaterally assign transactions without the required prior notice and consent. Although industry participants have taken steps to eliminate this practice and its effects on a going-forward basis, including through the adoption of the 2005 ISDA Novation Protocol, it is not yet clear how effective these efforts will be, and the steps that have been taken by the industry do not resolve the issue for derivative contracts that were previously entered into. Unauthorised assignments could introduce uncertainty as to the status of a transaction, impair our ability to evaluate credit risk and impede trade reconciliations, which could lead to a higher number of failed transactions and collateral call defaults. An increase in the number of failed transactions and collateral call defaults could adversely affect our business, financial condition and results of operations.

**Our risk management methods may leave us exposed to unidentified, unanticipated or incorrectly quantified risks, which could lead to material losses or material increases in liabilities**

Our risk management strategies may fail under certain circumstances, particularly when confronted with risks that have not been identified or anticipated. Risk methodologies and techniques that we adopt to assess credit risk, market risk, liquidity risk and operational risk may be flawed or may not take all risks into account, and it is possible that the methods for assessing these risks are not sound or are based on faulty information, or that they will be misunderstood, not implemented correctly or misapplied by our personnel. In addition, our risk management policies are constantly being re-evaluated and there may be a lag in implementation. Furthermore, some of our qualitative tools and metrics for managing risk are based upon the use of observed historical market behaviour. We apply statistical and other tools to these observations to arrive at quantifications of risk exposures. These tools and metrics may fail to predict future risk exposures. Our losses thus could be significantly greater than our measures would indicate. In addition, our quantified modelling does not take all risks into account. Our more qualitative approach to managing risks takes into account a broader set of risks, but is less precise than quantified modelling and could prove insufficient. Unanticipated or incorrectly quantified risk exposures could have a material adverse effect on our business, financial condition and results of operations.

**The growth of electronic trading and the introduction of new technology may adversely affect our business and may increase competition**

Technology is fundamental to our business and our industry. The growth of electronic trading and the introduction of new technologies is changing our businesses and presenting us with new challenges. Securities and derivatives transactions are increasingly occurring electronically, both on our own systems and through other alternative trading systems, and it appears that the trend toward alternative trading systems will continue and probably accelerate. Some of these alternative trading systems compete with our trading businesses, including our specialist businesses, and we may experience continued competitive pressures in these and other areas. In addition, the increased use by our clients of low-cost electronic trading systems and direct electronic access to trading markets could cause a reduction in commissions and spreads. An inability to compete and keep up with new technologies could have a material adverse effect on our business, financial condition and results of operations.

**We may be vulnerable to the failure of our IT systems and breaches of our security systems**

We rely on the proper functioning and continuity of our IT systems. Any significant interruption, degradation, failure or lack of capacity of our IT systems or any other systems in our clearing operations or elsewhere could cause us to fail to complete transactions on a timely basis or at all. A sustained failure of our IT systems centrally or across our branches would have a significant impact on our operations and the confidence of our customers in the reliability and safety of our banking systems. We are in the process of upgrading our group-wide IT systems. The upgrade may not proceed within the allocated time frame and budget and could cause disruption to our business.

In addition, when we acquire new operations, we need to integrate the IT systems of the acquired business with our existing systems and may experience disruptions or inefficiencies until that integration is complete.

The secure transmission of confidential information is a critical element of our operations. We cannot guarantee that our existing security measures will prevent security breaches, including break-ins, viruses and disruptions. Persons that circumvent the security measures could use our or our clients' confidential information wrongfully, which could expose us to a risk of loss, adverse regulatory consequences or litigation.

**There are regulatory and legal risks inherent in our businesses**

All of our operations entail considerable regulatory and legal risk, including litigation and liability risk. Each member of our group 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 our operations are contingent upon licences issued by financial authorities of the countries in which we operate.

Violations of rules and regulations, whether intentional or unintentional, may lead to the withdrawal of some of these licences or to liability claims. Any breach of these or other regulations may adversely affect our reputation or financial condition. 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 we operate our business and our market reputation.

We are also exposed to legal risks in our role as a financial intermediary, collateral manager and a consultant to third party businesses. These risks include potential liability for our role in determining the price of a company and for advice we provide to participants in corporate transactions and in disputes over the terms and conditions of complex trading arrangements. We also face the possibility that counterparties in complex or high-risk trading transactions will claim that we failed to properly inform them of the associated risks or that they were not authorised or permitted to enter into these transactions with us and that their obligations are therefore not enforceable. We are also exposed to customer claims.

We may also be subject to claims arising from disputes with employees for, among other things, alleged illegal 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 our business, financial condition and results of operations.

All the Northern European countries are members of the European Economic Area and/or the European Union. This provides us with regulatory conditions similar to those of other European banks. However, the interpretation and implementation of rules on securities trading may still differ among 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 we operate. Thus, we face a risk of incurring liability from violations of these regulations, which could have a material adverse effect on our business, financial condition and results of operations.

**Changes in certain tax laws and tax treaties or in their interpretation could harm our business**

Our results of operations could be harmed by changes in tax laws and tax treaties or the interpretation thereof, changes in corporate tax rates and the refusal of tax authorities to issue or extend advanced tax rulings. The unavailability of tax rulings could diminish the range of structured transactions we can enter into with our clients. Changes in the laws and tax treaties among the jurisdictions in which we provide products and services could undermine demand for our products. Any of these or other changes in the tax regimes in which we operate could have a material adverse effect on our business, results of operations and financial condition.

**Catastrophic events, terrorist attacks and other acts of war could have a negative impact on our business and results**

Catastrophic events, terrorist attacks, other acts of war or hostility, and responses to those acts may create economic and political uncertainties, which could have a negative impact on economic conditions in the regions in which we operate and, more specifically, on our business and results in ways that cannot be predicted.

**We may be unable to recruit or retain experienced and qualified personnel, and we are highly dependent on key members of management**

Our continuing success depends, in part, on the ability to continue to attract, retain and motivate qualified and experienced banking, accounting and management personnel, particularly those individuals who are experienced in investment banking, asset management and acquisition finance. Competition for personnel with relevant expertise is intense, due to the relatively small number of available qualified individuals. Competition for qualified personnel, including senior management, is particularly intense in Iceland, where the unemployment rate is currently below 2 per cent. The geographical location of employment may also make it less attractive to a large portion of potential applicants.

The loss of the services of key members of our senior management or staff with institutional and client knowledge may significantly delay our business objectives and could have a material adverse effect on our business, financial condition and results of operations. Furthermore, we are highly dependent on our executive chairman, chief executive officer and senior management team.

**Our insurance coverage may not adequately cover losses resulting from the risks for which they are insured**

We maintain customary insurance policies for our operations, including insurance for our liquid assets, money transport and directors' and officers' liability, as well as insurance against computer crimes and for employees' dishonesty and mistakes. Due to the nature of our operations and the nature of the risks that we face, there can be no assurance that the coverage that we maintain is adequate to cover the losses for which we believe we are insured.

**RISK FACTORS RELATING TO THE FUND, INCLUDING THE ABILITY OF THE FUND TO FULFIL ITS OBLIGATIONS IN RELATION TO THE COVERED BOND GUARANTEE****Finite resources available to the Fund to make payments due under the Covered Bond Guarantee**

The Fund's ability to meet its obligations under the Covered Bond Guarantee will depend on (i) the realisable value of Selected Loans and their Related Security in the Portfolio, (ii) the amount of Revenue Receipts generated by the Portfolio and the timing thereof and (iii) the receipt by it of credit balances and interest on credit balances on the GIC Account. The Fund will not have any other source of funds available to meet its obligations under the Covered Bond Guarantee.

Covered Bondholders should note that the Asset Coverage Test has been structured to ensure that the Adjusted Aggregate Loan Amount is equal to or greater than the ISK Equivalent of the aggregate Principal Amount Outstanding of the Covered Bonds for so long as Covered Bonds remain outstanding, which should reduce the risk of there being a shortfall (although there is no assurance of this); see *Summary of the Principal Documents – Fund Deed – Asset Coverage Test*.

**Maintenance of Portfolio**

The Asset Coverage Test is met if the Adjusted Aggregate Loan Amount is equal to or exceeds the ISK Equivalent of the aggregate Principal Amount Outstanding under the Covered Bonds from time to time. Pursuant to the terms of the Fund Deed, the Seller will agree to use all reasonable endeavours to transfer Loans and their Related Security or Substitution Assets to the Fund in order to ensure that the Portfolio is in compliance with the Asset Coverage Test. In consideration thereof, the Seller will receive a combination of (a) a cash payment made by the Fund (in ISK) and/or (b) being treated as having made an Equity Contribution to the Fund (in an amount up to the difference between the Outstanding Principal Balance of the Loans sold by the Seller to the Fund as at the relevant Assignment Date and the cash payment (if any) made by the Fund for such Loans).

Alternatively, Kaupthing Bank hf. (in its capacity as a Holder) may make a Cash Equity Contribution to the Fund pursuant to the Fund Deed in order to ensure that the Fund is in compliance with the Asset Coverage Test. If a breach of the Asset Coverage Test occurs on any Calculation Date and is not cured by the following Calculation Date, the Representative will serve an Asset Coverage Test Breach Notice on the Fund which (unless and until it is revoked) will result, *inter alia*, in the sale of Selected Loans; see further *Summary of the Principal Documents – Fund Deed – Sale of Selected Loans and their Related Security*. If an Asset Coverage Test Breach Notice has been served and not revoked on or before the second

Calculation Date after service of such Asset Coverage Test Breach Notice, then an Issuer Event of Default shall occur and the Representative shall be entitled (and, in certain circumstances, may be required) to serve an Issuer Acceleration Notice on the Issuer. Following service of an Issuer Acceleration Notice, the Representative must serve a Notice to Pay on the Fund. There is no specific recourse by the Fund to the Seller in respect of the failure to transfer Loans and their Related Security or Substitution Assets to the Fund, nor is there any specific recourse to Kaupthing Bank hf. if it does not make Cash Equity Contributions to the Fund.

If the collateral value of the Portfolio has not been maintained in accordance with the terms of the Asset Coverage Test then that may affect the realisable value of the Portfolio or any part thereof (both before and after the occurrence of a Fund Event of Default) and/or the ability of the Fund to make payments under the Covered Bond Guarantee.

Prior to service of a Notice to Pay or a Fund Acceleration Notice, the Asset Monitor will, subject to receipt of the relevant information from the Cash Manager, test the calculations performed by the Cash Manager in respect of the Asset Coverage Test every three months and more frequently in certain circumstances; see further *Summary of the Principal Documents – Asset Monitor Agreement*.

The Representative shall not be responsible for monitoring compliance with, nor the monitoring of, the Asset Coverage Test or any other test, or supervising the performance by any other party of its obligations under any Transaction Document.

**Factors that may affect the realisable value of the Portfolio or any part thereof or the ability of the Fund to make payments under the Covered Bond Guarantee**

The realisable value of Selected Loans and their Related Security comprised in the Portfolio may be reduced (which may affect the ability of the Fund to make payments under the Covered Bond Guarantee) by:

- no representations or warranties being given by the Fund or (unless otherwise agreed with the Seller) the Seller;
- default by Borrowers in payment of amounts due on their Loans;
- the Loans of New Sellers being included in the Portfolio;
- changes to the lending criteria of the Seller or any New Seller;
- set-off risks in relation to some types of Loans in the Portfolio;
- limited recourse to the Seller or any New Seller; and
- possible regulatory changes by regulatory authorities in Iceland.

Each of these factors is considered in more detail below. However, it should be noted that the Asset Coverage Test and the Eligibility Criteria are intended to ensure that there will be an adequate amount of Loans in the Portfolio and moneys standing to the credit of the GIC Account to enable the Fund to repay the Covered Bonds following service on the Fund of a Notice to Pay or a Fund Acceleration Notice, and accordingly it is expected (but there is no assurance) that Selected Loans and their Related Security could be realised for sufficient value to enable the Fund to meet its obligations under the Covered Bond Guarantee.

**Default by Borrowers in paying amounts due on their Loans**

Borrowers may default on their obligations under the Loans in the Portfolio. Defaults may occur for a variety of reasons. The Loans are affected by credit, liquidity and interest rate risks. Various factors influence mortgage delinquency rates, prepayment rates, repossession frequency and the ultimate payment of interest and principal, such as changes in the national or international economic climate, regional economic or housing conditions, changes in tax laws, interest rates, inflation, the availability of financing, yields on alternative investments, political developments and government policies. Other factors in Borrowers' individual, personal or financial circumstances may affect the ability of Borrowers to repay the Loans. Loss of earnings, illness, divorce and other similar factors may lead to an increase in delinquencies by and bankruptcies of Borrowers, and could ultimately have an adverse impact on the ability of Borrowers to repay the Loans. In addition, the ability of a Borrower to sell a property given as security for a Loan at a price sufficient to repay the amounts outstanding under that Loan will depend upon a number of factors, including the availability of buyers for that property, the value of that property and property values in general at the time.

Any Defaulted Loans in the Portfolio will be given a reduced weighting for the purposes of any calculation of the Asset Coverage Test.

**The Loans of New Sellers may be included in the Portfolio**

New Sellers may in the future accede to the Programme and sell Loans and their Related Security to the Fund. However, this would only be permitted if the conditions precedent relating to New Sellers acceding to the relevant Transaction Documents

(more fully described under *Summary of the Principal Documents – Mortgage Sale Agreement – New Sellers* below) are met. Provided that those conditions are met, the consent of Covered Bondholders to the accession of any New Seller to the relevant Transaction Documents will not need to be obtained.

Any loans originated by a New Seller will have been originated in accordance with the lending criteria of the New Seller which may differ from the Lending Criteria for Loans originated by the Seller. If the lending criteria differ in a way that affects the creditworthiness of the Loans in the Portfolio, that may lead to increased defaults by Borrowers and may affect the realisable value of the Portfolio or any part thereof or the ability of the Fund to make payments under the Covered Bond Guarantee. However, as noted above, Defaulted Loans will be given a reduced weighting for the purposes of the calculation of the Asset Coverage Test.

#### **Changes to the Lending Criteria of the Seller**

Each of the Loans originated by the Seller will have been originated in accordance with its Lending Criteria at the time of origination. It is expected that the Seller's Lending Criteria will generally consider type of property, term of loan, age of applicant, the loan-to-value ratio, status of applicants and credit history. In the event of the assignment or assignation of any Loans and their Related Security to the Fund, the Seller will warrant only that such Loans and Related Security were originated in accordance with its Lending Criteria applicable at the time of origination. The Seller retains the right to revise its Lending Criteria from time to time but would do so only to the extent that such a change would be acceptable to a Reasonable, Prudent Mortgage Lender. If the Lending Criteria change in a manner that affects the creditworthiness of the Loans, that may lead to increased defaults by Borrowers and may affect the realisable value of the Portfolio, or part thereof, and the ability of the Fund to make payments under the Covered Bond Guarantee. However, as noted above, Defaulted Loans will be given a reduced weighting for the purposes of the calculation of the Asset Coverage Test.

#### **Set-off risks in relation to some types of Loans may adversely affect the value of the Portfolio or any part thereof**

Once notice has been given to the Borrowers of the assignment or assignation (as appropriate) of the Loans and their Related Security to the Fund, independent set-off rights which a Borrower has against the Seller (such as, for example, set-off rights associated with Borrowers holding deposits with the Seller) will crystallise and further rights of independent set-off would cease to accrue from that date and no new rights of independent set-off could be asserted following that notice. Set-off rights arising under "transaction set-off" (which are set-off claims arising out of a transaction connected with the Loan) will not be affected by that notice and will continue to exist. In relation to potential transaction set-off in respect of the Loans, see the following risk factor.

It should be noted, however, that the Asset Coverage Test seeks to take account of the potential set-off risk associated with Borrowers holding deposits with the Seller (although there is no assurance that all such risks will be accounted for).

The exercise of set-off rights by Borrowers may adversely affect the realisable value of the Portfolio and/or the ability of the Fund to make payments under the Covered Bond Guarantee. The Asset Coverage Test seeks to take account of these set-off risks, including the set-off risk relating to any of the Loans in the Portfolio (although there is no assurance that such risks will be accounted for).

#### **Sale of Selected Loans and their Related Security following service of an Asset Coverage Test Breach Notice or a Notice to Pay**

If an Asset Coverage Test Breach Notice or a Notice to Pay is served on the Fund (and, in the case of an Asset Coverage Test Breach Notice, for as long as such notice has not been revoked), the Fund will be obliged to sell Selected Loans and their Related Security (selected on a random basis) in order to remedy a breach of the Asset Coverage Test or to make payments to the Fund's creditors, including payments under the Covered Bond Guarantee, as appropriate; see *Summary of the Principal Documents – Fund Deed – Sale of Selected Loans and their Related Security following service of an Asset Coverage Test Breach Notice* and *Summary of the Principal Documents – Fund Deed – Sale of Selected Loans and their Related Security following service of a Notice to Pay*.

There is no guarantee that a buyer will be found to acquire Selected Loans and their Related Security at the times required and there can be no guarantee or assurance as to the price which the Fund may be able to obtain, which may affect the ability of the Fund to make payments under the Covered Bond Guarantee.

#### **No representations or warranties to be given by the Fund or the Seller if Selected Loans and their Related Security are to be sold**

Following service of an Asset Coverage Test Breach Notice (which is not revoked) or a Notice to Pay, the Fund will be obliged to sell Selected Loans and their Related Security to third party purchasers, subject to a right of pre-emption in favour of the Seller pursuant to the terms of the Fund Deed; see *Summary of the Principal Documents – Fund Deed – Method of Sale of Selected Loans and their Related Security*. In respect of any sale of Selected Loans and their Related Security to third



parties, however, the Fund will not be permitted to give representations and warranties or indemnities in respect of those Selected Loans and their Related Security. There is no assurance that the Seller would give any representations and warranties or indemnities in respect of the Selected Loans and their Related Security. Any Representations and Warranties previously given by the Seller in respect of the Loans in the Portfolio may not have value for a third party purchaser if the Seller is then insolvent. Accordingly, there is a risk that the realisable value of the Selected Loans and their Related Security could be adversely affected by the lack of representations and warranties or indemnities which in turn could adversely affect the ability of the Fund to meet its obligations under the Covered Bond Guarantee.

#### **Excess Proceeds received by the Representative**

Following service of an Issuer Acceleration Notice, the Representative may receive Excess Proceeds. The Excess Proceeds will be paid by the Representative on behalf of the Covered Bondholders of the relevant Series to the Fund for its own account, as soon as practicable, and will be held by the Fund in the GIC Account. The Excess Proceeds will thereafter be used by the Fund in the same manner as all other moneys from time to time standing to the credit of the GIC Account. Any Excess Proceeds received by the Representative will discharge *pro tanto* the obligations of the Issuer in respect of the Covered Bonds, Receipts and Coupons (subject to restitution of the same if such Excess Proceeds shall be required to be repaid by the Representative or the Fund). However, the obligations of the Fund under the Covered Bond Guarantee are (subject only to service of a Notice to Pay or a Fund Acceleration Notice) unconditional and irrevocable and the receipt by the Representative of any Excess Proceeds will not reduce or discharge any such obligations.

By subscribing for the Covered Bonds, each of the Covered Bondholders will be deemed to have irrevocably directed the Representative to pay the Excess Proceeds to the Fund in the manner as described above.

#### **Limited recourse to the Seller**

The Fund and the Representative will not undertake any investigations, searches or other actions on any Loan or its Related Security and will rely instead on the Representations and Warranties given in the Mortgage Sale Agreement by the Seller in respect of the Loans sold by it to the Fund.

If any Loan sold by the Seller does not materially comply with any of the Representations and Warranties made by the Seller as at the Assignment Date of that Loan, then the Seller will be required to remedy the breach within 20 Business Days of receipt by it of a notice from the Fund requiring the Seller to remedy the breach.

If the Seller fails to remedy the breach of the relevant Representation and Warranty within such 20 Business Day period, then the Seller will be required to repurchase on or before the next following Calculation Date (or such other date as may be agreed between the Fund and the Seller) the relevant Loan and its Related Security and any other Loan secured or intended to be secured by that Related Security or any part of it at their Outstanding Principal Balance and all Arrears of Interest, Accrued Interest and amounts deducted from amounts outstanding under such Loan or Loans in accordance with the terms of the Mortgage Sale Agreement as of the date of repurchase.

There can be no assurance that the Seller will have the financial resources to repurchase a Loan or Loans and its or their Related Security. However, if the Seller does not repurchase those Loans and their Related Security which are in breach of the Representations and Warranties, then the Outstanding Principal Balance of those Loans will be excluded from the calculation of the Asset Coverage Test. There is no further recourse to the Seller in respect of a breach of a Representation or Warranty.

#### **Reliance of the Fund on third parties**

The Fund has entered into agreements with a number of third parties which have agreed to perform services for the Fund. In particular, but without limitation, the Servicer has been appointed to service Loans in the Portfolio, the Cash Manager has been appointed to calculate and monitor compliance with the Asset Coverage Test and to provide cash management services to the Fund, and the GIC Provider has been appointed to receive and hold moneys on behalf of the Fund and to provide an agreed rate of interest thereon. In the event that any of these parties fails to perform its obligations under the relevant agreement to which it is a party, the realisable value of the Portfolio or any part thereof or pending such realisation (if the Portfolio or any part thereof cannot be sold) the ability of the Fund to make payments under the Covered Bond Guarantee may be affected. For instance, if the Servicer has failed to administer the Loans adequately, this may lead to higher incidences of non-payment or default by Borrowers.

If a Servicer Event of Default occurs pursuant to the terms of the Servicing and Custody Agreement, then the Fund will be entitled to terminate the appointment of the Servicer and appoint a new servicer in its place. There can be no assurance that a substitute servicer with sufficient experience of administering mortgages of residential properties would be found who would be willing and able to service the Loans in the Portfolio on the terms of the Servicing and Custody Agreement. The ability of a substitute servicer to perform fully the required services would depend on, among other things, the information, software

and records available at the time of the appointment. Any delay or inability to appoint a substitute servicer may affect the realisable value of the Portfolio or any part thereof and/or the ability of the Fund to make payments under the Covered Bond Guarantee. However, if the Servicer ceases to be assigned a long-term, unsecured, unguaranteed and unsubordinated debt obligation rating by Moody's of at least Baa2, the Fund will be required to use reasonable endeavours to enter into a servicing and custody agreement with a third party in order to ensure continued servicing of the Loans in the Portfolio.

The Servicer has no obligation itself to advance payments that Borrowers fail to make in a timely fashion. The Servicer will not be required to seek the consent or approval of the Covered Bondholders before taking any action under the Servicing and Custody Agreement.

The Representative is not obliged in any circumstances to act as a servicer or to monitor the performance by the Servicer of its obligations.

### **Change of counterparties**

The parties to the Transaction Documents who receive and hold moneys pursuant to the terms of such documents (such as the Account Banks) are required to satisfy certain criteria in order that they can continue to receive and hold moneys.

These criteria include requirements imposed by the Financial Services Authority in Iceland and requirements in relation to the short-term, unsecured, unsubordinated and unguaranteed debt obligation ratings ascribed to such party by Moody's. If the party concerned ceases to satisfy the applicable criteria, including the ratings criteria detailed above, then the rights and obligations of that party (including the right or obligation to receive moneys on behalf of the Fund) may be required to be transferred to another entity which does satisfy the applicable criteria. In these circumstances, the terms agreed with the replacement entity may not be as favourable as those agreed with the original party pursuant to the relevant Transaction Document.

In addition, should the applicable criteria cease to be satisfied, then the parties to the relevant Transaction Document may agree to amend or waive certain of the terms of such document, including the applicable criteria, in order to avoid the need for a replacement entity to be appointed. The consent of Covered Bondholders may not be required in relation to such amendments and/or waivers.

## **FACTORS WHICH ARE MATERIAL FOR THE PURPOSE OF ASSESSING THE MARKET RISKS ASSOCIATED WITH COVERED BONDS ISSUED UNDER THE PROGRAMME**

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

Each of the risks highlighted below could adversely affect the trading price of any Covered Bonds or the rights of investors under any Covered Bonds and, as a result, investors could lose some or all of their investment. The Issuer believes that the factors described below represent the principal risks inherent in investing in Covered Bonds issued under the Programme, but the Issuer may be unable to pay or deliver amounts on or in connection with any Covered Bonds for other reasons than those set out below. Prospective investors should also read the detailed information set out elsewhere in this Prospectus (including any documents deemed to be incorporated by reference herein) and reach their own views prior to making any investment decision.

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

- (i) have sufficient knowledge and experience to make a meaningful evaluation of the Covered Bonds, the merits and risks of investing in the Covered Bonds and the information contained or incorporated by reference in this 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 Covered Bonds and the impact the Covered Bonds would have on its overall investment portfolio;
- (iii) have sufficient financial resources and liquidity to bear all of the risks of an investment in the Covered Bonds, including Covered Bonds 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 Covered Bonds 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.

In addition an investment in Covered Bonds linked to one or more Reference Item(s) may entail significant risks not associated with investments in a conventional debt security, including, but not limited to, the risks set out in *Risks related to the structure of a particular issue of Covered Bonds* below.

Some Covered Bonds 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 Covered Bonds which are complex financial instruments, unless it has the expertise (either alone or with a financial adviser) to evaluate how the Covered Bonds will perform under changing conditions, the resulting effects on the value of the Covered Bonds and the impact this investment would have on the potential investor's overall investment portfolio.

#### **Risks related to the structure of a particular issue of Covered Bonds**

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

##### *Covered Bonds subject to optional redemption by the Issuer*

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

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

#### **Risks relating to Reference Item Linked Covered Bonds**

Inflation Linked Annuity Covered Bonds, Variable Interest Covered Bonds and Dual Currency Interest Covered Bonds (together **Reference Item Linked Covered Bonds**) involve a high degree of risk.

Prospective investors in Reference Item Linked Covered Bonds should understand the risks of transactions involving Reference Item Linked Covered Bonds and should reach an investment decision only after careful consideration, with their advisers, of the suitability of such Reference Item Linked Covered Bonds in the light of their own particular financial circumstances, the information set forth herein and the information regarding the relevant Reference Item Linked Covered Bonds and the particular Reference Item(s) to which the value of, or payments in respect of, the relevant Reference Item Linked Covered Bonds may relate, as specified in the applicable Final Terms.

As the amount of interest payable periodically and/or principal payable at maturity may be linked to the performance of the relevant Reference Item(s), an investor in a Reference Item Linked Covered Bond must generally be correct about the direction, timing and magnitude of an anticipated change in the value of the relevant Reference Item(s).

Where the applicable Final Terms specify one or more Reference Item(s), the relevant Reference Item Linked Covered Bonds will represent an investment linked to the economic performance of such Reference Item(s) and prospective investors should note that the return (if any) on their investment in Reference Item Linked Covered Bonds will depend upon the performance of such Reference Item(s). Potential investors should also note that whilst the market value of such Reference Item Linked Covered Bonds is linked to such Reference Item(s) and will be influenced (positively or negatively) by such Reference Item(s), any change may not be comparable and may be disproportionate. It is impossible to predict how the level of the relevant Reference Item(s) will vary over time. In contrast to a direct investment in the relevant Reference Item(s), Reference Item Linked Covered Bonds represent the right to receive payment of the relevant cash amount and/or asset amount on the relevant Maturity Date as well as periodic payments of interest (if specified in the applicable Final Terms), all or some of which may be determined by reference to the performance of the relevant Reference Item(s). The applicable Final Terms will set out the provisions for the determination of any cash amount and/or asset amount and of any periodic interest payments.

**PROSPECTIVE INVESTORS MUST REVIEW THE APPLICABLE FINAL TERMS TO ASCERTAIN WHAT THE RELEVANT REFERENCE ITEM(S) ARE AND TO SEE HOW BOTH ANY CASH AMOUNTS AND/OR ASSET AMOUNTS ARE PAYABLE AND HOW ANY PERIODIC INTEREST PAYMENTS ARE DETERMINED AND WHEN ANY SUCH AMOUNTS ARE PAYABLE BEFORE MAKING ANY DECISION TO PURCHASE ANY REFERENCE ITEM LINKED COVERED BONDS.**

Fluctuations in the value and/or volatility of the relevant Reference Item(s) may affect the value of the relevant Reference Item Linked Covered Bonds. Investors in Reference Item Linked Covered Bonds may risk losing their entire investment if the value of the relevant Reference Item(s) does not move in the anticipated direction.

There is no return on Reference Item Linked Covered Bonds other than the potential payment of the relevant cash amount and/or asset amount on the Maturity Date and payment of any periodic interest payments.

Other factors which may influence the market value of Reference Item Linked Covered Bonds include interest rates, potential dividend or interest payments (as applicable) in respect of the relevant Reference Item(s), changes in the method of calculating the level of the relevant Reference Item(s) from time to time and market expectations regarding the future performance of the relevant Reference Item(s), its composition and such Reference Item Linked Covered Bonds.

If any of the relevant Reference Item(s) is an index, the value of such Reference Item on any day will reflect the value of its constituents on such day. Changes in the composition of such Reference Item and factors (including those described above) which either affect or may affect the value of the constituents will affect the value of such Reference Item and therefore may affect the return on an investment in Reference Item Linked Covered Bonds. The Issuer may issue several issues of Reference Item Linked Covered Bonds relating to particular Reference Item(s). However, no assurance can be given that the Issuer will issue any Reference Item Linked Covered Bonds other than the Reference Item Linked Covered Bonds to which the applicable Final Terms relate. At any given time, the number of Reference Item Linked Covered Bonds outstanding may be substantial. Reference Item Linked Covered Bonds provide opportunities for investment and pose risks to investors as a result of fluctuations in the value of the Reference Item(s) to which such Reference Item Linked Covered Bonds relate.

#### *Inflation Linked Annuity Covered Bonds and Dual Currency Interest Covered Bonds*

The Issuer may issue Covered Bonds 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 to other factors (each, a **Relevant Factor**). In addition, the Issuer may issue Covered Bonds with principal or interest payable in one or more currencies which may be different from the currency in which the Covered Bonds are denominated. Potential investors should be aware that:

- (i) the market price of such Covered Bonds may be volatile;
- (ii) they may receive no, or a limited amount of, 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 Covered Bonds 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.

The historical experience of an index should not be viewed as an indication of the future performance of such index during the term of any Inflation Linked Annuity Covered Bonds or Dual Currency Interest Covered Bonds. Accordingly, investors should consult their own financial and legal advisers about the risk entailed by an investment in any Inflation Linked Annuity Covered Bonds or Dual Currency Interest Covered Bonds and the suitability of such Covered Bonds in the light of their particular circumstances.

#### *Partly-paid Covered Bonds*

The Issuer may issue Covered Bonds 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 its investment.

#### *Variable rate Covered Bonds with a multiplier or other leverage factor*

Covered Bonds 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.

### *Range Accrual Covered Bonds*

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 Covered Bonds may be more volatile than the market value of other conventional fixed or variable rate debt securities.

### *Fixed/Floating Rate Covered Bonds*

Fixed/Floating Rate Covered Bonds 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 Covered Bonds 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 Covered Bonds may be less favourable than then prevailing spreads on comparable Floating Rate Covered Bonds tied to the same reference rate. In addition, the new floating rate at any time may be lower than the rates on other Covered Bonds. 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 Covered Bonds.

### *Covered Bonds 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.

## **RISK FACTORS RELATING TO THE COVERED BONDS**

### **The Issuer is liable to make payments when due on the Covered Bonds**

The Issuer is liable to make payments when due on the Covered Bonds. The obligations of the Issuer under the Covered Bonds are direct, unsecured, unconditional and unsubordinated obligations, ranking *pari passu* without any preference amongst themselves and equally with its other direct, unsecured, unconditional and unsubordinated obligations (save for any obligations required to be preferred by law).

The Fund has no obligation to pay the Guaranteed Amounts payable under the Covered Bond Guarantee until service of a Notice to Pay following service of an Issuer Acceleration Notice or a Fund Acceleration Notice following the occurrence of a Fund Event of Default.

The occurrence of an Issuer Event of Default does not constitute a Fund Event of Default. However, failure by the Fund to pay amounts when Due for Payment under the Covered Bond Guarantee will constitute a Fund Event of Default.

Following the occurrence of a Fund Event of Default, the Representative may accelerate the obligations of the Fund under the Covered Bond Guarantee by serving a Fund Acceleration Notice. Service of a Fund Acceleration Notice will also accelerate the obligations of the Issuer under the Covered Bonds (if they have not already become due and payable following service of an Issuer Acceleration Notice).

### **The Fund is only obliged to pay Guaranteed Amounts when the same are Due for Payment**

Following service of a Notice to Pay (but prior to service of a Fund Acceleration Notice) the Fund will be obliged under the terms of the Covered Bond Guarantee to pay Guaranteed Amounts as and when the same are Due for Payment. In these circumstances the Fund will not be obliged to pay any other amounts which become payable for any other reason.

Payments by the Fund under the Covered Bond Guarantee will be made subject to any applicable withholding or deduction and the Fund will not be obliged to pay any additional amounts as a consequence. Prior to service on the Fund of a Fund Acceleration Notice, the Fund will not be obliged to make any payments in respect of broken funding indemnities, penalties, premiums, default interest or interest on interest which may accrue on or in respect of the Covered Bonds.

Subject to the applicable grace period in the Terms and Conditions, if (after service of a Notice to Pay) the Fund fails to make a payment when Due for Payment under the Covered Bond Guarantee or any other Fund Event of Default occurs, then the Representative may accelerate the obligations of the Fund under the Covered Bond Guarantee by service of a Fund Acceleration Notice, whereupon the Representative will have a claim under the Covered Bond Guarantee for an amount equal to the Early Redemption Amount of each Covered Bond, together with accrued interest and all other amounts then due under the Covered Bonds.

### Limited description of the Portfolio

Covered Bondholders will not receive detailed statistics or information in relation to the Loans in the Portfolio, because it is expected that the constitution of the Portfolio will change due to, for instance:

- the Seller selling New Loans and their Related Security to the Fund;
- the Seller repurchasing Loans and their Related Security from the Fund in accordance with the Mortgage Sale Agreement and the Fund Deed; and
- New Sellers acceding to the Transaction Documents and selling and/or repurchasing New Seller Loans and their Related Security to or from the Fund.

There is no assurance that the characteristics of the New Loans or New Seller Loans assigned to the Fund on any Assignment Date will be the same as those Loans in the Portfolio as at that Assignment Date. However, each Loan will be required to meet the Eligibility Criteria and the Representations and Warranties set out in the Mortgage Sale Agreement; see *Summary of the Principal Documents – Mortgage Sale Agreement – Sale by the Seller of the Loans and Related Security* (although the Eligibility Criteria and Representations and Warranties may change in certain circumstances; see *The Representative may agree to modifications to the Transaction Documents without the Covered Bondholders' prior consent* below). In addition, the Asset Coverage Test is intended to ensure that the Adjusted Aggregate Loan Amount is an amount equal to or in excess of the ISK Equivalent of the aggregate Principal Amount Outstanding of the Covered Bonds for so long as Covered Bonds remain outstanding (although there is no assurance that it will do so) and the Cash Manager will provide monthly reports that will set out certain information in relation to the Asset Coverage Test.

### Ratings of the Covered Bonds

The ratings assigned by Moody's to a Series of Covered Bonds address the expected loss posed to investors by the legal final maturity date. Moody's ratings address only the credit risks associated with the transaction. Other non-credit risks have not been addressed, but may have a significant effect on yield to investors.

The expected ratings of the Covered Bonds shall be set out in the applicable Final Terms for each Series of Covered Bonds. A security rating is not a recommendation to buy, sell or hold securities and may be subject to revision, suspension or withdrawal at any time at the absolute discretion of the assigning rating organisation. If any rating assigned to the Covered Bonds is lowered or withdrawn, the market value of the Covered Bonds may be reduced.

### Rating Agency Confirmation in respect of Covered Bonds

The terms of certain of the Transaction Documents provide that, in certain circumstances, the Issuer must, and the Representative may, obtain confirmation from the Rating Agency that any particular action proposed to be taken by the Issuer, the Fund, the Seller, the Servicer, the Cash Manager or the Representative will not adversely affect or cause to be withdrawn the then current ratings of the Covered Bonds (a **Rating Agency Confirmation**).

By acquiring the Covered Bonds, investors will be deemed to have acknowledged and agreed that, notwithstanding the foregoing, a credit rating is an assessment of credit risk and does not address other matters that may be of relevance to Covered Bondholders, including, without limitation, in the case of a Rating Agency Confirmation, whether any action proposed to be taken by the Issuer, the Fund, the Seller, the Servicer, the Cash Manager or the Representative or any other party to a Transaction Document is either (i) permitted by the terms of the relevant Transaction Document, or (ii) in the best interests of, or not prejudicial to, some or all of the Covered Bondholders. In being entitled to have regard to the fact that the Rating Agency has confirmed that the then current ratings of the Covered Bonds would not be adversely affected or withdrawn, each of the Issuer, the Fund, the Representative and the Covered Bondholders is deemed to have acknowledged and agreed that the above does not impose or extend any actual or contingent liability on the Rating Agency to the Issuer, the Fund, the Representative, the Covered Bondholders or any other person or create any legal relations between the Rating Agency and the Issuer, the Fund, the Representative, the Covered Bondholders or any other person whether by way of contract or otherwise.

Any such Rating Agency Confirmation may or may not be given at the sole discretion of the Rating Agency. It should be noted that, depending on the timing of delivery of the request and any information needed to be provided as part of any such request, it may be the case that the Rating Agency cannot provide a Rating Agency Confirmation in the time available or at all, and the Rating Agency will not be responsible for the consequences thereof. Such confirmation, if given, will be given on the basis of the facts and circumstances prevailing at the relevant time. A Rating Agency Confirmation represents only a restatement of the opinions given, and is given on the basis that it will not be construed as advice for the benefit of any parties to the transaction.

### **Covered Bonds issued under the Programme**

Covered Bonds issued under the Programme will either be fungible with an existing Series of Covered Bonds or have different terms to an existing Series of Covered Bonds (in which case they will constitute a new Series). All Covered Bonds issued from time to time will rank *pari passu* with each other in all respects.

Following the occurrence of an Issuer Event of Default and service by the Representative of an Issuer Acceleration Notice, the Covered Bonds of all outstanding Series will accelerate against the Issuer but will be subject to, and have the benefit of, payments made by the Fund under the Covered Bond Guarantee (following service of a Notice to Pay).

Following the occurrence of a Fund Event of Default and service by the Representative of a Fund Acceleration Notice, the Covered Bonds of all Series outstanding will accelerate against the Issuer (if not already accelerated following service of an Issuer Acceleration Notice) and the obligations of the Fund under the Covered Bond Guarantee will accelerate.

### **Further Issues**

In order to ensure that any further issue of Covered Bonds under the Programme does not adversely affect existing Covered Bondholders:

- the Issuer will be obliged to apply the proceeds of any issue of Covered Bonds to make a Term Advance to the Fund. The Fund will use the proceeds of such Term Advance:
  - (a) to acquire Loans and their Related Security from the Seller;
  - (b) subject to an Asset Covered Test Breach Notice not having been served (and not revoked), to make a Unit Distribution to a Holder by way of a distribution of each Holder's holding of Units in the Fund in an amount equal to the ISK Equivalent of the Term Advance or any part thereof;
  - (c) to invest in Substitution Assets in an amount not exceeding the prescribed limit;
  - (d) if an existing Series, or part of an existing Series, of Covered Bonds is being refinanced by such issue of Covered Bonds, to repay the Term Advances corresponding to the Covered Bonds being refinanced; and/or
  - (e) to make a deposit in the GIC Account; and
- the Asset Coverage Test will be required to be met both before and immediately after any further issue of Covered Bonds.

### **Obligations under the Covered Bonds**

The Covered Bonds will not represent an obligation or be the responsibility of any of the Dealers, the Representative or any other party to the Programme, their officers, members, directors, employees, security holders or incorporators, other than the Issuer and the Fund. The Issuer and the Fund will be liable solely in their corporate capacity for their obligations in respect of the Covered Bonds and such obligations will not be the obligations of their respective officers, members, directors, employees, security holders or incorporators.

### **The Representative may agree to modifications to the Transaction Documents without the Covered Bondholders' prior consent**

Pursuant to the terms of the Representative and Agency Agreement, the Representative may, without the consent or sanction of any of the Covered Bondholders, concur with any person in making or sanctioning any modification to, or waive or authorise any breach or proposed breach in respect of, the Transaction Documents and the Terms and Conditions of the Covered Bonds.

- provided that the Representative is of the opinion that such modification, waiver or authorisation will not be materially prejudicial to the interests of any of the Covered Bondholders; or
- which is, in the sole opinion of the Representative, of a formal, minor or technical nature or is to correct a manifest error or an error which is, in the sole opinion of the Representative, proven, or is to comply with mandatory provisions of law.

Notwithstanding the above, the Issuer, the Fund and the Principal Paying Agent may, without the consent or sanction of the Representative or the Covered Bondholders, Receiptholders or Couponholders, concur with any person in making or sanctioning any modification to the provisions of any applicable Final Terms which is of a formal, minor or technical nature or is made to correct a proven or manifest error or to comply with any mandatory provisions of law.

### **Certain decisions of Covered Bondholders taken at Programme level**

Any Extraordinary Resolution to direct the Representative to serve an Issuer Acceleration Notice following an Issuer Event of Default or to direct the Representative to serve a Fund Acceleration Notice following a Fund Event of Default and any direction to the Representative to take any enforcement action must be passed at a single meeting of the holders of all Covered Bonds of all Series then outstanding.

### **Absence of secondary market**

There is not, at present, an active and liquid secondary market for the Covered Bonds and there can be no assurance that a secondary market for the Covered Bonds will develop. Neither the Covered Bonds nor the Covered Bond Guarantee has been, or will be, registered under the Securities Act or any other applicable securities laws and both are subject to certain restrictions on the resale and other transfer thereof as set forth under *Subscription and Sale*. If a secondary market does develop it may not continue for the life of the Covered Bonds or it may not provide Covered Bondholders with liquidity of investment, with the result that a Covered Bondholder may not be able to find a buyer to buy its Covered Bonds readily or at prices that will enable the Covered Bondholder to realise a desired yield.

### **Exchange of the Covered Bonds following any covered bond legislation coming into force in Iceland**

The Terms and Conditions of the Covered Bonds permit the Issuer to exchange, without the consent of the Representative or the Covered Bondholders, any existing Covered Bonds then outstanding for new Covered Bonds following the coming into force in Iceland of any legislation similar to covered bond legislation in force in any European Union country or any rules, regulations or guidelines published by any governmental authority that provide for covered bonds issued by Icelandic issuers to qualify for the same benefits available pursuant to covered bond legislation in force in any European Union country provided that, amongst other things, the Rating Agency then rating the existing Covered Bonds confirms in writing that any such new Covered Bonds will be assigned the same ratings as are then applicable to the existing Covered Bonds. Any such new Covered Bonds will qualify as covered bonds under such new legislation, rules, regulations or guidelines and will be in identical form, amounts and denominations and subject to the same economic terms and conditions as the existing Covered Bonds then outstanding.

### **Covered Bonds not in physical form**

Unless the Global Covered Bonds are exchanged for Definitive Covered Bonds, which exchange will only occur in the limited circumstances set out under *Form of the Covered Bonds* below, the beneficial ownership of the Covered Bonds will be recorded in book-entry form only with Euroclear and Clearstream, Luxembourg. The fact that the Covered Bonds are not represented in physical form could, among other things:

- result in payment delays on the Covered Bonds because distributions on the Covered Bonds will be sent by, or on behalf of, the Issuer to Euroclear or Clearstream, Luxembourg instead of directly to Covered Bondholders;
- make it difficult for Covered Bondholders to pledge the Covered Bonds as security if Covered Bonds in physical form are required or necessary for such purposes; and
- hinder the ability of Covered Bondholders to resell the Covered Bonds because some investors may be unwilling to buy Covered Bonds that are not in physical form.

## **GENERAL RISK FACTORS**

### **EU Savings Directive**

Under EC Council Directive 2003/48/EC on the taxation of savings income, Member States are required 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, including Switzerland, and certain dependent or associated territories of certain Member States have adopted similar measures (either provision of information or transitional withholding) (a withholding system in the case of Switzerland) in relation to payments made by a person within its jurisdiction to, or collected by such a person for, an individual resident in a Member State. In addition, the Member States have entered into reciprocal provision of information or transitional withholding arrangements with certain of those dependent or associated territories in relation to payments made by a person in a Member State to, or collected by such a person for, an individual resident in one of those territories.

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, none of the Issuer, any Paying Agent or any other person



would be obliged to pay additional amounts with respect to any Covered Bond 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.

#### **Changes of law**

The terms and conditions of the Covered Bonds are based on Icelandic law in effect as at the date of this Prospectus. No assurance can be given as to the impact of any possible judicial decision or change to Icelandic law or administrative practice after the date of this Prospectus.

#### **Covered Bonds where denominations involve integral multiples: definitive Covered Bonds**

In relation to any issue of Covered Bonds which have denominations consisting of a minimum Specified Denomination plus one or more higher integral multiples of another smaller amount, it is possible that such Covered Bonds may be traded in amounts that are not integral multiples of such minimum Specified Denomination. In such a case a holder who, as a result of trading such amounts, holds an amount which is less than the minimum Specified Denomination in his account with the relevant clearing system at the relevant time may not receive a definitive Covered Bond in respect of such holding (should definitive Covered Bonds be printed) and would need to purchase a principal amount of Covered Bonds such that its holding amounts to a Specified Denomination.

If definitive Covered Bonds are issued, holders should be aware that definitive Covered Bonds which have a denomination that is not an integral multiple of the minimum Specified Denomination may be illiquid and difficult to trade.

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

The Issuer will pay principal, interest and any other amount due on the Covered Bonds and the Fund will make any payments under the Covered Bond Guarantee 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 Covered Bonds, (2) the Investor's Currency-equivalent value of the principal payable on the Covered Bonds and (3) the Investor's Currency-equivalent market value of the Covered Bonds.

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 or any other amount than expected, or no interest or principal or any other amount.

#### **Interest rate risks**

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

#### **General legal investment considerations**

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

## Statements

### *Issuer's statement*

Kaupthing Bank hf. Icelandic ID-No. 560882-0419, registered office at Borgartún 19, 105 Reykjavík, Iceland, in its capacity as the Issuer hereby declares that, having taken all reasonable care to ensure that such is the case, the information contained in this Prospectus is, to the best of its knowledge, in accordance with the facts and contains no omission likely to affect its import.

Reykjavik, Iceland, February 29, 2008  
On behalf of the Issuer

Hreidar Már Sigurdsson  
Gudni Níels Adalsteinsson

### *Arranger's statement*

Kaupthing Bank hf., ID-No. 560882-0419, registered office at Borgartún 19, 105 Reykjavík, Iceland, in its capacity as the Arranger hereby declares that in preparing this Prospectus it has gathered the data which in its estimation was necessary to provide a true and fair view of the Issuer and the Covered Bonds. To the best of its knowledge the information contained in this Prospectus is in accordance with the facts and contains no omission likely to affect its import.

Reykjavik, Iceland, February 29, 2008  
On behalf of Kaupthing Bank hf.

Hreidar Már Sigurdsson  
Gudni Níels Adalsteinsson

### *Auditor's statement*

KPMG hf., Icelandic ID-No. 590975-0449, registered office at Borgartún 27, 105 Reykjavík, Iceland, hereby declares that it has audited and expressed an opinion on the financial statements of the Issuer for the financial years ended December 31, 2006 and 2007, and that they give a true and fair view of the financial position of the Issuer as at December 31, 2006 and 2007, as applicable, and of the results of the Issuer's operations and cash flows for these years. KPMG hf. furthermore confirms that any information in this Prospectus regarding such financial statements is consistent with the said financial statements.

Reykjavik, Iceland, February 29, 2008  
On behalf of KPMG hf.

Saemundur Valdimarsson  
Reynir Stefán Gylfason

## DOCUMENTS INCORPORATED BY REFERENCE

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

- (a) the Annual Report 2007 which contains the auditor's report and the audited consolidated financial statements for the financial year ended 31 December, 2007 including the information set out at the following pages in particular:

### Annual Report 2007

Balance Sheet.....	117
Income Statement .....	116
Statement of Cash Flows .....	119
Notes .....	122-192
Auditors Report .....	115

Any other information not listed above but contained in such document is incorporated by reference for information purposes only; and

- (b) the Annual Report 2006 which contains the auditor's report and the audited consolidated financial statements for the financial year ended 31 December, 2006 including the information set out at the following pages in particular:

### Annual Report 2006

Balance Sheet.....	118
Income Statement .....	117
Statement of Cash Flows .....	120-121
Notes .....	122-181
Auditors Report .....	116

Any other information not listed above but contained in such document is incorporated by reference for information purposes only;

Following the publication of this Prospectus a supplement may be prepared by the Issuer and the Fund and approved by the OMX Nordic Exchange Iceland hf. in accordance with Article 16 of the Prospectus Directive. Statements contained in any such supplement (or contained in any document incorporated by reference therein) shall, to the extent applicable (whether expressly, by implication or otherwise), be deemed to modify or supersede statements contained in this Prospectus or in a document which is incorporated by reference in this Prospectus. Any statement so modified or superseded shall not, except as so modified or superseded, constitute a part of this Prospectus.

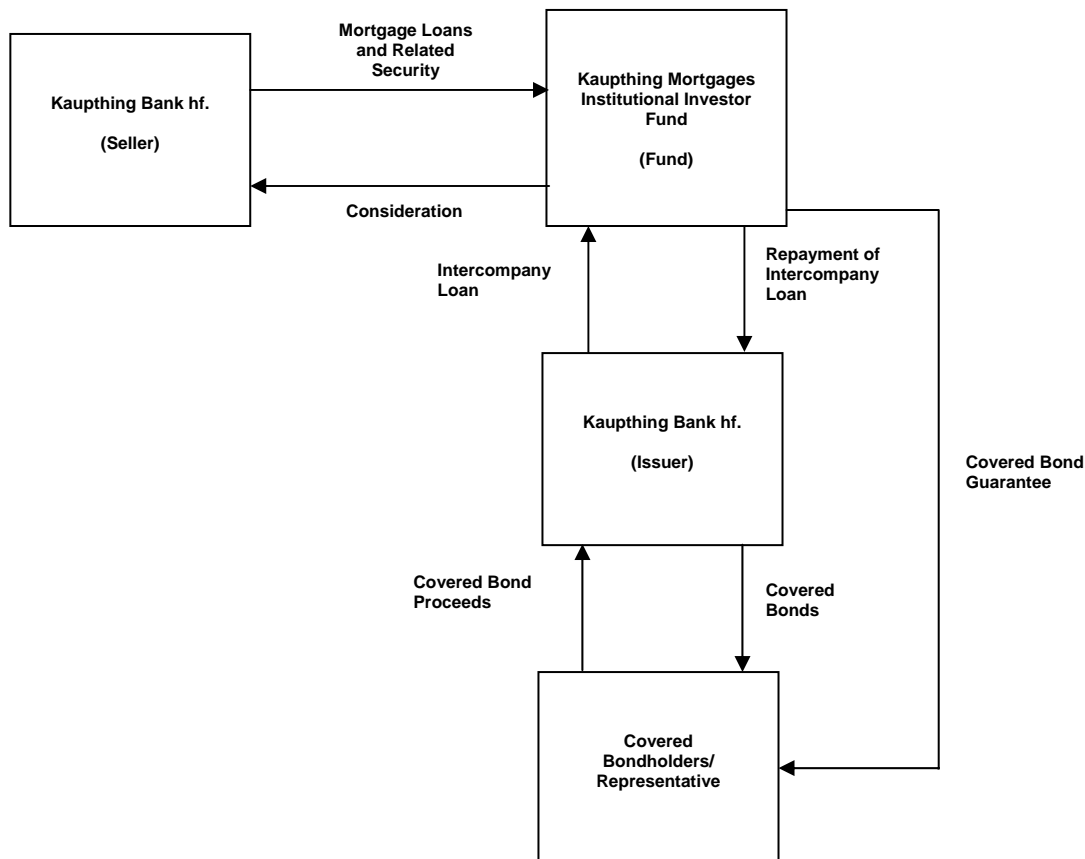
Copies of documents incorporated by reference in this Prospectus can be obtained from the registered office of the Issuer and from the specified office of the Principal Paying Agent for the time being in London.

The Issuer and the Fund will, in the event of any significant new factor, material mistake or inaccuracy relating to information included in this Prospectus which is capable of affecting the assessment of any Covered Bonds, prepare a supplement to this Prospectus or publish a new Prospectus for use in connection with any subsequent issue of Covered Bonds.

## STRUCTURE OVERVIEW

The information in this section is a summary of the structure relating to the Programme and does not purport to be complete. The information is taken from, and is qualified in its entirety by, the remainder of this Prospectus. Words and expressions defined elsewhere in this Prospectus shall have the same meanings in this summary. A glossary of certain defined terms used in this document is contained at the end of this Prospectus.

### Structure Diagram



### Structure Overview

- **Programme:** Under the terms of the Programme the Issuer will issue Covered Bonds to Covered Bondholders on each Issue Date. The Covered Bonds will be direct, unsecured and unconditional obligations of the Issuer.
- **Intercompany Loan Agreement:** Under the terms of the Intercompany Loan Agreement the Issuer will make Term Advances to the Fund in an amount equal to the gross proceeds of each Series or, as applicable, Tranche of Covered Bonds. Payments by the Issuer of amounts due under the Covered Bonds are not conditional upon receipt by the Issuer of payments from the Fund pursuant to the Intercompany Loan Agreement. Amounts owed by the Fund under the Intercompany Loan Agreement will be subordinated to amounts owed by the Fund under the Covered Bond Guarantee.
- **Covered Bond Guarantee:** Under the terms of the Covered Bond Guarantee, the Fund has provided a guarantee as to payments of interest, principal and indexation amounts due under the Covered Bonds. The Fund has agreed to pay an amount equal to the Guaranteed Amounts when the same shall become Due for Payment but which would otherwise be unpaid by the Issuer. The obligations of the Fund under the Covered Bond Guarantee constitute direct, unsecured and (following service of a Notice to Pay or a Fund Acceleration Notice) unconditional obligations of the Fund. The Representative will be required to serve a Notice to Pay on the Fund following the occurrence of an Issuer Event of Default and service of an Issuer Acceleration Notice. A Fund Acceleration Notice may be served by the Representative on the Fund following the occurrence of a Fund Event of Default.

If a Fund Acceleration Notice is served, the Covered Bonds will (if an Issuer Acceleration Notice has not been served) become immediately due and payable as against the Issuer and the Fund's obligations under the Covered Bond Guarantee will be accelerated. Payments made by the Fund under the Covered Bond Guarantee will be made subject to, and in accordance with, the Guarantee Priority of Payments or the Post-Enforcement Priority of Payments, as applicable. The recourse of the Covered Bondholders to the Fund under the Covered Bond Guarantee will be limited to the assets of the Fund from time to time.

- *The proceeds of Term Advances:* The Fund will use the proceeds of the Term Advances received under the Intercompany Loan Agreement from time to time:
  - (a) to purchase each New Portfolio, consisting of Loans and their Related Security, from the Seller in accordance with the terms of the Mortgage Sale Agreement;
  - (b) subject to an Asset Coverage Test Breach Notice not having been served (and not revoked), to make a Unit Distribution to Holders by way of a distribution of each Holder's holding of Units in the Fund in an amount equal to the ISK Equivalent of the Term Advance or any part thereof;
  - (c) to invest in Substitution Assets in an amount not exceeding the prescribed limit;
  - (d) if an existing Series, or part of an existing Series, of Covered Bonds is being refinanced (by the issue of a further Series or Tranche of Covered Bonds), to repay the Term Advance(s) corresponding to the Covered Bonds being refinanced; and/or
  - (e) to make a deposit in the GIC Account.
- *Consideration:* Under the terms of the Mortgage Sale Agreement, the consideration payable to the Seller for the sale of Loans and their Related Security to the Fund on any Assignment Date will be a combination of:
  - (a) a cash payment (in ISK) made by the Fund to the Seller; and/or
  - (b) the Seller being treated as having made an Equity Contribution to the Fund (in an amount up to the difference between the aggregate Outstanding Principal Balance of the Loans sold by the Seller as at the relevant Assignment Date and the cash payment (if any) made by the Fund).
- *Cashflows:* Prior to service on the Fund of an Asset Coverage Test Breach Notice, a Notice to Pay or a Fund Acceleration Notice, the Fund will apply Available Receipts to pay amounts due on the Term Advances to the Issuer. However, these payments will only be made after payment of certain items ranking higher in the Pre-Acceleration Priority of Payments. For further details of the Pre-Acceleration Priority of Payments, see (*Cashflows* below).

Following service on the Fund of an Asset Coverage Test Breach Notice (which has not been revoked) but prior to service of a Notice to Pay or a Fund Acceleration Notice, the Fund will continue to apply Available Receipts as described above, except that, whilst any Covered Bonds remain outstanding in respect of Available Receipts, no further amounts will be paid towards any Unit Distribution to the Holders and no payments will be made other than into the GIC Account (see *Cashflows* below).

Following service of a Notice to Pay on the Fund (but prior to service of a Fund Acceleration Notice) the Fund will use all moneys (other than Third Party Amounts) to pay Guaranteed Amounts in respect of the Covered Bonds when the same shall become Due for Payment subject to paying certain higher ranking obligations of the Fund in the Guarantee Priority of Payments.

Following service of a Fund Acceleration Notice on the Fund, the Covered Bonds will become immediately due and payable (if not already due and payable following service of an Issuer Acceleration Notice) and the Representative will then have a claim against the Fund under the Covered Bond Guarantee for an amount equal to the Early Redemption Amount in respect of each Covered Bond together with accrued interest and any other amounts due under the Covered Bonds.

- *Asset Coverage:* The Programme provides that the assets of the Fund are subject to an asset coverage test in respect of the Covered Bonds. Accordingly, for so long as Covered Bonds remain outstanding, the Fund must ensure that, on each Calculation Date, the Adjusted Aggregate Loan Amount will be in an amount equal to or in excess of the ISK Equivalent of the aggregate Principal Amount Outstanding of the Covered Bonds from time to time. The Asset Coverage Test will be tested by the Cash Manager on each Calculation Date. A breach of the Asset Coverage Test

on a Calculation Date which is not remedied on the immediately succeeding Calculation Date will require the Representative to serve an Asset Coverage Test Breach Notice on the Fund. The Asset Coverage Test Breach Notice will be revoked if, on any Calculation Date falling on or prior to the second Calculation Date following service of an Asset Coverage Test Breach Notice, the Asset Coverage Test is satisfied and neither a Notice to Pay nor a Fund Acceleration Notice has been served.

If an Asset Coverage Test Breach Notice has been delivered and has not been revoked:

- (a) the application of Available Receipts will be restricted;
- (b) the Fund will be required to sell Selected Loans; and
- (c) the Issuer will not be permitted to make to the Fund, and the Fund will not be permitted to borrow from the Issuer, any new Term Advances under the Intercompany Loan Agreement.

If an Asset Coverage Test Breach Notice has been served and not revoked on or before the second Calculation Date after service of such Asset Coverage Test Breach Notice, then an Issuer Event of Default shall occur and the Representative shall be entitled (and, in certain circumstances may be required) to serve an Issuer Acceleration Notice on the Issuer. Following service of an Issuer Acceleration Notice, the Representative must serve a Notice to Pay on the Fund.

- *Servicing:* In its capacity as Servicer Kaupthing Bank hf. has entered into the Servicing and Custody Agreement with the Fund pursuant to which it has agreed to provide certain administrative services in respect of the Loans and their Related Security sold by the Seller to the Fund. In addition, the Custody Agent has entered into the Servicing and Custody Agreement with the Fund pursuant to which it has agreed to provide certain services specified in Article 20 of the Act to the Fund.
- *Further Information:* For a more detailed description of the transactions summarised above relating to the Covered Bonds see, amongst other relevant sections of this Prospectus, *Summary of the Programme, above, and Terms and Conditions of the Covered Bonds, Summary of the Principal Documents, Credit Structure, Cashflows and The Portfolio* below.

## FORM OF THE COVERED BONDS

Each Tranche of Covered Bonds will be initially issued in the form of a temporary global covered bond without receipts and interest coupons attached (a **Temporary Global Covered Bond**) or, if so specified in the applicable Final Terms, a permanent global covered bond without receipts and interest coupons attached (a **Permanent Global Covered Bond** and, together with the Temporary Global Covered Bond, the **Global Covered Bonds** and each a **Global Covered Bond**) which, in each case, will:

- (i) if the Global Covered Bonds are intended to be issued in new global note (NGN) form, as stated in the applicable Final Terms, be delivered on or prior to the original issue date of the Tranche to a common safekeeper (the **Common Safekeeper**) for Euroclear Bank SA/NV (**Euroclear**) and Clearstream Banking, *société anonyme* (**Clearstream, Luxembourg**); and
- (ii) if the Global Covered Bonds are not intended to be issued in NGN form, as stated in the applicable Final Terms, be delivered on or prior to the original issue date of the Tranche to a common depository (the **Common Depository**) for Euroclear and/or Clearstream, Luxembourg and/or any other agreed clearing system.

Whilst any Covered Bond is represented by a Temporary Global Covered Bond, payments of principal, interest (if any) and any other amount payable in respect of the Covered Bonds due prior to the Exchange Date (as defined below) will be made against presentation of the Temporary Global Covered Bond (if the Temporary Global Covered Bond is not intended to be issued in NGN form), only to the extent that certification (in a form to be provided) to the effect that the beneficial owners of interests in such Covered Bond 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 Principal Paying Agent.

On and after the date (the **Exchange Date**) which is 40 days after a Temporary Global Covered Bond is issued, interests in such Temporary Global Covered Bond will be exchangeable (free of charge) upon a request as described therein either for (a) interests in a Permanent Global Covered Bond of the same Series or (b) for Definitive Covered Bonds 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 Covered Bonds, to such notice period as is specified in the applicable Final Terms), in each case against certification of non-U.S. beneficial ownership as described above unless such certification has already been given. The holder of a Temporary Global Covered Bond 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 Covered Bond for an interest in a Permanent Global Covered Bond or for Definitive Covered Bonds is improperly withheld or refused.

Payments of principal, interest (if any) or any other amounts on a Permanent Global Covered Bond will be made through Euroclear and/or Clearstream, Luxembourg against presentation or surrender (as the case may be) of the Permanent Global Covered Bond (if the Permanent Global Covered Bond is not intended to be issued in NGN form), without any requirement for certification.

The applicable Final Terms will specify that a Permanent Global Covered Bond will be exchangeable (free of charge), in whole but not in part, for Definitive Covered Bonds with, where applicable, receipts, interest coupons and talons attached upon either (a) 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 Covered Bond) to the Principal Paying Agent as described therein or (b) upon the occurrence of an Exchange Event. For these purposes, **Exchange Event** means that (i) 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, whether 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 (ii) the Issuer has or will become subject to adverse tax consequences which would not be suffered were the Global Covered Bond (and any interests therein) exchanged for Definitive Covered Bonds. The Issuer will promptly give notice to Covered Bondholders of each Series of Global Covered Bonds 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 Covered Bond) or the Representative may give notice to the Principal Paying Agent requesting exchange and, in the event of the occurrence of an Exchange Event as described in (ii) above, the Issuer may also give notice to the Principal Paying 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 Principal Paying Agent.

The following legend will appear on all Covered Bonds which have an original maturity of more than one year and on all receipts and interest coupons relating to such Covered Bonds:

"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 Covered Bonds, receipts or interest coupons and will not be entitled to capital gains treatment of any gain on any sale or other disposition in respect of such Covered Bonds, receipts or interest coupons.

Covered Bonds which are represented by a Global Covered Bond 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 Representative and Agency Agreement (as defined under *Terms and Conditions of the Covered Bonds*), the Principal Paying Agent shall arrange that, where a further Tranche of Covered Bonds is issued which is intended to form a single Series with an existing Tranche of Covered Bonds, the Covered Bonds of such further Tranche shall be assigned a common code and ISIN which are different from the common code and ISIN assigned to Covered Bonds of any other Tranche of the same Series until at least the Exchange Date applicable to the Covered Bonds of such further Tranche.

Any reference herein to Euroclear and/or Clearstream, Luxembourg shall, whenever the context so permits, except in relation to Global Covered Bonds issued in NGN form, be deemed to include a reference to any successor operator and/or successor clearing system and/or additional or alternative clearing system specified in the applicable Final Terms or as may otherwise be approved by the Issuer, the Principal Paying Agent and the Representative.

No Covered Bondholder, Receiptholder or Couponholder shall be entitled to proceed directly against the Issuer or the Fund unless the Representative, having become so bound to proceed, fails so to do within a reasonable period and the failure shall be continuing.



## APPLICABLE FINAL TERMS

*Set out below is the form of Final Terms which will be completed for each Tranche of Covered Bonds issued under the Programme with a denomination of less than EUR 50,000 (or its equivalent in another currency).*

[Date]

### KAUPTHING BANK HF.

**Issue of [Aggregate Nominal Amount of Tranche] [Title of Covered Bonds]  
irrevocably and unconditionally guaranteed as to payments by  
KAUPTHING MORTGAGES INSTITUTIONAL INVESTOR FUND  
under the ISK 200,000,000,000  
Covered Bond Programme**

[The Prospectus referred to below (as completed by these Final Terms) has been prepared on the basis that, except as provided in subparagraph (ii) below, any offer of Covered Bonds in any Member State of the European Economic Area which has implemented the Prospectus Directive (2003/71/EC) (each, a **Relevant Member State**) will be made pursuant to an exemption under the Prospectus Directive, as implemented in that Relevant Member State, from the requirement to publish a prospectus for offers of the Covered Bonds. Accordingly any person making or intending to make an offer of the Covered Bonds may only do so:

- (i) in circumstances in which no obligation arises for the Issuer or any Dealer to publish a prospectus pursuant to Article 3 of the Prospectus Directive or supplement a prospectus pursuant to Article 16 of the Prospectus Directive, in each case, in relation to such offer; or
- (ii) in those Public Offer Jurisdictions mentioned in Paragraph 35 of Part A below, provided such person is one of the persons mentioned in Paragraph 35 of Part A below and that such offer is made during the Offer Period specified for such purpose therein.

Neither the Issuer nor any Dealer has authorised, nor do they authorise, the making of any offer of Covered Bonds in any other circumstances].<sup>1</sup>

[The Prospectus referred to below (as completed by these Final Terms) has been prepared on the basis that any offer of Covered Bonds in any Member State of the European Economic Area which has implemented the Prospectus Directive (2003/71/EC) (each, a **Relevant Member State**) will be made pursuant to an exemption under the Prospectus Directive, as implemented in that Relevant Member State, from the requirement to publish a prospectus for offers of the Covered Bonds. Accordingly any person making or intending to make an offer in that Relevant Member State of the Covered Bonds may only do so in circumstances in which no obligation arises for the Issuer or any Dealer to publish a prospectus pursuant to Article 3 of the Prospectus Directive or supplement a prospectus pursuant to Article 16 of the Prospectus Directive, in each case, in relation to such offer. Neither the Issuer nor any Dealer has authorised, nor do they authorise, the making of any offer of Covered Bonds in any other circumstances].<sup>2</sup>

---

<sup>1</sup> Consider including this legend where a non-exempt offer of Covered Bonds is anticipated.

<sup>2</sup> Consider including this legend where only an exempt offer of Covered Bonds is anticipated.

## PART A – CONTRACTUAL TERMS

Terms used herein shall be deemed to be defined as such for the purposes of the Terms and Conditions set forth in the Prospectus dated [date] 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 Covered Bonds described herein for the purposes of Article 5.4 of the Prospectus Directive and must be read in conjunction with the Prospectus. Full information on the Issuer, the Fund and the offer of the Covered Bonds is only available on the basis of the combination of these Final Terms and the Prospectus. The Prospectus is 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 following alternative language applies if the first Tranche of an issue which is being increased was issued under a Prospectus with an earlier date.]*

Terms used herein shall be deemed to be defined as such for the purposes of the Terms and Conditions (the **Terms and Conditions**) set forth in the Prospectus dated [original date]. This document constitutes the Final Terms of the Covered Bonds described herein for the purposes of Article 5.4 of the Prospectus Directive (Directive 2003/71/EC) (the **Prospectus Directive**) and must be read in conjunction with the Prospectus dated [current date] which constitutes a base prospectus for the purposes of the Prospectus Directive, save in respect of the Terms and Conditions which are extracted from the Prospectus dated [original date] and are attached hereto. Full information on the Issuer, the Fund and the offer of the Covered Bonds is only available on the basis of the combination of these Final Terms and the Prospectuses dated [original date] and [current date]. Copies of such Prospectuses 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.]

*[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 subparagraphs.]*

*[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 Prospectus under Article 16 of the Prospectus Directive.]*

- |    |                                   |   |
|----|-----------------------------------|---|
| 1. | (a) Issuer:                       | Kaupthing Bank hf.  |
|    | (b) Guarantor:                    | Kaupthing Mortgages Institutional Investor Fund   |
| 2. | (a) Series Number:                | [ ]   |
|    | (b) Tranche Number:               | [ ]   |
|    |                                   | <i>(If fungible with an existing Series, details of that Series, including the date on which the Covered Bonds become fungible)</i>                     |
| 3. | Specified Currency or Currencies: | [ ]   |
| 4. | Aggregate Nominal Amount:         |   |
|    | (a) Series:                       | [ ]   |
|    | (b) Tranche:                      | [ ]   |
| 5. | Issue Price:                      | [ ] per cent. of the Aggregate Nominal Amount<br>[plus accrued interest from [insert date] (if applicable)]   |
| 6. | (a) Specified Denominations:      | [ ]   |
|    |                                   | <i>[(N.B. If an issue of Covered Bonds is: (i) NOT admitted to trading on an European Economic Area exchange; and (ii) only offered in the European</i> |

*Economic Area in circumstances where a prospectus is not required to be under the Prospectus Directive, the €1,000 minimum denomination is not required.))*

(b) Calculation Amount:

[ ]

*(If only one Specified Denomination, insert the Specified Denomination.*

*If more than one Specified Denomination, insert the highest common factor. Note: There must be a common factor in the case of two or more Specified Denominations.)*

7. (a) Issue Date:

[ ]

(b) Interest Commencement Date:

[specify/Issue Date/Not Applicable]

*(N.B. An Interest Commencement Date will not be relevant for certain Covered Bonds, for example Zero Coupon Covered Bonds.)*

8. Final Maturity Date:

[Fixed rate – specify date/  
Floating rate – Interest Payment Date falling in or nearest to [specify month]]

9. Interest Basis:

[Inflation Linked Interest]  
[[ ] per cent. Fixed Rate]  
[[LIBOR/EURIBOR] +/- [ ] per cent. Floating Rate]  
[Zero Coupon]  
[Index Linked Interest]  
[Dual Currency Interest]  
[Variable Interest]  
[specify other]  
(further particulars specified below)

10. Redemption/Payment Basis:

[Annuity]  
[Redemption at par]  
[Partly Paid]  
[Instalment]  
[specify other]

*[(N.B. If the Final Redemption Amount is other than 100 per cent. of the nominal value the Covered Bonds 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 Covered Bonds into another Interest Basis or Redemption/Payment Basis]

12. Call Option:

[Issuer Call]  
[(further particulars specified below)]

13. (a) Status of the Covered Bonds: Senior
- (b) Status of the Covered Bond Guarantee: Senior
- (c) [Date [Board] approval for issuance of Covered Bonds and Covered Bond Guarantee obtained: [ ] [and [ ], respectively]]  
(*N.B. Only relevant where Board (or similar) authorisation is required for the particular Tranche of Covered Bonds or related Covered Bond Guarantee*)
14. Method of distribution: [Syndicated/Non-syndicated]

#### PROVISIONS RELATING TO INFLATION LINKED ANNUITY COVERED BONDS

15. Inflation Linked Annuity Covered Bonds [Applicable/Not Applicable]  
(*if not applicable, delete the remaining subparagraphs of this paragraph*)
- (a) Rate(s) of Interest: [ ] per cent. per annum [payable [annually/semi-annually/quarterly/other (*specify*)] in arrear]
- (b) Interest Payment Date(s): [The [ ] day in each month]/[[ ] in each year] up to and including the Final Maturity Date
- (c) Day Count Fraction: [Actual/360 or Actual/Actual (ICMA) (*specify other*)]
- (d) Formula for calculation of principal amount due as specified in Condition 7.1: An amount calculated by the Calculation Agent in accordance with the following formula:
- $$A = \frac{r(1+r)^{k-1}}{(1+r)^n - 1} \times d$$
- where:
- A = The amount of each instalment of the relevant Covered Bonds;
- r =
- =
- $$\frac{c}{[insert\ number\ of\ interest\ payments\ per\ year];}$$
- c = The Rate of Interest applicable to the relevant Covered Bonds;
- d = The Specified Denomination of the relevant Covered Bonds;
- n = [*Insert total number of annuity payments on the relevant Covered Bonds*]; and
- k = The number of payments that have already taken place + 1 (*k = 1 for the first payment, k = 2 for the second payment, etc*)
- (e) Calculation of Annuity Amount: The formula to calculate the Annuity Amount is as follows:

$$P = \frac{r}{1 - (1 + r)^{-n}} \times IR \times d$$

where:

P = The combined payment of principal, interest and indexation amount of the relevant Covered Bonds;

r =

$$\frac{c}{[insert\ number\ of\ interest\ payments\ per\ year];}$$

c = The Rate of Interest applicable to the relevant Covered Bonds;

d = The Specified Denomination of the relevant Covered Bonds;

n = [Insert total number of annuity payments on the relevant Covered Bonds]; and

IR = The Index Ratio as determined in accordance with subparagraph (h) below

(f) Calculation Agent:

[Issuer] [specify other]

(g) Initial Annuity Amount:

[ ]

(h) Index Ratio:

The value of the Index Ratio (**IR**) on the relevant Interest Payment Date shall be the value of the Reference Index (**RI**) applicable to the relevant Interest Payment Date divided by the value of the Base Index (**BI**) as calculated by the Calculation Agent

$$\text{being } IR = \frac{RI}{BI}$$

where:

**Reference Index** or **RI** means:

- (i) for the first day of the relevant calendar month, the value of the Consumer Price Index (the **CPI**) for the relevant month as calculated by Statistics Iceland pursuant to the Consumer Price Index Act of 1995 (*lög um vísitölu neysluverðs nr. 12/1995*) and published monthly in the Legal Gazette (*Lögbirtingarblaðið*);
- (ii) for each day in the relevant calendar month other than the first day:
  - (A) if the CPI for the calendar month immediately succeeding the month in which the relevant

Interest Payment Date falls (the **Succeeding Month CPI**) has been published as at the relevant Interest Payment Date:

$$RI = CPI_t \times \left( \frac{CPI_{t+1}}{CPI_t} \right)^{\frac{d}{30}}$$

- (B) if the Succeeding Month CPI has not been published as at the relevant Interest Payment Date:

$$RI = CPI_t \times (1 + i)^{\frac{d}{360}}$$

where:

RI = Reference Index;

$CPI_t$  = CPI value for the first day of the relevant calendar month;

$CPI_{t+1}$  = Succeeding Month CPI;

d = number of days since the first day of the month; and

i = annualised inflation forecast of the Central Bank of Iceland

and

**Base Index** means [*to be inserted*], being the value of the CPI on [*to be inserted*].

If at any time a new index is substituted for the CPI, as of the calendar month from and including that in which such substitution takes effect:

- (i) the Reference Index shall be deemed to refer to the new index; and
- (ii) the new Base Index shall be the product of the existing Base Index and the Reference Index immediately following such substitution, divided by the Reference Index immediately prior to such substitution.

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

##### 16. Fixed Rate Covered Bond Provisions

[Applicable/Not Applicable]

(If not applicable, delete the remaining subparagraphs of this paragraph)

- (a) Rate(s) of Interest:

[ ] per cent. per annum [payable [annually/semi-annually/quarterly] in arrear]

- (b) Interest Payment Date(s):

[[ ] in each year up to and including the Final Maturity Date]/ [specify other]

*(N.B. This will need to be amended in the case of long or short coupons)*

- (c) Fixed Coupon Amount(s): ☐ per Calculation Amount
- (d) Broken Amount(s): ☐ per Calculation Amount, payable on the Interest Payment Date falling [in/on] ☐
- (e) Day Count Fraction: [30/360 or Actual/Actual (ISMA)/*[specify other]*]
- (f) 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 N.B. This will need to be amended in the case of regular interest payment dates which are not of equal durations.  
 (N.B. Only relevant where Day Count Fraction is Actual/Actual (ISMA))]*
- (g) Other terms relating to the method of calculating interest for Fixed Rate Covered Bonds: [None/Give details]

17. Floating Rate Covered Bond Provisions

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

- (a) Specified Period(s)/Specified Interest Payment Dates: ☐
- (b) First Interest Payment Date ☐
- (c) Business Day Convention: [Floating Rate Convention/Following Business Day Convention/Modified Following Business Day Convention/Preceding Business Day Convention/*[specify other]*]
- (d) Additional Business Centre(s): ☐
- (e) Manner in which the Rate of Interest and Interest Amount is to be determined: [Screen Rate Determination/ISDA Determination/*specify other*]
- (f) Party responsible for calculating the Rate of Interest and Interest Amount (if not the Principal Paying Agent): ☐
- (g) Screen Rate Determination:
- Reference Rate: ☐  
*(Either LIBOR, EURIBOR or other, although additional information is required if other – including amendment to fallback provisions in the Representative and 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)*

*(N.B. Equivalent for ISK to be inserted, if relevant)*

- Relevant Screen Page:

[ ]

*(In the case of EURIBOR, if not Reuters EURIBOR01 ensure it is a page which shows a composite rate or amend the fallback provisions appropriately)*

(h) ISDA Determination:

- Floating Rate Option:

[ ]

- Designated Maturity:

[ ]

- Reset Date:

[ ]

(i) Margin(s):

[+/-] [ ] per cent. per annum

(j) Minimum Rate of Interest:

[ ] per cent. per annum

(k) Maximum Rate of Interest:

[ ] per cent. per annum

(l) Day Count Fraction:

[Actual/Actual ISDA

Actual/365 (Fixed)

Actual/365 (Sterling)

Actual/360

30/360

30E/360

30E/360 (ISDA)

*Other]*

*(See Condition 5 for alternatives)*

(m) Fallback provisions, rounding provisions and any other terms relating to the method of calculating interest on Floating Rate Covered Bonds, if different from those set out in the Terms and Conditions:

[ ]

18. Zero Coupon Covered Bond Provisions

[Applicable/Not Applicable]

*(If not applicable, delete the remaining subparagraphs of this paragraph)*

(a) Accrual Yield:

[ ] per cent. per annum

(b) Reference Price:

[ ]

(c) Any other formula/basis of determining amount payable:

[ ]

(d) Day Count Fraction in relation to Early Redemption Amounts and late payment:

[Conditions 7.6(b) and 7.11 apply/specify other]

19. Variable Interest Covered Bond Provisions

[Applicable/Not Applicable]

(other than Dual Currency Interest Covered Bonds)

*(If not applicable, delete the remaining subparagraphs of this paragraph)*

(a) Index/Formula/other variable:

*[give or annex details]*

(b) Calculation Agent responsible for calculating the interest due:

[ ]



- (c) Provisions for determining Coupon where calculated by reference to Index and/or Formula and/or other variable: ☐
- (d) Provisions for determining Coupon where calculation by reference to Index and/or Formula is impossible or impracticable or otherwise disrupted: ☐ *(need to include a description of market disruption or settlement disruption events and adjustment provisions)*
- (e) Specified Period(s)/Specified Interest Payment Dates: ☐
- (f) Business Day Convention: ☐ [Floating Rate Convention/Following Business Day Convention/Modified Following Business Day Convention/Preceding Business Day Convention/specify other]
- (g) Additional Business Centre(s): ☐
- (h) Minimum Rate of Interest: ☐ per cent. per annum
- (i) Maximum Rate of Interest: ☐ per cent. per annum
- (j) Day Count Fraction: ☐
20. Dual Currency Interest Covered Bond Provisions ☐ [Applicable/Not Applicable]
- (If not applicable, delete the remaining subparagraphs of this paragraph)*
- (N.B. If the Final Redemption Amount is other than 100 per cent. of the nominal value the Covered Bonds will be derivative securities for the purposes of the Prospectus Directive and the requirements of Annex XII to the Prospectus Directive Regulation will apply.)*
- (a) Rate of Exchange/method of calculating Rate of Exchange: ☐ [give or annex details]
- (b) Party, if any, responsible for calculating the principal and/or interest due (if not the Agent): ☐
- (c) Provisions applicable where calculation by reference to Rate of Exchange impossible or impracticable: ☐ *[need to include a description of market disruption or settlement disruption events and adjustment provisions]*
- (d) Person at whose option Specified Currency(ies) is/are payable: ☐

#### PROVISIONS RELATING TO REDEMPTION

21. Issuer Call: ☐ [Applicable/Not Applicable]
- (If not applicable, delete the remaining subparagraphs of this paragraph)*
- (N.B. For Inflation Linked Annuity Covered Bonds, select "Applicable")*
- (a) Optional Redemption Date(s): ☐
- (N.B. For Inflation Linked Annuity Covered Bonds, select "Each Interest Payment Date")*

(b) Optional Redemption Amount of each Covered Bond and method, if any, of calculation of such amount(s): ☐ per Calculation Amount] *[specify formula]*  
[Condition 7.6(a) applies]

*(N.B. For Inflation Linked Annuity Covered Bonds, select "Condition 7.6(a) applies")*

(c) If redeemable in part:

(i) Minimum Redemption Amount: ☐

(ii) Maximum Redemption Amount: ☐

(d) Notice period (if other than as set out in the Terms and Conditions): ☐

*(N.B. If setting notice periods which are different to those provided in the Terms and 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 Principal Paying Agent or the Representative)*

22. Final Redemption Amount of each Covered Bond:

☐ per Calculation Amount/specify other/see Appendix

*(N.B. For Inflation Linked Annuity Covered Bonds, select "Not Applicable")*

*[(N.B. If the Final Redemption Amount is other than 100 per cent. of the nominal value the Covered Bonds will be derivative securities for the purposes of the Prospectus Directive and the requirements of Annex XII to the Prospectus Directive Regulation will apply.)]*

23. Early Redemption Amount of each Covered Bond payable on redemption on event of default, etc. and/or the method of calculating the same (if required or if different from that set out in Condition 7.5):

☐ per Calculation Amount/specify other/see Appendix

#### GENERAL PROVISIONS APPLICABLE TO THE COVERED BONDS

24. (a) Form of Covered Bonds:

[Temporary Global Covered Bond exchangeable for a Permanent Global Covered Bond which is exchangeable for Definitive Covered Bonds [on 60 days' notice given at any time/only after an Exchange Event]]

[Temporary Global Covered Bond exchangeable for Definitive Covered Bonds on and after the Exchange Date]

[Permanent Global Covered Bond exchangeable for Definitive Covered Bonds [on 60 days' notice given at any time/only after an Exchange Event]]

(b) New Global Note:

[Yes] [No]

25. Additional Financial Centre(s) or other special provisions relating to Payment Days:

[Not Applicable/give details]

*(Note that this item relates to the place of payment and not Interest Period end dates to which items 17(d) and 19(g) relate)*

26. Talons for future Coupons or Receipts to be attached to Definitive Covered Bonds (and dates on which such Talons mature): [Yes/No. *If yes, give details*]
27. Details relating to Partly Paid Covered Bonds: 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 Covered Bonds and interest due on late payment: [Not Applicable/*give details. N.B. a new form of Temporary Global Covered Bond and/or Permanent Global Covered Bond may be required for Partly Paid issues*]
28. Details relating to Instalment Covered Bonds:
- (a) Instalment Amount(s): [Not Applicable/*give details*]
- (b) Instalment Date(s): [Not Applicable/*give details*]
29. 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))*]
30. 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 Prospectus under Article 16 of the Prospectus Directive.)*]

## DISTRIBUTION

31. (a) 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.)*]
- (b) Date of [Subscription] Agreement: [ ]
- (c) Stabilising Manager (if any): [Not applicable/*give name*]
32. If non-syndicated, name of relevant Dealer: [ ]
33. Total commission and concession: [ ] per cent. Of the Aggregate Nominal Amount
34. U.S. Selling Restrictions: [Reg. S Compliance Category: TEFRA D/TEFRA C/TEFRA not applicable]
35. Non-exempt Offer  
  
[Not Applicable] [An offer of the Covered Bonds may be made by the Managers [and [*specify names*] of other financial intermediaries/placers making non-exempt offers, to the extent known OR consider a generic description of other parties involved in non-exempt offers (e.g. "other parties authorised by the Managers") or (if relevant) note that other parties may make non-exempt offers in the Public

*Offer Jurisdictions during the Offer Period, if not known]] (together with the Managers, the **Financial Intermediaries**) other than pursuant to Article 3(2) of the Prospectus Directive in [specify relevant Member State(s) – which must be jurisdictions where the Prospectus and any supplements have been passported (in addition to the jurisdiction where approved and published)] (**Public Offer Jurisdictions**) during the period from [specify date] until [specify date or a formula such as "the Issue Date" or "the date which falls [ ] Business Days thereafter"] (**Offer Period**). See further Paragraph 10 of Part B below.*

*(N.B. Consider any local regulatory requirements necessary to be fulfilled so as to be able to make a non-exempt offer in relevant jurisdictions. No such offer should be made in any relevant jurisdiction until those requirements have been met. Non-exempt offers may only be made into jurisdictions in which the base prospectus (and any supplement) has been notified/passported.)*

36. Additional selling restrictions: [Not Applicable/give details]
37. [Consider whether provisions detailing issuance of proposed Index linked Covered Bonds should be set out in the form of Final Terms]

## PURPOSE OF FINAL TERMS

These Final Terms comprise the final terms required for issue [and] [public offer in the Public Offer Jurisdictions] [and] [admission to trading on [specify relevant regulated market (for example the OMX Nordic Exchange Iceland hf.) and, if relevant, listing on an official list] of the Covered Bonds described herein] pursuant to the ISK 200,000,000,000 Covered Bond Programme of Kaupthing Bank hf.

## RESPONSIBILITY

Each of the Issuer and the Fund accepts responsibility for the information contained in these Final Terms. *[[Relevant third party information, for example in compliance with Annex XII to the Prospectus Directive Regulation in relation to an index or its components] has been extracted from [specify source]. Each of the Issuer and the Fund 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 [specify source], no facts have been omitted which would render the reproduced information inaccurate or misleading].*

Signed on behalf of the Issuer:

Signed on behalf of the Fund:

By: .....  
Duly authorised

By: .....  
Duly authorised

## PART B – OTHER INFORMATION

### 1. LISTING AND ADMISSION TO TRADING

[Application is expected to be made by the Issuer (or on its behalf) for the Covered Bonds to be admitted to trading on *[specify relevant regulated market (for example the OMX Nordic Exchange Iceland, the Bourse de Luxembourg, the London Stock Exchange's Gilt Edged and Fixed Interest Market or the Regulated Market of the Irish Stock Exchange) and, if relevant, listing on an official list (for example, the Official List of the UK Listing Authority)]* with effect from [ ].] [Not Applicable.]

### 2. RATINGS

Ratings:

The Covered Bonds 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 Covered Bonds of the type being issued under the Programme generally or, where the issue has been specifically rated, that rating.)*

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

[Save for any fees payable to the [Managers/Dealer], so far as the Issuer and the Fund are aware, no person involved in the issue of the Covered Bonds has an interest material to the offer. – Amend as appropriate if there are other interests]

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

(a) Reasons for the offer: [ ]

*(See "Use of Proceeds" wording in Prospectus – if reasons for offer different from making profit and/or hedging certain risks will need to include those reasons here.)*

(b) 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.)*

(c) Estimated total expenses:

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

*[(N.B.: If the Covered Bonds are derivative securities to which Annex XII of the Prospectus Directive Regulation applies (a) 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 (b) and (c) above are also required.)]*

**5. YIELD (Fixed Rate Covered Bonds 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.

**6. HISTORIC INTEREST RATES (Floating Rate Covered Bonds Only)**

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

**7. PERFORMANCE OF INDEX/FORMULA/CPI, EXPLANATION OF EFFECT ON VALUE OF INVESTMENT AND ASSOCIATED RISKS AND OTHER INFORMATION CONCERNING THE UNDERLYING (Index-linked Covered Bonds and Inflation Linked Annuity Covered Bonds Only)**

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

The Issuer [intends to provide post-issuance information *[specify what information will be reported and where it can be obtained]*] [does not intend to provide post-issuance information]

*[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 or is the CPI need to include details of where the information about the index/CPI can be obtained. Where the underlying is not an index need to include equivalent information.]*

*The following, updated as necessary, to be inserted for Inflation Linked Annuity Covered Bonds:*

*[Historic performance of the CPI and its influence on the value of the Covered Bonds]*

The general cash-flow of the Covered Bonds is determined in real terms on the Issue Date. The nominal value of each future payment depends on the development of the CPI as demonstrated by the formula in paragraph 15 of Part A of this Final Terms.

Based on data from Statistics Iceland, the year to year inflation, measured as changes in the CPI, has over the last 30 years ranged from -0.04 per cent. in 1994 to 102.8 per cent. in 1982. The average value over the period is 19 per cent. with standard deviation of 21.8 per cent. The same statistic for the last 10 years is an average inflation rate of 4.2 per cent. and standard deviation of 2.2 per cent.

The development of the CPI since 2001 is set out in the table below:

	2001	2002	2003	2004	2005	2006	2007	2008
<b>January</b>	202.4	221.5	224.7	230.1	239.2	249.7	266.9	282.3
<b>February</b>	202.8	220.9	224.3	229.4	239.7	249.5	268.0	
<b>March</b>	204.0	221.8	226.7	230.7	241.5	252.3	267.1	
<b>April</b>	206.5	221.9	227.0	232.0	242.0	255.2	268.7	
<b>May</b>	209.4	221.8	226.6	233.9	240.7	258.9	271.0	
<b>June</b>	212.6	222.8	226.8	235.7	242.4	261.9	272.4	
<b>July</b>	214.2	223.0	226.5	234.6	242.7	263.1	273.0	
<b>August</b>	214.9	221.8	226.3	234.6	243.2	264.0	273.1	
<b>September</b>	216.3	222.9	227.9	235.6	246.9	265.6	276.1	
<b>October</b>	217.7	224.1	229.0	237.4	248.4	266.2	278.1	
<b>November</b>	218.5	223.7	229.3	237.9	248.0	266.1	279.9	
<b>December</b>	219.5	223.9	230.0	239.0	248.9	266.2	281.8	

[Table to be updated for each issue to ensure most recent data is included]

Source: Statistics Iceland

The Central Bank's main objective is price stability, defined as a 12-month rise in the CPI of 2.5 per cent. The aim is to keep the rate of inflation on average as close to the target as possible. If it deviates by more than 1.5 per cent. in either direction, the Central Bank is obliged to present the Icelandic Government with a report, which will be made public, explaining the reasons for the deviation from the target and the Central Bank's responses to the deviation.

The development of 12 month inflation (in percentage terms) since 2001 is set out in the table below:

	2001	2002	2003	2004	2005	2006	2007	2008
<b>January</b>	3.5%	9.4%	1.4%	2.4%	4.0%	4.4%	6.9%	5.9%
<b>February</b>	4.1%	8.9%	1.5%	2.3%	4.5%	4.1%	7.4%	
<b>March</b>	3.9%	8.7%	2.2%	1.8%	4.7%	4.5%	5.9%	
<b>April</b>	4.5%	7.5%	2.3%	2.2%	4.3%	5.5%	5.3%	
<b>May</b>	5.5%	5.9%	2.2%	3.2%	2.9%	7.6%	4.7%	
<b>June</b>	6.8%	4.8%	1.8%	3.9%	2.8%	8.0%	4.0%	
<b>July</b>	7.0%	4.1%	1.6%	3.6%	3.5%	8.4%	3.8%	
<b>August</b>	7.9%	3.2%	2.0%	3.7%	3.7%	8.6%	3.4%	
<b>September</b>	8.4%	3.1%	2.2%	3.4%	4.8%	7.6%	4.0%	
<b>October</b>	8.0%	2.9%	2.2%	3.7%	4.6%	7.2%	4.5%	
<b>November</b>	8.1%	2.4%	2.5%	3.8%	4.2%	7.3%	5.2%	
<b>December</b>	8.6%	2.0%	2.7%	3.9%	4.1%	7.0%	5.9%	

[Table to be updated for each issue to ensure most recent data is included]

Source: Statistics Iceland

If policy changes or if the Icelandic economy runs into long-term stagnation it is possible that the level of the CPI will go down over time resulting in individual future payments on the Covered Bonds being lower in nominal terms than the real value of the same payment on the Issue Date.

Information about the CPI can be obtained from *[to be inserted]*.

## 8. PERFORMANCE OF RATE[S] OF EXCHANGE AND EXPLANATION OF EFFECT ON VALUE OF INVESTMENT *(Dual Currency Covered Bonds 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.]*

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

*[(When completing this paragraph, consideration should be given as to whether such matters described constitute “significant new factors” and consequently trigger the need for a supplement to the Prospectus under Article 16 of the Prospectus Directive.)]*

## 9. OPERATIONAL INFORMATION

- |     |  |   |
|-----|--|---|
| (a) | ISIN Code:   | [ ]   |
| (b) | Common Code:   | [ ]   |
| (c) | Any clearing system(s) other than Euroclear Bank S.A./N.V. or Clearstream Banking, <i>société anonyme</i> and the relevant identification number(s): | [Not Applicable/give name(s) and number(s)] |
| (d) | Delivery:  | Delivery [against/free of] payment          |
| (e) | Names and addresses of initial Paying Agent(s) (if any):   | [ ]   |
| (f) | Intended to be held in a manner which would allow Eurosystem eligibility:  | [Yes] [No]                                  |

[Note that the designation "yes" simply means that the Covered Bonds are intended upon issue to be deposited with one of the ICSDs as common safekeeper and does not necessarily mean that the Covered Bonds will be recognised as eligible collateral for Eurosystem monetary policy and intra-day credit operations by the Eurosystem either upon issue or at any or all times during their life. Such recognition will depend upon satisfaction of the Eurosystem eligibility criteria.] *[include this text if "yes" selected in which case the Covered Bonds must be issued in NGN form]*

## 10. TERMS AND CONDITIONS OF THE OFFER

- |     |  |                               |
|-----|--|-------------------------------|
| (a) | Offer Price:   | [Issue Price/specify]         |
| (b) | Conditions to which the offer is subject:                    | [Not applicable/give details] |
| (c) | Description of the application process:                      | [Not applicable/give details] |
| (d) | Details of the minimum and/or maximum amount of application: | [Not applicable/give details] |



- (e) Description of possibility to reduce subscriptions and manner for refunding excess amount paid by applicants: [Not applicable/*give details*]
- (f) Details of the method and time limits for paying up and delivering the Covered Bonds: [Not applicable/*give details*]
- (g) Manner in and date on which results of the offer are to be made public: [Not applicable/*give details*]
- (h) Procedure for exercise of any right of pre-emption, negotiability of subscription rights and treatment of subscription rights not exercised: [Not applicable/*give details*]
- (i) Categories of potential investors to which the Covered Bonds are offered and whether tranche(s) have been reserved for certain countries: [Not applicable/*give details*]
- (j) Process for notification to applicants of the amount allotted and the indication whether dealing may begin before notification is made: [Not applicable/*give details*]
- (k) Amount of any expenses and taxes specifically charged to the subscriber or purchaser: [Not applicable/*give details*]
- (l) Name(s) and address(es), to the extent known to the Issuer, of the placers in the various countries where the offer takes place. [Not applicable/*give details*]

## APPLICABLE FINAL TERMS

*Set out below is the form of Final Terms which will be completed for each Tranche of Covered Bonds issued under the Programme with a denomination of at least EUR 50,000 (or its equivalent in another currency).*

[Date]

### KAUPTHING BANK HF.

**Issue of [Aggregate Nominal Amount of Tranche] [Title of Covered Bonds]  
irrevocably and unconditionally guaranteed as to payments by  
KAUPTHING MORTGAGES INSTITUTIONAL INVESTOR FUND  
under the ISK 200,000,000,000  
Covered Bond Programme**

## PART A – CONTRACTUAL TERMS

Terms used herein shall be deemed to be defined as such for the purposes of the Terms and Conditions set forth in the Prospectus dated [date] 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 Covered Bonds described herein for the purposes of Article 5.4 of the Prospectus Directive and must be read in conjunction with the Prospectus. Full information on the Issuer, the Fund and the offer of the Covered Bonds is only available on the basis of the combination of these Final Terms and the Prospectus. The Prospectus is 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 following alternative language applies if the first Tranche of an issue which is being increased was issued under a Prospectus with an earlier date.]*

Terms used herein shall be deemed to be defined as such for the purposes of the Terms and Conditions (the **Terms and Conditions**) set forth in the Prospectus dated [original date]. This document constitutes the Final Terms of the Covered Bonds described herein for the purposes of Article 5.4 of the Prospectus Directive (Directive 2003/71/EC) (the **Prospectus Directive**) and must be read in conjunction with the Prospectus dated [current date] which constitutes a base prospectus for the purposes of the Prospectus Directive, save in respect of the Terms and Conditions which are extracted from the Prospectus dated [original date] and are attached hereto. Full information on the Issuer, the Fund and the offer of the Covered Bonds is only available on the basis of the combination of these Final Terms and the Prospectuses dated [original date] and [current date]. Copies of such Prospectuses 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.]

*[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 subparagraphs.]*

*[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 Prospectus under Article 16 of the Prospectus Directive.]*

- |    |     |                 |   |
|----|-----|-----------------|---|
| 1. | (a) | Issuer:         | Kaupthing Bank hf.  |
|    | (b) | Guarantor:      | Kaupthing Mortgages Institutional Investor Fund   |
| 2. | (a) | Series Number:  | [ ]   |
|    | (b) | Tranche Number: | [ ]   |
|    |     |                 | <i>(If fungible with an existing Series, details of that Series, including the date on which the Covered Bonds become fungible)</i> |

3. Specified Currency or Currencies: [ ]
4. Aggregate Nominal Amount:
- (a) Series: [ ]
- (b) Tranche: [ ]
5. Issue Price: [ ] per cent. of the Aggregate Nominal Amount [plus accrued interest from [insert date] (if applicable)]
6. (a) Specified Denominations: [ ]

*(Note – where multiple denominations above [€50,000] or equivalent are being used the following sample wording should be followed:*

*"[€50,000] and integral multiples of [€1,000] in excess thereof up to and including [€99,000]. No Covered Bonds in definitive form will be issued with a denomination above [€99,000].")*

*(N.B. If an issue of Covered Bonds 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 €50,000 minimum denomination is not required.)*

- (b) Calculation Amount:

[ ]

*(If only one Specified Denomination, insert the Specified Denomination.*

*If more than one Specified Denomination, insert the highest common factor. Note: There must be a common factor in the case of two or more Specified Denominations.)*

7. (a) Issue Date: [ ]
- (b) Interest Commencement Date: [specify/Issue Date/Not Applicable]

*(N.B. An Interest Commencement Date will not be relevant for certain Covered Bonds, for example Zero Coupon Covered Bonds.)*

8. Final Maturity Date: [Fixed rate – specify date/  
Floating rate – Interest Payment Date falling in or nearest to [specify month]]

9. Interest Basis: [Inflation Linked Interest]  
[[ ] per cent. Fixed Rate]  
[[LIBOR/EURIBOR] +/- [ ] per cent. Floating Rate]  
[Zero Coupon]  
[Variable Interest]  
[Dual Currency Interest]  
  
[specify other]  
(further particulars specified below)
10. Redemption/Payment Basis: [Annuity]  
[Redemption at par]  
[Partly Paid]  
[Instalment]  
[specify other]  
  
*[(N.B. If the Final Redemption Amount is other than 100 per cent. of the nominal value the Covered Bonds 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 Covered Bonds into another Interest Basis or Redemption/Payment Basis]*
12. Call Option: [Issuer Call]  
[(further particulars specified below)]
13. (a) Status of the Covered Bonds: Senior  
(b) Status of the Covered Bond Guarantee: Senior  
(c) [Date [Board] approval for issuance of Covered Bonds and Covered Bond Guarantee obtained: [ ] [and [ ], respectively]]  
*(N.B. Only relevant where Board (or similar) authorisation is required for the particular Tranche of Covered Bonds or related Covered Bond Guarantee)*
14. Method of distribution: [Syndicated/Non-syndicated]

#### **PROVISIONS RELATING TO INFLATION LINKED ANNUITY COVERED BONDS**

15. Inflation Linked Annuity Covered Bonds [Applicable/Not Applicable]  
*(if not applicable, delete the remaining subparagraphs of this paragraph)*
- (a) Rate(s) of Interest: [ ] per cent. per annum [payable [annually/semi-annually/quarterly/other (specify)] in arrear]
- (b) Interest Payment Date(s): [The [ ] day in each month]/[ ] in each year up to and including the Final Maturity Date]
- (c) Day Count Fraction: [Actual/360 or Actual/Actual (ICMA) (specify other)]

- (d) Formula for calculation of principal amount due as specified in Condition 7.1:
- An amount calculated by the Calculation Agent in accordance with the following formula:
- $$A = \frac{r(1+r)^{k-1}}{(1+r)^n - 1} \times d$$
- where:
- A = The amount of each instalment of the relevant Covered Bonds;
- R =
- $$\frac{c}{[insert\ number\ of\ interest\ payments\ per\ year];}$$
- c = The Rate of Interest applicable to the relevant Covered Bonds;
- d = The Specified Denomination of the relevant Covered Bonds;
- n = [Insert total number of annuity payments on the relevant Covered Bonds]; and
- k = The number of payments that have already taken place + 1 (*k* = 1 for the first payment, *k* = 2 for the second payment, etc)
- (e) Calculation of Annuity Amount:
- The formula to calculate the Annuity Amount is as follows:
- $$P = \frac{r}{1 - (1+r)^{-n}} \times IR \times d$$
- where:
- P = The combined payment of principal, interest and indexation amount of the relevant Covered Bonds;
- R =
- $$\frac{c}{[insert\ number\ of\ interest\ payments\ per\ year];}$$
- c = The Rate of Interest applicable to the relevant Covered Bonds;
- d = The Specified Denomination of the relevant Covered Bonds;
- n = [Insert total number of annuity payments on the relevant Covered Bonds]; and
- IR = The Index Ratio as determined in accordance with subparagraph (h) below
- (f) Calculation Agent: [Issuer] [specify other]
- (g) Initial Annuity Amount: [ ]

(h) Index Ratio:

The value of the Index Ratio (**IR**) on the relevant Interest Payment Date shall be the value of the Reference Index (**RI**) applicable to the relevant Interest Payment Date divided by the value of the Base Index (**BI**) as calculated by the Calculation Agent

$$\text{being IR} = \frac{\text{RI}}{\text{BI}}$$

where:

**Reference Index** or **RI** means:

- (i) for the first day of the relevant calendar month, the value of the Consumer Price Index (the **CPI**) for the relevant month as calculated by Statistics Iceland pursuant to the Consumer Price Index Act of 1995 (*lög um vísitölu neysluverðs nr. 12/1995*) and published monthly in the Legal Gazette (*Lögbirtingarblaðið*);
- (ii) for each day in the relevant calendar month other than the first day:
  - (A) if the CPI for the calendar month immediately succeeding the month in which the relevant Interest Payment Date falls (the **Succeeding Month CPI**) has been published as at the relevant Interest Payment Date:

$$RI = CPI_t \times \left( \frac{CPI_{t+1}}{CPI_t} \right)^{\frac{d}{30}}$$

- (B) if the Succeeding Month CPI has not been published as at the relevant Interest Payment Date:

$$RI = CPI_t \times (1 + i)^{\frac{d}{360}}$$

where:

RI = Reference Index;

$CPI_t$  = CPI value for the first day of the relevant calendar month;

$CPI_{t+1}$  = Succeeding Month CPI;

d = number of days since the first day of the month; and

i = annualised inflation forecast of

the Central Bank of Iceland

and

**Base Index** means *[to be inserted]*, being the value of the CPI on *[to be inserted]*.

If at any time a new index is substituted for the CPI, as of the calendar month from and including that in which such substitution takes effect:

- (i) the Reference Index shall be deemed to refer to the new index; and
- (ii) the new Base Index shall be the product of the existing Base Index and the Reference Index immediately following such substitution, divided by the Reference Index immediately prior to such substitution.

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

16. Fixed Rate Covered Bond Provisions: [Applicable/Not Applicable]  
*(If not applicable, delete the remaining subparagraphs of this paragraph)*
- (a) Rate(s) of Interest: [ ] per cent. per annum [payable [annually/semi-annually/quarterly] in arrear]
  - (b) Interest Payment Date(s): [[ ] in each year up to and including the Final Maturity Date]/ *[specify other]*  
  
*(N.B. This will need to be amended in the case of long or short coupons)*
  - (c) Fixed Coupon Amount(s): [ ] per Calculation Amount
  - (d) Broken Amount(s): [ ] per Calculation Amount, payable on the Interest Payment Date falling [in/on] [ ]
  - (e) Day Count Fraction: [30/360 or Actual/Actual (ISMA)]/ *[specify other]*
  - (f) 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 N.B. This will need to be amended in the case of regular interest payment dates which are not of equal durations.  
(N.B. Only relevant where Day Count Fraction is Actual/Actual (ISMA))]*
  - (g) Other terms relating to the method of calculating interest for Fixed Rate Covered Bonds: [None/Give details]
17. Floating Rate Covered Bond Provisions: [Applicable/Not Applicable]  
*(If not applicable, delete the remaining subparagraphs of this paragraph)*
- (a) Specified Period(s)/Specified Interest Payment Dates: [ ]

- (b) First Interest Payment Date ☐
- (c) Business Day Convention: ☐ Floating Rate Convention/Following Business Day Convention/Modified Following Business Day Convention/Preceding Business Day Convention/ *[specify other]*
- (d) Additional Business Centre(s): ☐
- (e) Manner in which the Rate of Interest and Interest Amount is to be determined: ☐ Screen Rate Determination/ISDA Determination/*specify other*
- (f) Party responsible for calculating the Rate of Interest and Interest Amount (if not the Principal Paying Agent): ☐
- (g) Screen Rate Determination:
- Reference Rate: ☐  
*(Either LIBOR, EURIBOR or other, although additional information is required if other – including amendment to fallback provisions in the Representative and 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)*  
*(N.B. Equivalent for ISK to be inserted, if relevant)*
  - Relevant Screen Page: ☐  
*(In the case of EURIBOR, if not Reuters EURIBOR01 ensure it is a page which shows a composite rate or amend the fallback provisions appropriately)*
- (h) ISDA Determination:
- Floating Rate Option: ☐
  - Designated Maturity: ☐
  - Reset Date: ☐
- (i) Margin(s): ☐ +/- ☐ per cent. per annum
- (j) Minimum Rate of Interest: ☐ per cent. per annum
- (k) Maximum Rate of Interest: ☐ per cent. per annum
- (l) Day Count Fraction: ☐ Actual/Actual ISDA  
Actual/365 (Fixed)  
Actual/365 (Sterling)  
Actual/360  
30/360  
30E/360  
30E/360 (ISDA)



*Other]*

*(See Condition 5 for alternatives)*

- (m) Fallback provisions, rounding provisions and any other terms relating to the method of calculating interest on Floating Rate Covered Bonds, if different from those set out in the Terms and Conditions: ☐
18. Zero Coupon Covered Bond Provisions ☐ [Applicable/Not Applicable]  
*(If not applicable, delete the remaining subparagraphs of this paragraph)*
- (a) Accrual Yield: ☐ per cent. per annum
- (b) Reference Price: ☐
- (c) Any other formula/basis of determining amount payable: ☐
- (d) Day Count Fraction in relation to Early Redemption Amounts and late payment: ☐ [Conditions 7.6(b) and 7.11 apply/specify other]
19. Variable Interest Covered Bond Provisions (other than Dual Currency Interest Covered Bonds): ☐ [Applicable/Not Applicable]  
*(If not applicable, delete the remaining subparagraphs of this paragraph)*
- (a) Index/Formula/other variable: ☐ [give or annex details]
- (b) Calculation Agent responsible for calculating the interest due: ☐
- (c) Provisions for determining Coupon where calculated by reference to Index and/or Formula and/or other variable: ☐
- (d) Provisions for determining Coupon where calculation by reference to Index and/or Formula is impossible or impracticable or otherwise disrupted: ☐ *(need to include a description of market disruption or settlement disruption events and adjustment provisions)*
- (e) Specified Period(s)/Specified Interest Payment Dates: ☐
- (f) Business Day Convention: ☐ [Floating Rate Convention/Following Business Day Convention/Modified Following Business Day Convention/Preceding Business Day Convention/ specify other]
- (g) Additional Business Centre(s): ☐
- (h) Minimum Rate of Interest: ☐ per cent. per annum
- (i) Maximum Rate of Interest: ☐ per cent. per annum
- (j) Day Count Fraction: ☐
20. Dual Currency Interest Covered Bond Provisions: ☐ [Applicable/Not Applicable]  
*(If not applicable, delete the remaining subparagraphs of this paragraph)*
- (N.B. If the Final Redemption Amount is other than 100 per cent. of the nominal value the Covered Bonds will be derivative securities for the purposes of the Prospectus Directive and the*

*requirements of Annex XII to the Prospectus Directive Regulation will apply.)*

- (a) Rate of Exchange/method of calculating Rate of Exchange: [give or annex details]
- (b) Party, if any, responsible for calculating the principal and/or interest due (if not the Agent): [ ]
- (c) Provisions applicable where calculation by reference to Rate of Exchange impossible or impracticable: [need to include a description of market disruption or settlement disruption events and adjustment provisions]
- (d) Person at whose option Specified Currency(ies) is/are payable: [ ]

## PROVISIONS RELATING TO REDEMPTION

21. Issuer Call: [Applicable/Not Applicable]  
*(If not applicable, delete the remaining subparagraphs of this paragraph)*  
*(N.B. For Inflation Linked Annuity Covered Bonds, select "Applicable")*
- (a) Optional Redemption Date(s): [ ]  
*(N.B. For Inflation Linked Annuity Covered Bonds, select "Each Interest Payment Date")*
  - (b) Optional Redemption Amount of each Covered Bond and method, if any, of calculation of such amount(s): [[ ] per Calculation Amount] [specify formula]  
[Condition 7.6(a) applies]  
*(N.B. For Inflation Linked Annuity Covered Bonds, select "Condition 7.6(a) applies")*
  - (c) If redeemable in part:
    - (i) Minimum Redemption Amount: [ ]
    - (ii) Maximum Redemption Amount: [ ]
  - (d) Notice period (if other than as set out in the Terms and Conditions): [ ]  
*(N.B. If setting notice periods which are different to those provided in the Terms and 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 Principal Paying Agent or the Representative)*
22. Final Redemption Amount of each Covered Bond: [ ] per Calculation Amount/specify other/see Appendix  
*(N.B. For Inflation Linked Annuity Covered Bonds, select "Not Applicable")*  
*[(N.B. If the Final Redemption Amount is other than 100 per cent. of the nominal value the Covered Bonds will be derivative securities for the purposes of the Prospectus Directive and the requirements of Annex XII to the Prospectus*

*Directive Regulation will apply.))]*

23. Early Redemption Amount of each Covered Bond payable on redemption on event of default, etc. and/or the method of calculating the same (if required or if different from that set out in Condition 7.5): ☐ per Calculation Amount/specify other/see Appendix

#### GENERAL PROVISIONS APPLICABLE TO THE COVERED BONDS

24. (a) Form of Covered Bonds: [Temporary Global Covered Bond exchangeable for a Permanent Global Covered Bond which is exchangeable for Definitive Covered Bonds [on 60 days' notice given at any time/only after an Exchange Event]]\*  
[Temporary Global Covered Bond exchangeable for Definitive Covered Bonds on and after the Exchange Date]\*  
[Permanent Global Covered Bond exchangeable for Definitive Covered Bonds [on 60 days' notice given at any time/only after an Exchange Event]]\*
- (Ensure that this is consistent with the wording in the "Form of the Covered Bonds " section in the Prospectus and the Covered Bonds themselves. N.B. The exchange upon notice/at any time options should not be expressed to be applicable if the Specified Denomination of the Covered Bonds in paragraph 6 includes language substantially to the following effect: "[€50,000] and integral multiples of [€1,000] in excess thereof up to and including [€99,000]." Furthermore, such Specified Denomination construction is not permitted in relation to any issue of Notes which is to be represented on issue by a Temporary Global Note exchangeable for Definitive Notes.)*
- (b) New Global Note: [Yes] [No]
25. Additional Financial Centre(s) or other special provisions relating to Payment Days: [Not Applicable/give details]  
*(Note that this item relates to the place of payment and not Interest Period end dates to which items 17(d) and 19(g) relate)*
26. Talons for future Coupons or Receipts to be attached to Definitive Covered Bonds (and dates on which such Talons mature): [Yes/No. If yes, give details]
27. Details relating to Partly Paid Covered Bonds: 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 Covered Bonds and interest due on late payment: [Not Applicable/give details. N.B. a new form of Temporary Global Covered Bond and/or Permanent Global Covered Bond may be required for Partly Paid issues]
28. Details relating to Instalment Covered Bonds:
- (a) Instalment Amount(s): [Not Applicable/give details]
- (b) Instalment Date(s): [Not Applicable/give details]

29. 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))]
30. 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 Prospectus under Article 16 of the Prospectus Directive.)

## DISTRIBUTION

31. (a) 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.)
- (b) Stabilising Manager (if any): [Not applicable/give name]
32. If non-syndicated, name of relevant Dealer: [ ]
33. U.S. Selling Restrictions: [Reg. S Compliance Category: TEFRA D/TEFRA C/TEFRA not applicable]
34. Additional selling restrictions: [Not Applicable/give details]
35. [Consider whether provisions detailing issuance of proposed Index linked Covered Bonds should be set out in the form of Final Terms]

## PURPOSE OF FINAL TERMS

These Final Terms comprise the final terms required for issue and admission to trading on [specify relevant regulated market (for example the OMX Nordic Exchange Iceland hf.) and, if relevant, listing on an official list of the Covered Bonds described herein pursuant to the ISK 200,000,000,000 Covered Bond Programme of Kaupthing Bank hf.

## RESPONSIBILITY

Each of the Issuer and the Fund accepts responsibility for the information contained in these Final Terms. [[Relevant third party information, for example in compliance with Annex XII to the Prospectus Directive Regulation in relation to an index or its components] has been extracted from [specify source]]. Each of the Issuer and the Fund 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 [specify source], no facts have been omitted which would render the reproduced information inaccurate or misleading.

Signed on behalf of the Issuer:

Signed on behalf of the Fund:

By: .....

*Duly authorised*

By: .....

*Duly authorised*

## PART B – OTHER INFORMATION

### 1. LISTING AND ADMISSION TO TRADING

- (a) Admission to trading [Application is expected to be made by the Issuer (or on its behalf) for the Covered Bonds to be admitted to trading on [specify relevant regulated market (for example the OMX Nordic Exchange Iceland, the Bourse de Luxembourg, the London Stock Exchange's Gilt Edged and Fixed Interest Market or the Regulated Market of the Irish Stock Exchange) and, if relevant, listing on an official list (for example, the Official List of the UK Listing Authority)] with effect from [ ].] [Not Applicable.]
- (b) Estimate of total expenses related to admission to trading [ ]

### 2. RATINGS

- Ratings: The Covered Bonds 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 Covered Bonds of the type being issued under the Programme generally or, where the issue has been specifically rated, that rating.)

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

[Save for any fees payable to the [Managers/Dealer], so far as the Issuer and the Fund are aware, no person involved in the issue of the Covered Bonds has an interest material to the offer. – Amend as appropriate if there are other interests]

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

- (a) Reasons for the offer: [ ]  
  
(See "Use of Proceeds" wording in Prospectus – if reasons for offer different from making profit and/or hedging certain risks will need to include those reasons here.)
- (b) 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.)
- (c) Estimated total expenses: [ ]. [Expenses are required to be broken down into each principal intended "use" and presented in order of priority of such "uses".]  
  
[(N.B.: If the Covered Bonds are derivative securities to which Annex XII of the Prospectus Directive Regulation applies (a) 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 (b) and (c) above are also required.))*

**5. YIELD** *(Fixed Rate Covered Bonds 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.

**6. HISTORIC INTEREST RATES** *(Floating Rate Covered Bonds Only)*

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

**7. PERFORMANCE OF INDEX/FORMULA/CPI, EXPLANATION OF EFFECT ON VALUE OF INVESTMENT AND ASSOCIATED RISKS AND OTHER INFORMATION CONCERNING THE UNDERLYING** *(Index-linked Covered Bonds and Inflation Linked Annuity Covered Bonds Only)*

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

The Issuer [intends to provide post-issuance information *[specify what information will be reported and where it can be obtained]*] [does not intend to provide post-issuance information]

*[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 or is the CPI need to include details of where the information about the index/CPI can be obtained. Where the underlying is not an index need to include equivalent information.]*

*The following, updated as necessary, to be inserted for Inflation Linked Annuity Covered Bonds:*

*[Historic performance of the CPI and its influence on the value of the Covered Bonds]*

The general cash-flow of the Covered Bonds is determined in real terms on the Issue Date. The nominal value of each future payment depends on the development of the CPI as demonstrated by the formula in paragraph 15 of Part A of these Final Terms.

Based on data from Statistics Iceland, the year to year inflation, measured as changes in the CPI, has over the last 30 years ranged from -0.04 per cent. in 1994 to 102.8 per cent. in 1982. The average value over the period is 19 per cent. with standard deviation of 21.8 per cent. The same statistic for the last 10 years is an average inflation rate of 4.2 per cent. and standard deviation of 2.2 per cent.

The development of the CPI since 2001 is set out in the table below:

	2001	2002	2003	2004	2005	2006	2007	2008
<b>January</b>	202.4	221.5	224.7	230.1	239.2	249.7	266.9	282.3
<b>February</b>	202.8	220.9	224.3	229.4	239.7	249.5	268.0	
<b>March</b>	204.0	221.8	226.7	230.7	241.5	252.3	267.1	
<b>April</b>	206.5	221.9	227.0	232.0	242.0	255.2	268.7	
<b>May</b>	209.4	221.8	226.6	233.9	240.7	258.9	271.0	
<b>June</b>	212.6	222.8	226.8	235.7	242.4	261.9	272.4	
<b>July</b>	214.2	223.0	226.5	234.6	242.7	263.1	273.0	
<b>August</b>	214.9	221.8	226.3	234.6	243.2	264.0	273.1	
<b>September</b>	216.3	222.9	227.9	235.6	246.9	265.6	276.7	
<b>October</b>	217.7	224.1	229.0	237.4	248.4	266.2	278.1	
<b>November</b>	218.5	223.7	229.3	237.9	248.0	266.1	279.9	
<b>December</b>	219.5	223.9	230.0	239.0	248.9	266.2	281.8	

[Table to be updated for each issue to ensure most recent data is included]

Source: Statistics Iceland

The Central Bank's main objective is price stability, defined as a 12-month rise in the CPI of 2.5 per cent. The aim is to keep the rate of inflation on average as close to the target as possible. If it deviates by more than 1.5 per cent. in either direction, the Central Bank is obliged to present the Icelandic Government with a report, which will be made public, explaining the reasons for the deviation from the target and the Central Bank's responses to the deviation.

The development of 12 month inflation (in percentage terms) since 2001 is set out in the table below:

	2001	2002	2003	2004	2005	2006	2007	2008
<b>January</b>	3.5%	9.4%	1.4%	2.4%	4.0%	4.4%	6.9%	5.9%
<b>February</b>	4.1%	8.9%	1.5%	2.3%	4.5%	4.1%	7.4%	
<b>March</b>	3.9%	8.7%	2.2%	1.8%	4.7%	4.5%	5.9%	
<b>April</b>	4.5%	7.5%	2.3%	2.2%	4.3%	5.5%	5.3%	
<b>May</b>	5.5%	5.9%	2.2%	3.2%	2.9%	7.6%	4.7%	
<b>June</b>	6.8%	4.8%	1.8%	3.9%	2.8%	8.0%	4.0%	
<b>July</b>	7.0%	4.1%	1.6%	3.6%	3.5%	8.4%	3.8%	
<b>August</b>	7.9%	3.2%	2.0%	3.7%	3.7%	8.6%	3.4%	
<b>September</b>	8.4%	3.1%	2.2%	3.4%	4.8%	7.6%	4.0%	
<b>October</b>	8.0%	2.9%	2.2%	3.7%	4.6%	7.2%	4.5%	
<b>November</b>	8.1%	2.4%	2.5%	3.8%	4.2%	7.3%	5.2%	
<b>December</b>	8.6%	2.0%	2.7%	3.9%	4.1%	7.0%	5.9%	

[Table to be updated for each issue to ensure most recent data is included]

Source: Statistics Iceland

If policy changes or if the Icelandic economy runs into long-term stagnation it is possible that the level of the CPI will go down over time resulting in individual future payments on the Covered Bonds being lower in nominal terms than the real value of the same payment on the Issue Date.



Information about the CPI can be obtained from *[to be inserted]*.

**8. PERFORMANCE OF RATE[S] OF EXCHANGE AND EXPLANATION OF EFFECT ON VALUE OF INVESTMENT** *(Dual Currency Covered Bonds 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.]*

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

*[(When completing this paragraph, consideration should be given as to whether such matters described constitute “significant new factors” and consequently trigger the need for a supplement to the Prospectus under Article 16 of the Prospectus Directive.)]*

**9. OPERATIONAL INFORMATION**

- (a) ISIN Code: ☐ ☐
- (b) Common Code: ☐ ☐
- (c) Any clearing system(s) other than Euroclear Bank S.A./N.V. or Clearstream Banking, société anonyme and the relevant identification number(s): ☐ *[Not Applicable/give name(s) and number(s)]*
- (d) Delivery: ☐ Delivery ☐ *[against/free of] payment*
- (e) Names and addresses of initial Paying Agent(s) (if any): ☐ ☐
- (f) Intended to be held in a manner which would allow Eurosystem eligibility: ☐ ☐ *[Yes] [No]*

*[Note that the designation "yes" simply means that the Covered Bonds are intended upon issue to be deposited with one of the ICSDs as common safekeeper and does not necessarily mean that the Covered Bonds will be recognised as eligible collateral for Eurosystem monetary policy and intra-day credit operations by the Eurosystem either upon issue or at any or all times during their life. Such recognition will depend upon satisfaction of the Eurosystem eligibility criteria.] [include this text if "yes" selected in which case the Covered Bonds must be issued in NGN form]*

## TERMS AND CONDITIONS OF THE COVERED BONDS

*The following are the Terms and Conditions of the Covered Bonds which will be incorporated by reference into each Global Covered Bond (as defined below) and each Definitive Covered Bond (as defined below), 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 Covered Bond will have endorsed thereon or attached thereto such Terms and Conditions. The applicable Final Terms in relation to any Tranche of Covered Bonds 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 Covered Bonds. The applicable Final Terms (or the relevant provisions thereof) will be endorsed on, or attached to, each Global Covered Bond and Definitive Covered Bond. Reference should be made to "Form of the Covered Bonds" for a description of the content of Final Terms which will specify which of such terms are to apply in relation to the relevant Covered Bonds.*

This Covered Bond is one of a Series (as defined below) of Covered Bonds issued by Kaupthing Bank hf. (the **Issuer**) pursuant to the Representative and Agency Agreement (as defined below).

Save as provided for in Conditions 10 and 15, references herein to the **Covered Bonds** shall be references to the Covered Bonds of this Series and shall mean:

- (a) in relation to any Covered Bonds represented by a global Covered Bond (a **Global Covered Bond**), units of each Specified Denomination in the Specified Currency;
- (b) any Global Covered Bond; and
- (c) any definitive Covered Bonds (**Definitive Covered Bonds**) issued in exchange for a Global Covered Bond.

The Covered Bonds, the Receipts (as defined below) and the Coupons (as defined below) have the benefit of an Amended and Restated Representative and Agency Agreement (such representative and agency agreement as amended and/or supplemented and/or restated from time to time, the **Representative and Agency Agreement**) dated February 29, 2008 and made between the Issuer, Kaupthing Mortgages Institutional Investor Fund as guarantor (the **Fund**), Deutsche Trustee Company Limited as the representative of the Covered Bondholders (as defined below) (the **Representative**, which expression shall include any successor as Representative), Deutsche Bank AG, London Branch, as issuing and principal paying agent and agent bank (in such capacity, the **Principal Paying Agent**, which expression shall include any successor principal paying agent and, together with Kaupthing Bank hf., the **Paying Agents**, which expression shall include any additional or successor paying agents).

Interest-bearing Definitive Covered Bonds 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 Covered Bonds repayable in instalments have receipts (**Receipts**) for the payment of the instalments of principal (other than the final instalment) attached on issue. Global Covered Bonds do not have Receipts, Coupons or Talons attached on issue.

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

The Fund has, in the Representative and Agency Agreement, irrevocably and unconditionally guaranteed the due and punctual payment of Guaranteed Amounts in respect of the Covered Bonds as and when the same shall become Due for Payment, but only after service of a Notice to Pay on the Fund following service of an Issuer Acceleration Notice on the Issuer (after the occurrence of an Issuer Event of Default) or service of a Fund Acceleration Notice on the Fund (after the occurrence of a Fund Event of Default).

The Representative acts for the benefit of the holders for the time being of the Covered Bonds (the **Covered Bondholders**, which expression shall, in relation to any Covered Bonds represented by a Global Covered Bond, be construed as provided below), the holders of the Receipts (the **Receiptholders**) and the holders of the Coupons (the **Couponholders**, which expression shall, unless the context otherwise requires, include the holders of the Talons), and for the holders of each other Series of Covered Bonds in accordance with the provisions of the Representative and Agency Agreement.

As used herein, **Tranche** means Covered Bonds which are identical in all respects (including as to listing and admission to trading) and **Series** means a Tranche of Covered Bonds together with any further Tranche or Tranches of Covered Bonds 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.

Copies of the Master Definitions and Construction Agreement (as defined below), the Representative and Agency Agreement and each of the other Transaction Documents are available for inspection during normal business hours at the office for the time being of the Representative being at February 29, 2008 at Winchester House, 1 Great Winchester Street, London EC2N 2DB and 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 Covered Bondholders, the Receiptholders and the Couponholders are deemed to have notice of, are bound by, and are entitled to the benefit of, all the provisions of, and definitions contained in, the Master Definitions and Construction Agreement, the Representative and Agency Agreement, each of the other Transaction Documents 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 Representative and Agency Agreement.

Except where the context otherwise requires, capitalised terms used and not otherwise defined in these Terms and Conditions (including the preceding paragraphs) shall bear the meanings given to them in the applicable Final Terms and/or the amended and restated master definitions and construction agreement made between the parties to the Transaction Documents on or about February 29, 2008 (as amended and/or supplemented and/or restated from time to time, the **Master Definitions and Construction Agreement**), provided that, in the event of inconsistency between the Master Definitions and Construction Agreement and the applicable Final Terms, the applicable Final Terms will prevail.

## **1. Form, Denomination and Title**

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

This Covered Bond may be an Inflation Linked Annuity Covered Bond, a Fixed Rate Covered Bond, a Floating Rate Covered Bond, a Zero Coupon Covered Bond, an Index Linked Interest Covered Bond, a Credit Linked Interest Covered Bond, an Equity Linked Interest Covered Bond, a Dual Currency Interest Covered Bond or a combination of any of the foregoing, depending upon the Interest Basis shown in the applicable Final Terms.

If this Covered Bond is not an Inflation Linked Annuity Covered Bond denominated in Icelandic króna (being the lawful currency of Iceland), the Issuer has obtained confirmation from the relevant Rating Agency that this Covered Bond will have the same rating as the rating of the Covered Bond of all Series then outstanding and that the rating of the Covered Bond of all Series then outstanding will not be adversely affected or withdrawn as a result of the issuance of this Covered Bond.

This Covered Bond may be an Inflation Linked Annuity Covered Bond, an Instalment Covered Bond, a Partly Paid Covered Bond or a combination of any of the foregoing, depending upon the Redemption/Payment Basis shown in the applicable Final Terms.

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

Definitive Covered Bonds are issued with Receipts, unless they are not Inflation Linked Annuity Covered Bonds or Instalment Covered Bonds in which case references to Receipts and Receiptholders in these Terms and Conditions are not applicable.

Subject as set out below, title to the Covered Bonds, Receipts and Coupons will pass by delivery. The Issuer, the Fund, the Paying Agents and the Representative will (except as otherwise required by law) deem and treat the bearer of any Covered Bond, 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 Covered Bond, without prejudice to the provisions set out in the next succeeding paragraph.

For so long as any of the Covered Bonds is represented by a Global Covered Bond held on behalf of or, as the case may be, registered in the name of a common depositary for, Euroclear Bank S.A./N.V. (**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 Clearstream, Luxembourg as the holder of a particular nominal amount of such Covered Bonds (in which regard any certificate or other document issued by Euroclear or Clearstream, Luxembourg as to the nominal amount of such Covered Bonds standing to the account of any person shall be conclusive and binding for all purposes save in the case of manifest error or proven error) shall be treated by the Issuer, the Fund, the Paying Agents and the Representative as the holder of such nominal amount of such Covered Bonds in accordance with and subject to the terms of the relevant Global Covered Bond and the expressions **Covered Bondholder** and **holder of Covered Bonds** and related expressions shall be construed accordingly. In determining whether a particular person is entitled to a particular nominal amount of Covered Bonds as aforesaid, the Representative may rely on such evidence and/or information and/or certification as it shall, in its absolute discretion, think fit and, if it does so rely, such evidence and/or information and/or certification shall, in the absence of manifest error or proven error, be conclusive and binding on all concerned.

Covered Bonds which are represented by a Global Covered Bond 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, except in relation to Covered Bonds in NGN form, be deemed to include a reference to any additional or alternative clearing system specified in the applicable Final Terms or as may otherwise be approved by the Issuer, the Fund, the Principal Paying Agent and the Representative.

## **2. Status of the Covered Bonds and the Covered Bond Guarantee**

### **2.1. Status of the Covered Bonds**

The Covered Bonds and any relative Receipts and Coupons constitute direct, unconditional, unsubordinated and (subject to 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.

### **2.2. Status of the Covered Bond Guarantee**

The payment of Guaranteed Amounts in respect of the Covered Bonds when the same shall become Due for Payment has been unconditionally and irrevocably guaranteed by the Fund pursuant to the Representative and Agency Agreement (the **Covered Bond Guarantee**). However, the Fund shall have no obligation under the Covered Bond Guarantee to pay any Guaranteed Amounts when the same shall become Due for Payment under the Covered Bonds until service of a Notice to Pay by the Representative on the Fund (which the Representative will be required to serve following the occurrence of an Issuer Event of Default and service of an Issuer Acceleration Notice by the Representative on the Issuer) or, if earlier, the occurrence of a Fund Event of Default and service of a Fund Acceleration Notice by the Representative on the Fund. The obligations of the Fund under the Covered Bond Guarantee are, subject as aforesaid, direct, unconditional, unsubordinated and unsecured obligations of the Fund (save for certain obligations required to be preferred by law) equally with all other unsecured obligations (other than subordinated obligations, if any) of the Fund, from time to time outstanding.

Any payment made by the Fund under the Covered Bond Guarantee shall (unless such obligation shall have been discharged as a result of the payment of Excess Proceeds to the Representative pursuant to Condition 10) discharge *pro tanto* the obligations of the Issuer in respect of such payment under the Covered Bonds, Receipts and Coupons, except where such payment by the Fund has been declared void, voidable or otherwise recoverable in whole or in part and recovered from the Representative or the Covered Bondholders.

## **3. Negative Pledge**

So long as any of the Covered Bonds, 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 Covered Bonds, Receipts and Coupons are equally and rateably 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 Representative and Agency Agreement) of the Covered Bondholders.

For the purposes of these Terms and 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:

- (a) 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
- (b) 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 (i) the extent of such recourse to such borrower is limited solely to the amount of any recoveries made on any such enforcement, and (ii) 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
- (c) 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): (a) mortgage receivables; or (b) receivables against Government Entities; or (c) asset-backed securities backed by any of the assets under paragraph (a) or (b); or (d) a prior Security Interest granted over an asset existing before such asset is acquired by the Issuer or one of its Subsidiaries, provided that that Security Interest was not created in contemplation of the acquisition of such asset by the Issuer or its Subsidiary; or (e) any other assets permitted by any applicable governing law to collateralise the covered bonds issued by the Issuer or any of its Subsidiaries, 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 relevant laws relating to such 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**

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

The election will have effect as follows:

- (a) the Covered Bonds and the Receipts shall be deemed to be redenominated into euro in the denomination of euro 0.01 with a principal amount for each Covered Bond and Receipt equal to the principal amount of that Covered Bond or Receipt in the Specified Currency, converted into euro at the Established Rate, provided that, if the Issuer determines, with the agreement of the Principal Paying Agent and the Representative, 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 Covered Bondholders, the stock exchange (if any) on which the Covered Bonds may be listed and the Paying Agents of such deemed amendments;
- (b) save to the extent that an Exchange Notice has been given in accordance with paragraph (d) below, the amount of interest due in respect of the Covered Bonds will be calculated by reference to the aggregate principal amount of Covered Bonds 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;
- (c) if Definitive Covered Bonds 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 Principal Paying Agent and the Representative may approve) euro 0.01 and such other denominations as the Principal Paying Agent shall determine and notify to the Covered Bondholders;
- (d) if issued prior to the Redenomination Date, all unmatured Coupons denominated in the Specified Currency (whether or not attached to the Covered Bonds) will become void with effect from the date on which the Issuer gives notice (the **Exchange Notice**) that replacement euro-denominated Covered Bonds, 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 Covered Bonds and Receipts so issued will also become void on that date although those Covered Bonds and Receipts will continue to constitute valid exchange obligations of the Issuer. New euro denominated Covered Bonds, Receipts and Coupons will be issued in exchange for Covered Bonds, Receipts and Coupons denominated in the Specified Currency in such manner as the Principal Paying Agent may specify and as shall be notified to the Covered Bondholders 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 Covered Bonds;
- (e) after the Redenomination Date, all payments in respect of the Covered Bonds, 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 Covered Bonds 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;
- (f) if the Covered Bonds are Fixed Rate Covered Bonds 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:

- (i) in the case of the Covered Bonds represented by a Global Covered Bond, by applying the Rate of Interest to the aggregate outstanding nominal amount of the Covered Bonds represented by such Global Covered Bond; and
- (ii) in the case of definitive Covered Bonds, by applying the Rate of Interest to the Calculation Amount,

and, in each case, 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. Where the Specified Denomination of a Fixed Rate Covered Bond in definitive form comprises more than one Calculation Amount, the amount of interest payable in respect of such Fixed Rate Covered Bond shall be the aggregate of the amounts (determined in the manner provided above) for each Calculation Amount comprising the Specified Denomination without any further rounding; and

- (g) if the Covered Bonds are Floating Rate Covered Bonds, the applicable Final Terms will specify any relevant changes to the provisions relating to interest.

For the purposes of these Terms and Conditions:

**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 Covered Bonds) any date for payment of interest under the Covered Bonds or (in the case of Zero Coupon Covered Bonds) any date, in each case specified by the Issuer in the notice given to the Noteholders pursuant to this Condition 4 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

### 5.1. *Interest on Inflation Linked Annuity Covered Bonds*

Each Inflation Linked Annuity Covered Bond bears interest from (and including) the Interest Commencement Date at the rate per annum equal to the Rate of Interest payable in arrear on the Interest Payment Date(s) in each year up to (and including) the Final Maturity Date.

If interest is required to be calculated for a period other than an Interest Period (as defined in Condition 5.8) such interest shall be calculated by applying the Rate of Interest to each Specified Denomination, multiplying such sum by the applicable Day Count Fraction (as defined in Condition 5.8), and rounding the resultant figure to the nearest sub-unit (as defined in Condition 5.8) of the relevant Specified Currency, half of any such sub-unit being rounded upwards or otherwise in accordance with applicable market convention.

### 5.2. *Interest on Fixed Rate Covered Bonds*

Each Fixed Rate Covered Bond bears interest from (and including) the Interest Commencement Date at the rate(s) per annum equal to the Rate(s) of Interest payable, subject as provided in these Terms and Conditions, in arrear on the Interest Payment Date(s) in each year up to (and including) the Final Maturity Date.

If the Covered Bonds are in definitive form, except as provided in the applicable Final Terms, the amount of interest payable on each Interest Payment Date in respect of the 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.

Except in the case of Covered Bonds in definitive form where an applicable Fixed Coupon Amount or Broken Amount is specified in the applicable Final Terms, interest shall be calculated in respect of any period by applying the Rate of Interest to:

- (A) in the case of Fixed Rate Covered Bonds which are represented by a Global Covered Bond, the aggregate outstanding nominal amount of the Fixed Rate Covered Bonds represented by such Global Covered Bond (or, if they are Partly Paid Rate Covered Bonds, the aggregate amount paid up); or
- (B) in the case of Fixed Rate Covered Bonds in definitive form, the Calculation Amount,

and, in each case, 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. Where the Specified Denomination of a Fixed Rate Covered Bond in definitive form comprises more than one Calculation Amount, the amount of interest payable in respect of such Fixed Rate Covered Bond shall be the aggregate of the amounts (determined in the manner provided above) for each Calculation Amount comprising the Specified Denomination without any further rounding.

### 5.3. *Interest on Floating Rate Covered Bonds and Variable Interest Covered Bonds*

#### (a) *Interest Payment Dates*

Each Floating Rate Covered Bond and Variable Interest Covered Bond bears interest from (and including) the Interest Commencement Date and such interest will be payable in arrear on either:

- (i) the Specified Interest Payment Date(s) in each year specified in the applicable Final Terms; or
- (ii) 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.

#### (b) *Rate of Interest*

The Rate of Interest payable from time to time in respect of Floating Rate Covered Bonds and Variable Interest Covered Bonds will be determined in the manner specified in the applicable Final Terms.

##### (i) ISDA Determination for Floating Rate Covered Bonds

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 subparagraph (i), **ISDA Rate** for an Interest Period means a rate equal to the Floating Rate that would be determined by the Principal Paying Agent or other person specified in the applicable Final Terms under an interest rate swap transaction if the Principal Paying Agent or that other person were acting as Calculation Agent for that swap transaction under the terms of an agreement incorporating the 2006 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 Covered Bonds (the **ISDA Definitions**), and under which:

- (A) the Floating Rate Option is as specified in the applicable Final Terms;
- (B) the Designated Maturity is the period specified in the applicable Final Terms; and
- (C) unless otherwise stated in the applicable Final Terms, the relevant Reset Date is the first day of that Interest Period.

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

##### (ii) Screen Rate Determination for Floating Rate Covered Bonds

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:



- (A) the offered quotation (if there is only one quotation on the Relevant Screen Page); or
- (B) 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 Principal Paying 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 Principal Paying Agent for the purpose of determining the arithmetic mean (rounded as provided above) of such offered quotations.

The Representative and Agency Agreement contains provisions for determining the Rate of Interest pursuant to this subparagraph (ii) in the event that the Relevant Screen Page is not available or if, in the case of (A) above, no such offered quotation appears or, in the case of (B) 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 Covered Bonds is specified in the applicable Final Terms as being other than LIBOR or EURIBOR, the Rate of Interest in respect of such Covered Bonds will be determined as provided in the applicable Final Terms.

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

If the applicable Final Terms for a Floating Rate Covered Bond or a Variable Interest Covered Bond 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 (b) 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 for a Floating Rate Covered Bond or a Variable Interest Covered Bond 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 (b) above is greater than such Maximum Rate of Interest, the Rate of Interest for such Interest Period shall be such Maximum Rate of Interest.

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

The Principal Paying Agent, in the case of Floating Rate Covered Bonds, and the Calculation Agent, in the case of Variable Interest Covered Bonds, 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 Variable Interest Covered Bonds, the Calculation Agent will notify the Principal Paying 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 Covered Bonds or Index Linked Interest Covered Bonds for the relevant Interest Period by applying the Rate of Interest to:

- (A) in the case of Floating Rate Covered Bonds or Variable Interest Covered Bonds which are represented by a Global Covered Bond, the aggregate outstanding nominal amount of the Covered Bonds represented by such Global Covered Bond (or, if they are Partly Paid Covered Bonds, the aggregate amount paid up); or
- (B) in the case of Floating Rate Covered Bonds or Variable Interest Covered Bonds in definitive form, the Calculation Amount,

and, in each case, 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. Where the Specified Denomination of a Floating Rate Covered Bond or an Variable Interest Covered Bond in definitive form comprises more than one Calculation Amount, the Interest Amount payable in respect of such Covered Bond shall be the aggregate of the amounts (determined in the manner provided above) for each Calculation Amount comprising the Specified Denomination without any further rounding.

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

The Principal Paying 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, the Fund, the Representative and to any stock exchange or other relevant competent authority or quotation system on which the relevant Floating Rate Covered Bonds or Variable Interest Covered Bonds are for the time being listed, quoted and/or traded or by which they have been admitted to listing or trading and to be published in accordance with Condition 14 as soon as possible after their determination but in no event later than the fourth Business Day (as defined in Condition 5.8) thereafter. Each Interest Amount and Interest Payment Date so notified may subsequently be amended (or appropriate alternative arrangements made by way of adjustment) without notice in the event of an extension or shortening of the Interest Period. Any such amendment or alternative arrangements will be promptly notified to the Representative and each stock exchange or other relevant authority on which the relevant Floating Rate Covered Bonds or Variable Interest Covered Bonds are for the time being listed, quoted and/or traded or by which they have been admitted to listing or trading and to Covered Bondholders in accordance with Condition 14.

(f) *Determination or Calculation by Representative*

If for any reason at any relevant time, the Principal Paying Agent or, as the case may be, the Calculation Agent defaults in its obligation to determine the Rate of Interest or the Principal Paying Agent defaults in its obligation to calculate any Interest Amount in accordance with subparagraph (b)(i) or (ii) above or as otherwise specified in the applicable Final Terms, as the case may be, and in each case in accordance with paragraph (d) above, the Representative shall determine the Rate of Interest at such rate as, in its absolute discretion (having such regard as it shall think fit to the foregoing provisions of this Condition, but subject always to any Minimum Rate of Interest or Maximum Rate of Interest specified in the applicable Final Terms), it shall deem fair and reasonable in all the circumstances or, as the case may be, the Representative shall calculate the Interest Amount(s) in such manner as it shall deem fair and reasonable in all the circumstances. In making any such determination or calculation, the Representative may appoint and rely on a determination or calculation by a calculation agent (which shall be an investment bank or other suitable entity of international repute). Each such determination or calculation shall be deemed to have been made by the Principal Paying Agent or the Calculation Agent, as the case may be.

(g) *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 5.3, whether by the Principal Paying Agent, the Calculation Agent or the Representative shall (in the absence of wilful default, bad faith or manifest error as aforesaid) be binding on the Issuer, the Fund, the Principal Paying Agent, the Calculation Agent, the other Paying Agents, the Representative and all Covered Bondholders, Receiptholders and Couponholders and (in the absence as aforesaid) no liability to the Issuer, the Fund, the Covered Bondholders, the Receiptholders or the Couponholders shall attach to the Principal Paying Agent, the Calculation Agent or the Representative in connection with the exercise or non-exercise by it of its powers, duties and discretions pursuant to such provisions.

5.4. *Interest on Dual Currency Interest Covered Bonds*

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

5.5. *Interest on Partly-Paid Covered Bonds*

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

5.6. *Interest following a Notice to Pay*

If a Notice to Pay is served on the Fund, the Fund shall, in accordance with the terms of the Covered Bond Guarantee, pay Guaranteed Amounts corresponding to the amounts of interest described under Conditions 5.1, 5.2, 5.3, 5.4 or 5.5 (as the case may be) under the Covered Bond Guarantee in respect of the Covered Bonds on the Due for Payment Dates.

5.7. *Accrual of interest*

Each Covered Bond (or in the case of the redemption of part only of a Covered Bond, that part only of such Covered Bond) 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 in accordance with Sections 5 and 6 of the Act on Interest and Price Indexation no. 38/2001 (*lög um vexti og verðtryggingu*). If this is a Zero Coupon Covered Bond, interest will accrue as provided in Condition 7.11.

5.8. *Business Day, Business Day Convention, Day Count Fractions and other adjustments*

(a) In these Terms and Conditions, **Business Day** means:

- (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 London, Reykjavik and any Additional Business Centre specified in the applicable Final Terms; and
- (ii) either (A) 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, Reykjavik and any Additional Business Centre and which if the Specified Currency is Australian dollars or New Zealand dollars shall be Sydney and Auckland, respectively) or (B) 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.

(b) If a **Business Day Convention** is specified in the applicable Final Terms and (x) if there is no numerically corresponding day in 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:

- (i) in any case where Specified Periods are specified in accordance with Condition 5.3(a)(ii), the **Floating Rate Convention**, such Interest Payment Date (1) in the case of (x) above, shall be the last day that is a Business Day in the relevant month and the provisions of (II) below shall apply mutatis mutandis, or (2) 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 (I) such Interest Payment Date shall be brought forward to the immediately preceding Business Day, and (II) 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
- (ii) the **Following Business Day Convention**, such Interest Payment Date shall be postponed to the next day which is a Business Day; or
- (iii) 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
- (iv) the **Preceding Business Day Convention**, such Interest Payment Date shall be brought forward to the immediately preceding Business Day.

(c) **Day Count Fraction** means, in respect of the calculation of an amount of interest for any Interest Period:

- (i) if **Actual/Actual (ISMA)** is specified in the applicable Final Terms:
- (A) in the case of Covered Bonds 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 (as defined in Condition 5.8(d)) during which the Accrual Period ends, the number of days in such Accrual Period divided by the product of (I) the number of days in such

Determination Period and (II) 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 Covered Bonds where the Accrual Period is longer than the Determination Period during which the Accrual Period ends, the sum of (I) 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 (II) 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;
- (ii) if **Actual/Actual (ISDA)** 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 (i) the actual number of days in that portion of the Interest Period falling in a leap year divided by 366, and (ii) the actual number of days in that portion of the Interest Period falling in a non-leap year divided by 365);
- (iii) if **Actual/365 (Fixed)** is specified in the applicable Final Terms, the actual number of days in the Interest Period divided by 365;
- (iv) 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;
- (v) if **Actual/360** is specified in the applicable Final Terms, the actual number of days in the Interest Period divided by 360;
- (vi) 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, calculated on a formula basis as follows:

$$\text{Day Count Fraction} = \frac{[360 \times (Y_2 - Y_1)] + [30 \times (M_2 - M_1)] + (D_2 - D_1)}{360}$$

where:

"Y<sub>1</sub>" is the year, expressed as a number, in which the first day of the Interest Period falls;

"Y<sub>2</sub>" is the year, expressed as a number, in which the day immediately following the last day of the Interest Period falls;

"M<sub>1</sub>" is the calendar month, expressed as a number, in which the first day of the Interest Period falls;

"M<sub>2</sub>" is the calendar month, expressed as a number, in which the day immediately following the last day of the Interest Period falls;

"D<sub>1</sub>" is the first calendar day, expressed as a number, of the Interest Period, unless such number is 31, in which case D<sub>1</sub> will be 30; and

"D<sub>2</sub>" is the calendar day, expressed as a number, immediately following the last day included in the Interest Period, unless such number would be 31 and D<sub>1</sub> is greater than 29, in which case D<sub>2</sub> will be 30;

- (vii) if **30E/360 or Eurobond Basis** is specified in the applicable Final Terms, the number of days in the Interest Period divided by 360, calculated on a formula basis as follows:

$$\text{Day Count Fraction} = \frac{[360 \times (Y_2 - Y_1)] + [30 \times (M_2 - M_1)] + (D_2 - D_1)}{360}$$

where:

"Y<sub>1</sub>" is the year, expressed as a number, in which the first day of the Interest Period falls;

"Y<sub>2</sub>" is the year, expressed as a number, in which the day immediately following the last day of the Interest Period falls;

"M<sub>1</sub>" is the calendar month, expressed as a number, in which the first day of the Interest Period falls;

"M<sub>2</sub>" is the calendar month, expressed as a number, in which the day immediately following the last day of the Interest Period falls;

"D<sub>1</sub>" is the first calendar day, expressed as a number, of the Interest Period, unless such number would be 31, in which case D<sub>1</sub> will be 30; and

"D<sub>2</sub>" is the calendar day, expressed as a number, immediately following the last day included in the Interest Period, unless such number would be 31, in which case D<sub>2</sub> will be 30;

(viii) if **30E/360 (ISDA)** is specified in the applicable Final Terms, the number of days in the Interest Period divided by 360, calculated on a formula basis as follows:

$$\text{Day Count Fraction} = \frac{[360 \times (Y_2 - Y_1)] + [30 \times (M_2 - M_1)] + (D_2 - D_1)}{360}$$

where:

"Y<sub>1</sub>" is the year, expressed as a number, in which the first day of the Interest Period falls;

"Y<sub>2</sub>" is the year, expressed as a number, in which the day immediately following the last day of the Interest Period falls;

"M<sub>1</sub>" is the calendar month, expressed as a number, in which the first day of the Interest Period falls;

"M<sub>2</sub>" is the calendar month, expressed as a number, in which the day immediately following the last day of the Interest Period falls;

"D<sub>1</sub>" is the first calendar day, expressed as a number, of the Interest Period, unless (i) that day is the last day of February or (ii) such number would be 31, in which case D<sub>1</sub> will be 30; and

"D<sub>2</sub>" is the calendar day, expressed as a number, immediately following the last day included in the Interest Period, unless (i) that day is the last day of February but not the Maturity Date or (ii) such number would be 31 and D<sub>2</sub> will be 30.

(ix) such other Day Count Fraction as may be specified in the applicable Final Terms.

- (d) **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).
- (e) **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.
- (f) **Principal Amount Outstanding** means, in respect of a Covered Bond, on any day the principal amount of that Covered Bond on the Issue Date less principal amounts (if any) received by the holder of such Covered Bond in respect thereof on or prior to that day.
- (g) **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, euro 0.01.

## 6. Payments

### 6.1. *Payments in respect of Inflation Linked Annuity Covered Bonds*

If this is an Inflation Linked Annuity Covered Bond, the Issuer shall, on each relevant Interest Payment Date, make a combined payment of principal due under Condition 7.1, interest due under Condition 5.1 and any indexation amount (together, the **Annuity Amount**) as calculated by the Calculation Agent in accordance with the formula specified in the applicable Final Terms.

6.2. *Method of payment*

Subject as provided below:

- (a) payments in a Specified Currency other than euro will be made by credit or transfer to an account in the relevant Specified Currency 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
- (b) 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.

6.3. *Presentation of Definitive Covered Bonds, Receipts and Coupons*

Payments of principal in respect of Definitive Covered Bonds will (subject as provided below) be made in the manner provided in Condition 6.2 above only against presentation and surrender (or, in the case of part payment of any sum due, endorsement) of Definitive Covered Bonds, and payments of interest in respect of Definitive Covered Bonds 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), other than the final instalment, will (subject as provided below) be made in the manner provided in Condition 6.2 above only against presentation and surrender (or, in the case of part 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 Condition 6.2 above only against presentation or surrender (or, in the case of part of any sum due, endorsement) of the relevant Covered Bond in accordance with the preceding paragraph. Each Receipt must be presented for payment of the relevant instalment together with the Definitive Covered Bond to which it appertains. Receipts presented without the Definitive Covered Bond to which they appertain do not constitute valid obligations of the Issuer. Upon the date on which any Definitive Covered Bond becomes due and payable, unmatured Receipts (if any) relating thereto (whether or not attached) shall become void and no payment shall be made in respect of them.

Inflation Linked Annuity Covered Bonds and Fixed Rate Covered Bonds in definitive form (other than Long Maturity Covered Bonds (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 total amount due) will be deducted from the amount 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 9) in respect of such principal (whether or not such Coupon would otherwise have become void under Condition 9) or, if later, four years from the date on which such Coupon would otherwise have become due but in no event thereafter.

Upon any Inflation Linked Annuity Covered Bond or Fixed Rate Covered Bond in definitive form becoming due and repayable by the Issuer (in the absence of a Notice to Pay or a Fund Acceleration Notice) or by the Fund under the Covered Bond Guarantee (if a Notice to Pay or a Fund Acceleration Notice has been served) prior to its Final 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 Covered Bond, Variable Interest Covered Bond or Long Maturity Covered Bond in definitive form becomes due and repayable, all 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 Covered Bond** is a Fixed Rate Covered Bond (other

than a Fixed Rate Covered Bond which on issue had a Talon attached) whose nominal amount on issue is less than the aggregate interest payable thereon provided that such Covered Bond shall cease to be a Long Maturity Covered Bond on the Interest Payment Date on which the aggregate amount of interest remaining to be paid after that date is less than the Principal Amount Outstanding of such Covered Bond.

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

6.4. *Payments in respect of Global Covered Bonds*

Payments of principal, interest (if any) and other amounts (if any) in respect of Covered Bonds represented by any Global Covered Bond will (subject as provided below) be made in the manner specified above in relation to Definitive Covered Bonds and otherwise in the manner specified in the relevant Global Covered Bond against presentation or surrender, as the case may be, of such Global Covered Bond 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 Covered Bond, distinguishing between any payment of principal and any payment of interest, will be made on such Global Covered Bond 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.

No payments of principal, interest or other amounts due in respect of a Global Covered Bond will be made by mail to an address in the United States or by transfer to an account maintained in the United States.

6.5. *General provisions applicable to payments*

The holder of a Global Covered Bond shall be the only person entitled to receive payments in respect of Covered Bonds represented by such Global Covered Bond and the obligations of the Issuer or, as the case may be, the Fund will be discharged by payment to, or to the order of, the holder of such Global Covered Bond 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 Covered Bonds represented by such Global Covered Bond must look solely to Euroclear or Clearstream, Luxembourg, as the case may be, for his share of each payment so made by the Issuer or, as the case may be, the Fund to, or to the order of, the holder of such Global Covered Bond.

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

- (a) 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/or interest and/or any other amount on the Covered Bonds in the manner provided above when due;
- (b) payment of the full amount of such principal and/or interest and/or any other amount at 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/or interest and/or any other amount in U.S. Dollars; and
- (c) such payment is then permitted under United States law without involving, in the opinion of the Issuer and the Fund, adverse tax consequences to the Issuer or the Fund.

6.6. *Payment Day*

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

- (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:
  - (i) the relevant place of presentation;
  - (ii) London; and
  - (iii) each Additional Financial Centre specified in the applicable Final Terms; and
- (b) either (i) 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 and Auckland, respectively) or (ii) in relation to any sum payable in euro, a day on which the TARGET System is open.

#### 6.7. *Interpretation of principal*

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

- (a) the Final Redemption Amount of the Covered Bonds;
- (b) the Early Redemption Amount of the Covered Bonds;
- (c) the Optional Redemption Amount(s) (if any) of the Covered Bonds;
- (d) in relation to Covered Bonds (other than Inflation Linked Annuity Covered Bonds) redeemable in instalments, the Instalment Amounts;
- (e) in relation to Zero Coupon Covered Bonds, the Amortised Face Amount (as defined in Condition 7.6);
- (f) any premium and any other amounts (other than interest) which may be payable under or in respect of the Covered Bonds; and
- (g) any Excess Proceeds attributable to principal which may be payable by the Representative to the Fund in respect of the Covered Bonds.

### 7. **Redemption and Purchase**

#### 7.1. *Redemption of Inflation Linked Annuity Covered Bonds*

Unless previously redeemed or purchased and cancelled, each Inflation Linked Annuity Covered Bond will, subject to Condition 6.1, be redeemed in one or more amounts, calculated in accordance with the formula specified in the applicable Final Terms, in the relevant Specified Currency on the relevant Interest Payment Dates.

#### 7.2. *Final Redemption*

Unless previously redeemed or purchased and cancelled, each Covered Bond (other than an Inflation Linked Annuity Covered Bond) 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 Final Maturity Date.

#### 7.3. *Redemption at the option of the Issuer (Issuer Call)*

If Issuer Call is specified in the applicable Final Terms, the Issuer may, having given:

- (a) not less than 15 nor more than 30 days' notice to the Covered Bondholders in accordance with Condition 14; and
- (b) not less than 15 days before the giving of the notice referred to in (a) above, notice to the Representative and to the Principal Paying Agent;

(which notices shall be irrevocable and shall specify the date fixed for redemption), redeem all or some only of the Covered Bonds 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 Covered Bonds, the Covered Bonds to be redeemed (**Redeemed Covered Bonds**) will be selected individually by lot, in the case of Redeemed Covered Bonds represented by Definitive Covered Bonds, and in accordance with the rules of Euroclear and/or Clearstream, Luxembourg, (to be reflected in the records of Euroclear and Clearstream, Luxembourg as either a pool factor or a reduction in nominal amount, at their discretion) in the case of Redeemed Covered Bonds represented by a Global Covered Bond, 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 Covered Bonds represented by Definitive Covered Bonds, a list of the serial numbers of such Redeemed Covered Bonds will be published in accordance with Condition 14 not less than 15 days prior to the date fixed for redemption. No exchange of the relevant Global Covered Bond will be permitted during the period from (and including) the Selection Date to (and including) the date fixed for redemption pursuant to this Condition 7.3 and notice to that effect shall be given by the Issuer to the Covered Bondholders in accordance with Condition 14 at least five days prior to the Selection Date.

#### 7.4. *Redemption due to illegality or invalidity*

The Covered Bonds of all Series may be redeemed at the option of the Issuer in whole, but not in part, at any time, on giving not less than 30 nor more than 60 days' notice to the Representative and the Principal Paying Agent and, in accordance with Condition 14, all Covered Bondholders (which notice shall be irrevocable), if the Issuer satisfies the Representative immediately before the giving of such notice that it has, or will, before the next Interest Payment Date of any Covered Bond of any Series, become unlawful for the Issuer to make, fund or allow to remain outstanding any Term Advance made by it to the Fund under the Intercompany Loan Agreement, as a result of any change in, or amendment to, the applicable laws or regulations or any change in the application or official interpretation of such laws or regulations, which change or amendment has become or will become effective before the next such Interest Payment Date.

Covered Bonds redeemed pursuant to this Condition 7.4 will be redeemed at their Early Redemption Amount referred to in Condition 7.6 together (if appropriate) with interest accrued (and, if this is an Inflation Linked Annuity Covered Bond, adjusted for indexation in accordance with the provisions set out in the applicable Final Terms) to (but excluding) the date of redemption.

#### 7.5. *Certification*

Prior to the publication of any notice of redemption pursuant to Condition 7.4, the Issuer shall deliver to the Representative a certificate signed by two Directors of the Issuer stating that the Issuer is entitled or required 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 the Representative shall be entitled to accept the certificate as sufficient evidence of the satisfaction of the conditions precedent set out above, in which event it shall be conclusive and binding on all Covered Bondholders, Receiptholders and Couponholders.

#### 7.6. *Early Redemption Amounts*

For the purpose of Conditions 7.4 and Condition 10, each Covered Bond will be redeemed at its Early Redemption Amount calculated as follows:

- (a) in the case of a Covered Bond (other than a Zero Coupon Covered Bond but including an Instalment Covered Bond and a Partly Paid Covered Bond), 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 Principal Amount Outstanding (and, in the case of an Inflation Linked Annuity Covered Bond, adjusted for indexation in accordance with the provisions set out in the applicable Final Terms); or
- (b) in the case of a Zero Coupon Covered Bond, 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 Covered Bonds to (but excluding) the date fixed for redemption or (as the case may be) the date upon which such Covered Bond 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.

7.7. *Instalments*

Instalment Covered Bonds 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 Condition 7.6.

7.8. *Partly Paid Covered Bonds*

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

7.9. *Purchases*

The Issuer, any of its Subsidiaries or the Fund may at any time purchase Covered Bonds (provided that, in the case of Definitive Covered Bonds, all unmatured Receipts, Coupons and Talons appertaining thereto are purchased therewith) at any price in the open market or otherwise. Subject to the proviso below, such Covered Bonds may be held, reissued, resold or, at the option of the Issuer, surrendered to any Paying Agent for cancellation, provided that any Covered Bonds purchased by the Fund must be immediately surrendered to any Paying Agent for cancellation.

7.10. *Cancellation*

All Covered Bonds 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 Covered Bonds so cancelled and any Covered Bonds purchased and surrendered for cancellation pursuant to Condition 7.9 and cancelled (together with all unmatured Receipts, Coupons and Talons cancelled therewith) shall be forwarded to the Principal Paying Agent and cannot be reissued or resold.

7.11. *Late Payment on Zero Coupon Covered Bonds*

If the amount payable in respect of any Zero Coupon Covered Bond upon redemption of such Zero Coupon Covered Bond pursuant to Condition 7.2, 7.3 or 7.4 above or upon its becoming due and repayable as provided in Condition 11 is improperly withheld or refused, the amount due and repayable in respect of such Zero Coupon Covered Bond shall be the amount calculated as provided in Condition 7.6(b) above as though the references therein to the date fixed for the redemption or the date upon which such Zero Coupon Covered Bond becomes due and payable were replaced by references to the date which is the earlier of:

- (a) the date on which all amounts due in respect of such Zero Coupon Covered Bond have been paid; and
- (b) five days after the date on which the full amount of the moneys payable in respect of such Zero Coupon Covered Bonds has been received by the Representative or the Principal Paying Agent and notice to that effect has been given to the Covered Bondholders in accordance with Condition 14.

7.12. *Legislative Exchange*

Following the coming into force in Iceland, at any time after the Programme Date, of (i) any legislation similar to covered bond legislation in force in any European Union country, or (ii) any rules, regulations or guidelines published by any governmental authority that provides for bonds issued by Icelandic issuers to qualify for the same benefits available to covered bonds issued under covered bond legislation in force in any European Union country, the Issuer may, at its option and without the consent of the Representative, the Covered Bondholders, the Receiptholders or the Couponholders, exchange all (but not some only) of the Covered Bonds of all Series then outstanding (the **Existing Covered Bonds**) for new Covered Bonds which qualify as covered bonds under such new

legislation, rules, regulations or guidelines (the **New Covered Bonds**) in identical form, amount and denomination as the Existing Covered Bonds and on the same economic terms and conditions as the Existing Covered Bonds (the **Legislative Exchange**) if not more than 60 nor less than 30 days' notice to the Covered Bondholders (in accordance with Condition 14), the Representative and the Principal Paying Agent is given by the Issuer and provided that:

- (a) on the date on which such notice expires the Issuer delivers to the Representative a certificate signed by two Directors of the Issuer and a certificate signed by two Directors of the Management Company on behalf of the Fund confirming that, in the case of the Issuer, no Issuer Event of Default (as defined in Condition 10.1) or Potential Issuer Event of Default (as defined in Condition 15) and, in the case of the Fund, no Fund Event of Default (as defined in Condition 10.2) or Potential Fund Event of Default (as defined in Condition 15), shall have occurred and be continuing (disregarding for the purposes of this certificate any such event which occurs or which has occurred due to the implementation of such legislation, rules, regulations or guidelines);
- (b) the Rating Agency which has previously assigned a rating to the Existing Covered Bonds confirms to the Issuer in writing that the New Covered Bonds will be assigned the same rating as is then applicable to the Existing Covered Bonds; and
- (c) if the Existing Covered Bonds are listed, quoted and/or traded on or by a competent and/ or relevant listing authority, stock exchange and/or quotation system on or before the date on which such notice expires the Issuer delivers to the Representative a certificate signed by two Directors of the Issuer confirming that all applicable rules of such competent and/or relevant listing authority, stock exchange and/or quotation system have been or will be complied with (or compliance with such rules has been waived by the relevant listing authority, stock exchange and/or quotation system).

The Existing Covered Bonds will be cancelled concurrently with the issue of the New Covered Bonds and with effect on and from the date of issue thereof all references herein to Covered Bonds shall be deemed to be references to the New Covered Bonds and the Representative may, pursuant to the provisions described in Condition 15, agree with the Issuer and the Fund such modifications to the Transaction Documents as may be necessary for the issue of the New Covered Bonds under the new legislation, rules, regulations or guidelines.

## **8. Taxation**

All payments in respect of the Covered Bonds, Receipts and Coupons by the Issuer will be made without withholding or deduction for or on account of any present or future taxes or 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 not pay any additional amounts in respect of amounts withheld pursuant to such withholding or deduction.

For the purposes of these Terms and Conditions, **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.

If any payments made by the Fund under the Covered Bond Guarantee are or become subject to any withholding or deduction on account of any taxes or duties of whatever nature imposed or levied by or on behalf of any Tax Jurisdiction, the Fund will not be obliged to pay any additional amount as a consequence.

## **9. Prescription**

The Covered Bonds, Receipts and Coupons will become void in accordance with Act 150/2007 unless presented for payment within 10 years (in the case of principal) and four years (in the case of interest or any other amount) after the Relevant Date (as defined below).

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 6.3 or any Talon which would be void pursuant to Condition 6.3.

For the purposes of these Terms and Conditions, **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 Representative or the Principal Paying

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 Covered Bondholders in accordance with Condition 14.

## **10. Events of Default, Acceleration and Enforcement**

### **10.1. Issuer Events of Default**

The Representative at its discretion may, and if so requested in writing by the holders of at least one-fifth of the aggregate Principal Amount Outstanding of the Covered Bonds (which for this purpose or the purpose of any Extraordinary Resolution referred to in this Condition 10.1 means the Covered Bonds of this Series together with the Covered Bonds of any other Series then outstanding) then outstanding as if they were a single Series or if so directed by an Extraordinary Resolution of all the Covered Bondholders shall (subject in each case to being indemnified and/or secured to its satisfaction), give notice (an **Issuer Acceleration Notice**) in writing to the Issuer that as against the Issuer (but not, for the avoidance of doubt, against the Fund under the Covered Bond Guarantee) each Covered Bond of each Series then outstanding is, and each such Covered Bond shall thereupon immediately become, due and repayable at its Early Redemption Amount together with accrued interest (and, if this is an Inflation Linked Annuity Covered Bond, adjusted for indexation in accordance with the provisions specified in the applicable Final Terms) as provided in the Representative and Agency Agreement if any of the following events (each an **Issuer Event of Default**) shall occur and be continuing:

- (a) if default is made in the payment of any principal, premium (if any), interest or any other amount due in respect of the Covered Bonds or any of them and the default continues for a period of five days in the case of principal or premium (if any) and five days in the case of interest or any other amount; or
- (b) if the Issuer fails to perform or observe any of its other obligations under these Terms and Conditions, the Conditions of any other Series of Covered Bonds or any other Transaction Document (other than the Programme Agreement and each Subscription Agreement) (but excluding any obligation of the Issuer to comply with the Asset Coverage Test) and (except in any case where, in the opinion of the Representative, 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 the Representative on the Issuer of notice requiring the same to be remedied; or
- (c) 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 subparagraph (c), the borrowed money must, when aggregated with all other borrowed money to which any part of this Condition 10.1(c) applies, exceed U.S.\$25,000,000 (or its equivalent in any other currency); or
- (d) 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 Covered Bondholders; or
- (e) 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 Covered Bondholders, 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
- (f) 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

- (g) 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); or
- (h) if an Asset Coverage Test Breach Notice has been served and not revoked (in accordance with the terms of the Transaction Documents) on or before the second Calculation Date after service of such Asset Coverage Test Breach Notice,

provided that any condition, event or act described in subparagraphs (b), (c), (e), (f) and (g) above shall only constitute an Issuer Event of Default if the Representative shall have certified in writing to the Issuer and the Fund that such condition, event or act is, in its opinion, materially prejudicial to the interests of the Covered Bondholders of any Series.

For the purposes of these Terms and Conditions:

**Principal Subsidiary** at any time shall mean a Subsidiary of the Issuer:

- (i) 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
- (ii) 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 Representative and Agency Agreement.

A report by the auditors of the Issuer (whether or not addressed to the Representative) 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.

Upon the Covered Bonds becoming immediately due and payable against the Issuer pursuant to this Condition 10.1, the Representative shall forthwith serve a notice to pay (the **Notice to Pay**) on the Fund pursuant to the Covered Bond Guarantee. If a Notice to Pay has been served, the Fund shall be required to make payments of Guaranteed Amounts when the same shall become Due for Payment in accordance with the terms of the Covered Bond Guarantee.

Following service of an Issuer Acceleration Notice, the Representative may or shall take such proceedings against the Issuer in accordance with the first paragraph of Condition 10.3.

The Representative and Agency Agreement provides that all moneys received by the Representative from the Issuer or any administrator, administrative or other receiver, manager or other similar official appointed in relation to the Issuer following service of an Issuer Acceleration Notice (the **Excess Proceeds**), shall be paid by the Representative on behalf of the Covered Bondholders of the relevant Series to the Fund for its own account, as soon as practicable, and shall be held by the Fund in the GIC Account and shall be used by the Fund in the same manner as all other moneys from time to time standing to the credit of the GIC Account pursuant to the Fund Deed. Any Excess Proceeds received by the Representative shall discharge *pro tanto* the obligations of the Issuer in respect of the payment of the amount of such Excess Proceeds under the Covered Bonds, Receipts and Coupons. However, the

obligations of the Fund under the Covered Bond Guarantee are (following service of a Notice to Pay) unconditional and irrevocable and the receipt by the Representative of any Excess Proceeds shall not reduce or discharge any of such obligations. By subscribing for this Covered Bond, each Covered Bondholder shall be deemed to have irrevocably directed the Representative to pay the Excess Proceeds to the Fund in the manner as described above.

10.2. *Fund Events of Default*

The Representative at its discretion may, and if so requested in writing by the holders of at least one-fifth of the aggregate Principal Amount Outstanding of the Covered Bonds (which for this purpose and the purpose of any Extraordinary Resolution referred to in this Condition 10.2 means the Covered Bonds of this Series together with the Covered Bonds of any other Series then outstanding) then outstanding as if they were a single Series or if so directed by an Extraordinary Resolution of all the Covered Bondholders shall (subject in each case to being indemnified and/or secured to its satisfaction), give notice (a **Fund Acceleration Notice**) in writing to the Issuer and the Fund, that (i) each Covered Bond of each Series then outstanding is, and each Covered Bond of each Series then outstanding shall as against the Issuer (if not already due and repayable against the Issuer following service of an Issuer Acceleration Notice), thereupon immediately become, due and repayable at its Early Redemption Amount together with accrued interest (and, if this is an Inflation Linked Annuity Covered Bond, such accrued interest to be adjusted for indexation in accordance with the provisions set out in the applicable Final Terms), and (ii) all amounts payable by the Fund under the Covered Bond Guarantee shall thereupon immediately become due and payable at the Guaranteed Amount corresponding to the Early Redemption Amount for each Covered Bond of each Series then outstanding together with accrued interest (and, if this is an Inflation Linked Annuity Covered Bond, adjusted for indexation in accordance with the provisions set out in the applicable Final Terms), in each case as provided in the Representative and Agency Agreement if any of the following events (each a **Fund Event of Default**) shall occur and be continuing:

- (a) if default is made in the payment of any Guaranteed Amounts which are Due for Payment on the relevant Guaranteed Amounts Due Date in respect of the Covered Bonds of any Series then outstanding and the default continues for a period of five days except in the case of the payments of a Guaranteed Amount which is Due for Payment under Condition 10.1 when the Fund shall be required to make payments of Guaranteed Amounts which are Due for Payment on the dates specified therein; or
- (b) if the Fund fails to perform or observe any of its other obligations under the Covered Bond Guarantee, the Representative and Agency Agreement or any other Transaction Document (other than the obligation to satisfy the Asset Coverage Test in accordance with Clause 10 of the Fund Deed) to which the Fund is a party and (except in any case where, in the opinion of the Representative, is incapable of remedy when no such continuation and notice as is hereinafter mentioned will be required) the failure continues for the period of 30 days next following the service by the Representative on the Fund of notice requiring the same to be remedied; or
- (c) if an order is made by any competent court or resolution passed for the winding up or dissolution of the Fund; or
- (d) if the Fund ceases or threatens to cease to carry on the whole or a substantial part of its business or the Fund 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, 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
- (e) if (A) proceedings are initiated against the Fund 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 Fund 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

- (f) if the Fund 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),

provided that any condition, event or act described in subparagraphs (b) and (d) to (f) (inclusive) above shall only constitute a Fund Event of Default if the Representative shall have certified in writing to the Issuer and the Fund that such condition, event or act is, in its opinion, materially prejudicial to the interests of the Covered Bondholders of any Series then outstanding.

Following service of a Fund Acceleration Notice, the Representative may or shall take such proceedings or steps in accordance with the first and second paragraphs, respectively, of Condition 10.3.

Upon service of a Fund Acceleration Notice, the Covered Bondholders shall have a claim against the Fund, under the Covered Bond Guarantee, for an amount equal to the Early Redemption Amount in respect of each Covered Bond together with accrued interest and any other amount due under such Covered Bonds as provided in the Representative and Agency Agreement.

### 10.3. *Enforcement*

The Representative may at any time, at its discretion and without further notice, take such proceedings against the Issuer and or the Fund, as the case may be, and/or any other person as it may think fit to enforce the provisions of the Representative and Agency Agreement, the Covered Bonds, the Receipts, the Coupons or any other Transaction Document, but it shall not be bound to take any such enforcement proceedings in relation to the Representative and Agency Agreement, the Covered Bonds, the Receipts, the Coupons or any other Transaction Document unless (i) it shall have been so directed by an Extraordinary Resolution of all the Covered Bondholders of all Series then outstanding (with the Covered Bonds of all Series taken together as a single Series as aforesaid) or so requested in writing by the holders of not less than one-fifth of the aggregate Principal Amount Outstanding of the Covered Bonds of all Series then outstanding and (ii) it shall have been indemnified and/or secured to its satisfaction.

In exercising any of its powers, authorities and discretions the Representative shall only have regard to the interests of the Covered Bondholders of all Series then outstanding.

No Covered Bondholder, Receiptholder or Couponholder shall be entitled to proceed directly against the Issuer or the Fund or to take any action with respect to the Representative and Agency Agreement, any other Transaction Document, the Covered Bonds, the Receipts or the Coupons unless the Representative, having become bound so to proceed, fails so to do within a reasonable period and such failure shall be continuing.

## 11. **Replacement of Covered Bonds, Receipts, Coupons and Talons**

Should any Covered Bond, Receipt, Coupon or Talon be lost, stolen, mutilated, defaced or destroyed, it may be replaced at the specified office of the Principal Paying 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 Covered Bonds, 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, with the prior written approval of the Representative, 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 a Principal Paying Agent;
- (b) there will at times be a Paying Agent having short-term, unsecured, unsubordinated and unguaranteed debt obligation rating of at least P-1 by Moody's (which may be the Principal Paying Agent) in a jurisdiction within Europe, other than Iceland;

- (c) so long as the Covered Bonds are listed on any stock exchange or admitted to listing or trading by any other relevant authority, there will at all times be a Paying Agent with a specified office in such place as may be required by the rules and regulations of the relevant stock exchange or other relevant authority; and
- (d) there will at all times be a Paying Agent in a Member State of the European Union that will not be 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 the United States in the circumstances described in Condition 6.5. Notice of any such variation, termination, appointment or change will be given by the Issuer to the Covered Bondholders as soon as reasonably practicable in accordance with Condition 14.

In acting under the Representative and Agency Agreement, the Paying Agents act solely as agents of the Issuer and the Fund and, in certain circumstances specified therein, of the Representative and do not assume any obligation to, or relationship of agency with, any Covered Bondholders, Receiptholders or Couponholders. The Representative and 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 Principal Paying 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 Covered Bond to which it appertains) a further Talon, subject to the provisions of Condition 9.

### **14. Notices**

All notices regarding the Covered Bonds will be valid if published (a) in a leading English language daily newspaper of general circulation in London; and (b) if and for so long as the Covered Bonds are admitted to trading on, and listed on the OMX Nordic Exchange Iceland hf., in a daily newspaper of general circulation in Iceland. It is expected that any such publication in a newspaper will be made in the *Financial Times* in London and any daily newspaper in Iceland. The Issuer shall also ensure that notices are duly published in a manner which complies with the rules and regulations of any stock exchange or any other relevant authority on which the Covered Bonds 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. If publication as provided above is not practicable, notice will be given in such other manner, and will be deemed to have been given on such date, as the Representative shall approve.

Until such time as any Definitive Covered Bonds are issued, so long as any Global Covered Bonds representing the Covered Bonds 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 Covered Bonds and, in addition, for so long as any Covered Bonds are listed on a stock exchange or admitted to listing or trading by any other relevant authority and the rules of the stock exchange, or other 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 Covered Bonds 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 Covered Bondholder shall be in writing and given by lodging the same, together (in the case of any Covered Bond in definitive form) with the relevant Covered Bond or Covered Bonds, with the Principal Paying Agent. Whilst any of the Covered Bonds are represented by a Global Covered Bond, such notice may be given by any holder of a Covered Bond to the Principal Paying Agent through Euroclear and/or Clearstream, Luxembourg, as the case may be, in such manner as the Principal Paying Agent and Euroclear and/or Clearstream Luxembourg, as the case may be, may approve for this purpose.

### **15. Meetings of Covered Bondholders, Modification and Waiver**

**Covered Bondholders, Receiptholders and Couponholders should note that the Issuer, the Fund and the Principal Paying Agent may without their consent or the consent of the Representative agree to modify any provision of any**



**applicable Final Terms which is of a formal, minor or technical nature or is made to correct a proven or manifest error or to comply with any mandatory provisions of law.**

The Representative and Agency Agreement contains provisions for convening meetings of the Covered Bondholders to consider any matter affecting their interests, including the sanctioning by Extraordinary Resolution of a modification to the Covered Bonds, the Receipts, the Coupons or any of the provisions of the Representative and Agency Agreement. Such a meeting may be convened by the Issuer, the Fund or the Representative and shall be convened by the Issuer at the request in writing of Covered Bondholders holding not less than five per cent. of the Principal Amount Outstanding of the Covered Bonds for the time being 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. of the aggregate Principal Amount Outstanding of the Covered Bonds for the time being outstanding, or at any adjourned meeting one or more persons being or representing Covered Bondholders whatever the Principal Amount Outstanding of the Covered Bonds so held or represented, except that at any meeting the business of which includes the modification of any Reserved Matter (as defined in the Representative and Agency Agreement), the quorum shall be one or more persons holding or representing not less than two-thirds of the aggregate Principal Amount Outstanding of the Covered Bonds for the time being outstanding, or at any adjourned such meeting one or more persons holding or representing not less than one-third of the aggregate Principal Amount Outstanding of the Covered Bonds for the time being outstanding. An Extraordinary Resolution passed at any meeting of the Covered Bondholders shall, subject as provided below, be binding on all the Covered Bondholders, whether or not they are present at the meeting, and on all Receiptholders and Couponholders. Pursuant to the Representative and Agency Agreement, the Representative may convene a single meeting of the holders of Covered Bonds of more than one Series if in the opinion of the Representative there is no conflict between the holders of such Covered Bonds, in which event the provisions of this paragraph shall apply thereto *mutatis mutandis*.

Notwithstanding the provisions of the immediately preceding paragraph, any Extraordinary Resolution to direct the Representative to accelerate the Covered Bonds pursuant to Condition 10 or to direct the Representative to take any enforcement action pursuant to Condition 10 (each a **Programme Resolution**) shall only be capable of being passed at a single meeting of the holders of the Covered Bonds of all Series then outstanding. Any such meeting to consider a Programme Resolution may be convened by the Issuer, the Fund or the Representative or by Covered Bondholders, in the case of a direction to accelerate the Covered Bonds pursuant to Conditions 10.1 and 10.2 or to take enforcement action pursuant to Condition 10.3, holding at least one-fifth of the Principal Amount Outstanding of the Covered Bonds of all Series then outstanding. The quorum at any such meeting for passing a Programme Resolution is one or more persons holding or representing at least 50 per cent. of the aggregate Principal Amount Outstanding of the Covered Bonds of all Series for the time being outstanding, or at any adjourned such meeting one or more persons holding or representing Covered Bonds whatever the Principal Amount Outstanding of the Covered Bonds of all Series then outstanding. A Programme Resolution passed at any meeting of the Covered Bondholders of all Series shall be binding on all Covered Bondholders of all Series, whether or not they are present at the meeting, and on all related Receiptholders and Couponholders.

In connection with any meeting of the holders of Covered Bonds of more than one Series where such Covered Bonds are not denominated in ISK, the nominal amount of the Covered Bonds of any Series not denominated in ISK shall be converted into ISK at the spot rate of exchange determined by the Representative.

The Representative, the Fund and the Issuer may also agree, without the consent of the Covered Bondholders, Receiptholders or Couponholders (and for this purpose the Representative may disregard whether any such modification relates to a Reserved Matter), to:

- (a) any modification of the terms and conditions applying to Covered Bonds of one or more Series (including these Terms and Conditions), the related Receipts and/or Coupons or any Transaction Document provided that, in the sole opinion of the Representative, such modification is not materially prejudicial to the interests of any of the Covered Bondholders of any Series then outstanding; or
- (b) any modification of the terms and conditions applying to Covered Bonds of any one or more Series (including these Terms and Conditions), the related Receipts and/or Coupons or any Transaction Document which is, in the sole opinion of the Representative, of a formal, minor or technical nature or is to correct a manifest error or an error which is, in the sole opinion of the Representative, proven, or is to comply with mandatory provisions of law.

Notwithstanding the above, the Issuer, the Fund and the Principal Paying Agent may agree, without the consent of the Representative, the Covered Bondholders, Receiptholders or Couponholders, to any modification of any of the provisions of

any Final Terms which is of a formal, minor or technical nature or is made to correct a proven or manifest error or to comply with any mandatory provisions of law.

The Representative may also agree, without the consent of the Covered Bondholders of any Series then outstanding, the related Receiptholders and/or Couponholders, to the waiver or authorisation of any breach or proposed breach of any of the provisions of the Covered Bonds of any Series, or determine, without any such consent as aforesaid, that any Issuer Event of Default or Fund Event of Default or Potential Issuer Event of Default or Potential Fund Event of Default shall not be treated as such, provided that, in any such case, it is not, in the sole opinion of the Representative, materially prejudicial to the interests of any of the Covered Bondholders of any Series then outstanding.

In connection with the exercise by it of any of its powers, authorities and discretions (including, without limitation, any modification, waiver, authorisation or determination), the Representative shall have regard to the general interests of the Covered Bondholders as a class (but shall not have regard to any interests arising from circumstances particular to individual Covered Bondholders, Receiptholders or Couponholders whatever their number) and, in particular but without limitation, shall not have regard to the consequences of any such exercise for individual Covered Bondholders, the related Receiptholders, Couponholders (whatever their number) resulting from their being for any purpose domiciled or resident in, or otherwise connected with, or subject to the jurisdiction of, any particular territory or any political sub-division thereof and the Representative shall not be entitled to require, nor shall any Covered Bondholder, Receiptholder or Couponholder be entitled to claim, from the Issuer, the Fund, the Representative or any other person any indemnification or payment in respect of any tax consequences of any such exercise upon individual Covered Bondholders, Receiptholders and/or Couponholders.

For the purposes of these Terms and Conditions:

**Potential Fund Event of Default** means any condition, event or act which, with the lapse of time and/ or the issue, making or giving of any notice, certification, declaration, demand, determination and/or request and/or the taking of any similar action and/or the fulfilment of any similar condition, would constitute a Fund Event of Default; and

**Potential Issuer Event of Default** means any condition, event or act which, with the lapse of time and/or the issue, making or giving of any notice, certification, declaration, demand, determination and/or request and/or the taking of any similar action and/or the fulfilment of any similar condition, would constitute an Issuer Event of Default.

#### **16. Indemnification of the Representative and Representative Contracting with the Issuer and/or the Fund**

If, in connection with the exercise of its powers, authorities or discretions the Representative is of the opinion that the interests of the holders of the Covered Bonds of any one or more Series then outstanding would be materially prejudiced thereby, the Representative shall not exercise such power, authority or discretion without the approval of such Covered Bondholders by Extraordinary Resolution or by a direction in writing of such Covered Bondholders of at least one-fifth of the Principal Amount Outstanding of Covered Bonds then outstanding.

The Representative and Agency Agreement contain provisions for the indemnification of the Representative and for its relief from responsibility, including provisions relieving it from taking any action unless indemnified and/or secured to its satisfaction.

The Representative and Agency Agreement also contain provisions pursuant to which the Representative is entitled, *inter alia*, (i) to enter into business transactions with the Issuer, any of its Subsidiaries and affiliates and/or the Fund and to act as representative or trustee for the holders of any other securities issued or guaranteed by, or relating to, the Issuer, any of its Subsidiaries and affiliates and/or the Fund, (ii) to exercise and enforce its rights, comply with its obligations and perform its duties under or in relation to any such transactions or, as the case may be, any such trusteeship without regard to the interests of, or consequences for, the Covered Bondholders, Receiptholders or Couponholders, and (iii) to retain and not be liable to account for any profit made or any other amount or benefit received thereby or in connection therewith.

The Representative will not be responsible for any loss, expense or liability, which may be suffered as a result of any Loans or Related Security, or any deeds or documents of title thereto, being uninsured or inadequately insured or being held by clearing organisations or their operators or by intermediaries such as banks, brokers or other similar persons on behalf of the Representative. The Representative will not be responsible for (i) supervising the performance by the Issuer, the Fund or any other party to the Transaction Documents of their respective obligations under the Transaction Documents and the Representative will be entitled to assume, until it has written notice to the contrary, that all such persons are properly performing their duties, (ii) considering the basis on which approvals or consents are granted by the Issuer, the Fund or any

other party to the Transaction Documents under the Transaction Documents, (iii) monitoring the Portfolio, including, without limitation, whether the Portfolio is in compliance with the Asset Coverage Test, or (iv) monitoring whether Loans and Related Security satisfy the Eligibility Criteria. The Representative will have no responsibility in relation to the legality, validity, sufficiency and enforceability of the Transaction Documents.

The Representative will not be liable for any expense, loss or damage suffered by or occasioned by reason of any action taken or omitted to be taken by the Representative pursuant to the Representative and Agency Agreement, these Terms and Conditions or any other Transaction Document or in connection therewith unless directly caused by the fraud, gross negligence or wilful default of the Representative and, in no circumstances shall the Representative be liable for any special, general or consequential damages even if the Representative has been advised of the possibility of such damages.

#### **17. Further Issues**

The Issuer shall be at liberty from time to time without the consent of the Covered Bondholders, the Receiptholders or the Couponholders to create and issue further covered bonds having terms and conditions the same as the Covered Bonds 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 Covered Bonds.

#### **18. Ratings Confirmations**

By subscribing for or purchasing this Covered Bond, the holder of this Covered Bond shall be deemed to have acknowledged and agreed that a credit rating of the Covered Bonds is an assessment of credit risk and does not address other matters that may be of relevance to Covered Bondholders, including, without limitation, in the case of a confirmation by the Rating Agency that any action proposed to be taken by the Issuer, the Fund, the Seller, the Servicer, the Cash Manager, the Representative or any other party to a Transaction Document will not have an adverse effect on the then current rating of the Covered Bonds or cause such rating to be withdrawn (a **Rating Agency Confirmation**), whether such action is either (i) permitted by the terms of the relevant Transaction Document or (ii) in the best interests of, or not prejudicial to, some or all of the Covered Bondholders.

In being entitled to have regard to the fact that the Rating Agency has confirmed that the then current rating of the Covered Bonds would not be adversely affected or withdrawn, each of the Issuer, the Fund, the Representative and the Covered Bondholders is deemed to have acknowledged and agreed that a Rating Agency Confirmation does not impose or extend any actual or contingent liability on the Rating Agency to the Issuer, the Fund, the Representative, the Covered Bondholders or any other person or create any legal relations between the Rating Agency and the Issuer, the Fund, the Representative, the Covered Bondholders or any other person whether by way of contract or otherwise.

By subscribing for or purchasing this Covered Bond, the holder of this Covered Bond shall be deemed to have acknowledged and agreed that:

- (a) a Rating Agency Confirmation may or may not be given at the sole discretion of the Rating Agency;
- (b) depending on the timing of delivery of the request and any information needed to be provided as part of any such request, it may be the case that the Rating Agency cannot provide a Rating Agency Confirmation in the time available, or at all, and the Rating Agency shall not be responsible for the consequences thereof;
- (c) a Rating Agency Confirmation, if given, will be given on the basis of the facts and circumstances prevailing at the relevant time, and in the context of cumulative changes to the transaction of which the Covered Bonds forms a part; and
- (d) a Rating Agency Confirmation represents only a restatement of the opinions given, and shall not be construed as advice for the benefit of any Covered Bondholder or any other party.

#### **19. Appointment of the Representative**

By subscribing for or purchasing this Covered Bond, the holder of this Covered Bond shall be deemed to have acknowledged and agreed to the appointment of the Representative as its representative to act for the benefit of the holders for the time being of the Covered Bonds in accordance with the terms of the Representative and Agency Agreement.

## **20. Governing Law and Jurisdiction**

The Representative and Agency Agreement, the Covered Bonds, the Receipts, the Coupons and the other Transaction Documents are governed by, and shall be construed in accordance with, Icelandic law.

The Issuer irrevocably agrees that any dispute arising out of the Representative and Agency Agreement, the Covered Bonds, the Coupons, the Receipts and/or any other Transaction Document shall be subject to the exclusive jurisdiction of the District Court of Reykjavík (*Héraðsdómur Reykjavíkur*).

Legal action taken under this Condition 20 may be proceeded with in accordance with the Act on Civil Procedure No. 91/1991 (*Lög um meðferð einkamála*), Chapter 17.

### **USE OF PROCEEDS**

The gross proceeds from each issue of Covered Bonds will be used by the Issuer to make available Term Advances to the Fund pursuant to the terms of the Intercompany Loan Agreement, which in turn shall be used by the Fund either:

- (a) to acquire Loans and their Related Security;
- (b) subject to an Asset Coverage Test Breach Notice not having been served (and not revoked), to make a Unit Distribution to a Holder by way of a distribution of each Holder's holding of Units in the Fund in an amount equal to the ISK Equivalent of the Term Advance or any part thereof;
- (c) to invest in Substitution Assets in an amount not exceeding the prescribed limit;
- (d) if an existing Series, or part of an existing Series, of Covered Bonds is being refinanced by such issue of Covered Bonds, to repay the Term Advance(s) corresponding to the Covered Bonds being so refinanced; and/or
- (e) to deposit all or part of the proceeds into the GIC Account.

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 KAUPTHING BANK

### Overview

We provide integrated financial services to small and medium-sized companies (**SMEs**), institutional investors and high net worth individuals in Northern Europe. We are listed on the OMX ICE and the OMX STO and we are one of the seven largest banks in the Nordic region (in terms of market capitalisation). We currently operate in 12 countries, including all the Nordic countries, the United Kingdom, Luxembourg, Switzerland, the United States, the United Arab Emirates and Qatar. We hold banking licences in eight countries: Iceland, the United Kingdom, Denmark, Sweden, Finland, the Faroe Islands, Norway and Luxembourg. Iceland, Scandinavia and the United Kingdom have been our most important markets, generating 33.0 per cent., 25.8 per cent. and 31.3 per cent., respectively, of our operating income in 2007.

We offer integrated financial services to companies, institutional investors and individuals. Our services include investment banking, corporate banking, capital markets services and asset management and comprehensive wealth management for private banking clients.

We operate across five core business segments:

- Investment Banking;
- Banking;
- Capital Markets;
- Treasury; and
- Asset Management and Private Banking.

In addition, we operate a number of ancillary units such as risk management, information technology, finance and legal, compliance and human resources. We also operate a retail banking franchise in Iceland, where we have our headquarters and, to a lesser extent, in Norway and in Sweden.

We have expanded through organic growth and strategic acquisitions, such as the acquisition of FIH Erhvervsbank A/S (**FIH**) in July of 2004 for ISK 85,868 million (€980 million) and the acquisition of UK-based bank Singer & Friedlander Group plc (**Singer & Friedlander**) in July of 2005 for ISK 63,708 million (€796 million). These acquisitions have increased the diversification of our operations.

We believe that our results for 2007 reflect our focus on Northern Europe, which we consider to be our home market. Approximately 67 per cent. of our operating income in 2007 was generated outside Iceland. We expect this percentage to increase further as we seek to strengthen and expand our activities in Northern Europe. We currently have senior long-term debt ratings of 'A1' from Moody's and 'A' from Fitch. On September 19, 2007, following our announcement that we would acquire NIBC, Moody's affirmed that it has placed us on review for a possible downgrade, which was reaffirmed on November 29, 2007 and January 31, 2008. On February 28, 2008, Moody's downgraded our rating to A1 with stable outlook from Aa3, financial strength was downgraded from C- from C, subordinated debt was downgraded from A1 to A2 but Moody's affirmed the P1 rating for short term and commercial paper. On December 6, 2007, Fitch affirmed our ratings at Long-term IDR 'A' and Short-term IDR 'F1' but changed the outlook for our long-term IDR to negative from stable. On January 30 2008, following the Kaupthing cancellation of the NIBC acquisition, Fitch affirmed our ratings at Long-term IDR 'A' and Short-term IDR 'F1' and changed the outlook for our long-term IDR to stable from negative. In the end of 2007, our total assets were ISK 5,347,345 million, our Tier I ratio was 9.6 per cent. and our Capital Adequacy Directive (**CAD**) ratio was 11.8 per cent. Our net earnings in 2007 were ISK 71,191 million, a decrease of 17.6 per cent. from 2006 when net earnings were ISK 86,447 million. The main reason for this decrease is the one-off after-tax profit of ISK 21.4 billion on the disposition of our holding in the financial services company Exista and the listing of Exista on the OMX ICE (ICEX at that time) during the third quarter of 2006 and loss in net financial income in treasury department of ISK 17,793 million (before tax) during 2007.

The following chart illustrates our operations by business segment and location at end of 2007:

	Headcount	Banking	Investment Banking	Capital Markets	Treasury	Asset Management and Private Banking
<b>Iceland</b> .....	1,262	▲	▲	▲	▲	▲
<b>UK</b> .....	817	▲	▲	▲	▲	▲
<b>Sweden</b> .....	372	▲	▲	▲	▲	▲
<b>Denmark</b> .....	367	▲	▲	▲	▲	▲
<b>Luxembourg</b> .....	276	▲	▲	▲	▲	▲
<b>Finland</b> .....	117	○	○	○	○	○
<b>Norway</b> .....	104	▲	▲	▲	▲	▲
<b>United States<sup>(1)</sup></b> .....	13	X	X	●	X	X
<b>Middle East <sup>(2)</sup></b> .....	6	X	○	○	X	●
<b>Total</b> .....	3,334	957	160	345	98	408

▲ Segments in which we operate under a banking licence.

● Segments in which we do not operate under a banking licence.

○ Segments in which we have operations in a branch.

X Segments in which we do not offer products or services.

(1) Kaupthing Securities Inc. operates under a broker-dealer licence.

(2) Kaupthing Bank has been granted a licence to operate a branch in Dubai International Financial Centre and Qatar Financial Centre. Kaupthing Bank will initially focus on providing investment banking services in the region as well as arranging private banking and custody.

Our operating subsidiaries are Arion Custody Service, Rekstrarfelag Kaupthing's banka hf., and Kaupthing Líftryggingar hf. (formerly Althjóða líftryggingarfélagid hf.) (**Kaupthing Líftryggingar hf.** or **Kaupthing-Líf**) in Iceland, Kaupthing Ltd. and Kaupthing Singer & Friedlander in the United Kingdom, Singer & Friedlander Holdings Ltd. in the Isle of Man, Kaupthing Bank Sverige in Sweden, FIH in Denmark, Kaupthing Bank Luxembourg, Kaupthing Bank Sofi Oyj and Norvestia in Finland, Kaupthing Norge in Norway, Kaupthing Føroyar in the Faeroe Islands, Kaupthing Securities Inc. in the United States, and Kaupthing Asset Management in Switzerland. We also operate branches in Faroe Islands, Finland and Norway and we recently opened branches in Qatar and Dubai. All of our subsidiaries are wholly owned by us except for Arion Custody Service (in which we hold a 99.98 per cent. interest) and Norvestia (in which we hold a 30.6 per cent. economic interest and 54.6 per cent. of the voting rights).

The tables below shows the geographical distribution of our operating income for the year ended December 31, 2007 and the year ended December 31, 2006.

<b>Year ended December 31, 2007</b>	<b>Iceland</b>	<b>Scandinavia</b>	<b>UK</b>	<b>Luxem- bourg</b>	<b>Other</b>	<b>Total</b>
				(ISK millions)		
Net interest income.....	26,747	21,092	23,759	6,706	1,809	80,113
Net fee and commission income.....	22,241	9,319	16,270	6,115	1,076	55,021
Net financial income.....	446	6,272	7,411	369	(65)	14,433
Other income .....	5,315	6,117	4,517	284	18	16,251
Operating income .....	54,749	42,800	51,957	13,474	2,837	165,818

<b>Year ended December 31, 2006</b>	<b>Iceland</b>	<b>Scandinavia</b>	<b>UK</b>	<b>Luxembourg</b>	<b>Other</b>	<b>Total</b>
				(ISK millions)		
Net interest income.....	16,592	17,311	12,099	4,882	1,478	52,362
Net fee and commission income.....	14,724	5,935	10,543	4,355	1,727	37,284
Net financial income.....	34,995	17,181	5,975	1,842	164	60,157
Other income .....	12,233	993	4,168	—	19	17,413
<b>Operating income</b> .....	<b>78,544</b>	<b>41,420</b>	<b>32,785</b>	<b>11,079</b>	<b>3,388</b>	<b>167,216</b>

The tables below show our operating income for the year ended December 31, 2007 and the year ended December 31, 2006 by business segment:

Year ended December 31, 2007	Capital Markets	Investment Banking	Treasury	Banking	Asset Management and Private Banking	Elimination and Cost Centres	Total
(ISK millions)							
Net interest income.....	2,436	(3,027)	22,759	60,664	11,183	(3,902)	80,113
Net fee and commission income.....	20,957	13,715	(707)	6,668	13,801	587	55,021
Net financial income .....	9,069	14,724	(17,793)	393	310	7,730	14,433
Other income .....	225	223	91	6,539	164	9,009	16,251
<b>Operating income .....</b>	<b>32,687</b>	<b>25,635</b>	<b>4,350</b>	<b>74,264</b>	<b>15,458</b>	<b>13,424</b>	<b>165,818</b>

Year ended December 31, 2006	Capital Markets	Investment Banking	Treasury	Banking	Asset Management and Private Banking	Elimination and Cost Centres	Total
(ISK millions)							
Net interest income	(408)	(3,348)	10,386	45,903	817	(988)	52,362
Net fee and commission income	9,881	9,577	443	5,744	11,231	409	37,284
Net financial income	7,913	42,984	8,411	750	531	(432)	60,157
Other income	0	43	26	6,631	962	9,751	17,413
<b>Operating income<sup>(1)</sup></b>	<b>17,386</b>	<b>49,256</b>	<b>19,266</b>	<b>59,028</b>	<b>13,541</b>	<b>8,740</b>	<b>167,216</b>

(1) Includes capital gains from Exista (ISK 26,084m) included in net financial income in Investment Banking and VÍS (ISK 7,421m) included in other income in Elimination and Cost Centres.

## History

Kaupthing Bank hf. was established in Reykjavík in 1982, coinciding with the launch of the free capital markets in Iceland. Kaupthing Bank hf. later became an investment bank and changed its name to Kaupthing Bank hf. in 2002. In September 2000, Kaupthing Bank hf. was listed on the Main List of the OMX ICE and in December 2002, it was listed on the O-list of the OMX STO, which has now been replaced by the Nordic List.

In May 2003, Kaupthing Bank hf. and Búnadarbanki Íslands hf. merged under the name Kaupthing Búnadarbanki hf., which later became Kaupthing Bank hf. Kaupthing Bank hf. acquired the assets and liabilities of Búnadarbanki Íslands hf. and shareholders in Búnadarbanki Íslands hf. received 48.23 per cent. of the total share capital in Kaupthing in exchange for their shares. Búnadarbanki Íslands hf. dates back to 1929, when the Icelandic parliament passed a law on the founding of Búnadarbanki Íslands. At the beginning of 1998, Búnadarbanki Íslands became a limited liability company and the government began to sell its holdings in the bank. Búnadarbanki Íslands hf. was listed on the Main List of the OMX ICE in December 1998. The bank was privatised in stages and this process was completed at the beginning of 2003.

## Principal Acquisitions

In recent years, in line with our strategy to diversify geographically and expand our home market outside of Iceland, we have expanded organically through the establishment of subsidiaries but have also grown considerably through acquisitions. The most important acquisitions to date have been the following:

- **Kaupthing Singer & Friedlander.** In July 2005, we acquired the remaining share capital of Singer & Friedlander, which we subsequently renamed Kaupthing Singer & Friedlander, for €796 million. We had previously acquired a 9.5 per cent. interest in November 2003 and an additional 10 per cent. interest in February 2004. The acquisition established a broad growth platform in the important UK SME market. Following a comprehensive integration and restructuring programme, Kaupthing Singer & Friedlander has become an integrated part of our group.
- **FIH.** In July 2004, we acquired the entire share capital of FIH, which owns FIH Erhvervsbank A/S in Denmark, for €980 million. The acquisition was funded by an issue of subordinated bonds and an offering of new shares in Kaupthing. We acquired FIH, a corporate lender with a strong local presence, to further strengthen our presence in Northern Europe. We have since adopted FIH's credit models across the entire



group. FIH is the third largest corporate bank in Denmark with a 12 per cent. market share based on the Monetary Financial Institution (MFI) statistics published by the Danish Central Bank at the end of September 2007. This transaction was an important step towards becoming a full service Nordic investment bank.

- **Búnadarbanki Íslands hf.** In May 2003, Kaupthing Bank hf. and Búnadarbanki Íslands hf. merged under the name Kaupthing Búnadarbanki hf., which later became Kaupthing Bank hf. The combined market capitalization of the banks was €741 million on March 28, 2003, the date on which the boards of directors of the banks announced commencement of formal discussions in relation to a co-operation or merger between the two parties. Kaupthing Bank hf. acquired the assets and liabilities of Búnadarbanki and shareholders in Búnadarbanki received 48.23 per cent. of the total share capital in Kaupthing in exchange for their shares. We merged with Búnadarbanki in order to benefit from the synergies between our investment banking and Búnadarbanki's commercial banking businesses, which were complementary in terms of products, customers and IT platform. As a result of the merger we became the largest bank in Iceland based on our market capitalisation and a leading provider of corporate banking, investment banking and capital markets services and products in Iceland.

In line with our long term strategy, we intend to continue to expand our operations in Northern Europe, our targeted geographic area, through a balanced combination of organic growth and selected acquisitions that fit our strategic vision, although, at present, we are not considering any material acquisitions.

### **Ratings**

Our credit ratings are important to our business. Our credit ratings directly affect our liquidity, our access to the capital markets and our cost of funding.

The tables below show the development of our ratings by both Moody's and Fitch:

<b>Moody's</b>	<b>Long-term debt</b>	<b>Subordinated debt</b>	<b>Financial strength</b>	<b>Short-term debt</b>
May 2003.....	A3	Baa1	C	P-1
December 2003.....	A2	A3	C+	P-1
November 2004.....	A1	A2	C+	P-1
May 2005.....	A1	A2	C+	P-1
April 2006.....	A1	A2	C+	P-1
September 2006.....	A1	A2	C	P-1
February 2007.....	Aaa	Aa1	C	P-1
April 2007.....	Aa3	A1	C	P-1
August 2007.....	Aa3	A1	C	P-1
September 2007 <sup>(1)</sup> .....	Aa3	A1	C	P-1
November 2007 <sup>(2)</sup> .....	Aa3	A1	C	P-1
January 2008.....	Aa3	A1	C	P-1
February 2008.....	A1	A2	C-	P-1

(1) On September 19, 2007, Moody's affirmed that it had placed us on review for a possible downgrade.

(2) On November 29, 2007, and January 30, 2008, Moody's announced that our ratings still remain under review for possible downgrade.

(3) On February 28, 2008, Moody's downgraded our rating to A1 with stable outlook from Aa3, financial strength was downgraded to C- from C and subordinated from A1 to A2 but the P1 rating for short term and commercial paper was affirmed..

<b>Fitch</b>	<b>Long-term debt</b>	<b>Subordinated debt</b>	<b>Support</b>	<b>Short-term debt</b>
February 2006.....	A	A-	2	F1
August 2006.....	A	A-	2	F1
March 2007.....	A	A-	2	F1

July 2007 .....	A	A-	2	F1
August 2007.....	A	A-	2	F1
December 2007.....	A	A-	2	F1
January 2008.....	A	A-	2	F1

Our long- and short-term debt ratings were last reviewed by Fitch and by Moody's on January 30, 2008. On December 6, 2007, Fitch affirmed our ratings at Long-term IDR 'A' and short-term IDR 'F1' but changed the Outlook for our long-term IDR to Negative from Stable. Moody's reaffirmed that our Aa3/C remain under review for possible downgrade. On April 11, 2007, Moody's downgraded our long-term debt rating to Aa3. The downgrade came in the wake of an upgrade by four notches in February 2007, which was based on Moody's new joint default analysis methodology which takes into account potential sources of external support for banks. Following adjustments to the new methodology, Moody's credit rating for Kaupthing, and many other banks, was revised with the aforementioned results. On September 12, 2006, Moody's downgraded our bank financial strength rating from C+ to C, citing our high dependence on wholesale funding, the heightened risk profile of our assets due to the proportion of equities held relative to our Tier I capital and the fact that proprietary trading and investment activities continue to account for a sizeable portion of our risk profile and revenues and contribute potential volatility to our earnings. On September 19, 2007, following our announcement that we would acquire NIBC, Moody's affirmed that it had placed us on review for a possible downgrade, which was reaffirmed on November 29, 2007 and January 30, 2008. On February 28, 2008, Moody's downgraded our rating to A1 with stable outlook from Aa3, financial strength was downgraded to C- from C and subordinated debt was downgraded from A1 to A2 but the P1 rating was affirmed for short term and commercial paper.

## RECENT DEVELOPMENTS

### *Acquisition of NIBC*

On August 15, 2007, Kaupthing Bank announced that it intended to purchase the entire share capital of NIBC Holding NV (**NIBC**) for EUR 2,985 million. Due to the continued instability in financial markets since the announcement of the intended purchase of NIBC, Kaupthing Bank on January 30, 2008 announced that the proposed acquisition would not be proceeding. Simultaneously relevant regulatory submissions were withdrawn and the share purchase agreement was terminated. In light of this development, the proposed rights issue in Kaupthing Bank in the first quarter of 2008 was also cancelled.

### *Funding*

We accessed three new capital markets in 2007 for our funding needs. In February 2007, we issued CHF 200 million 3.0 per cent. Notes due 2010 in the Swiss fixed income market. We reopened this issue in March 2007 by CHF 100 million. In February 2007, we issued CAD\$500 million 4.7 per cent. Notes due 2010 in the Canadian fixed income market. In October 2007, we issued 2.3 billion Mexican peso (\$200 million equivalent) floating rate Notes due 2012. In addition, in October 2007, we issued \$400 million 9.0 per cent. subordinated bonds constituting Tier I capital. As a result of these and prior capital markets issuances, we believe we have sufficient funds to cover our current maturing financial liabilities through 2008. See "Sources of Funds" below.

### *Ratings*

On January 30 2008 Fitch affirmed our ratings at Long-term IDR 'A' and Short-term IDR 'F1' and changed the outlook for our long-term IDR to stable from negative.. On February 28, 2008, Moody's downgraded our long term debt rating to A1 with stable outlook from Aa3, financial strength was downgraded to C- from C, subordinated debt was downgraded from A1 to A2 but P1 rating affirmed for short term and commercial paper See chapter "Ratings" in "Description of Kaupthing Bank" above.

### *Launching of New Operations in the Middle East*

In September 2007, we were granted a license to operate branches in the Dubai International Financial Centre and in the Qatar Financial Centre. Kaupthing Bank will initially focus on providing investment banking services in the region as well as arranging private banking and custody. At the end of 2007, six people were employed in the region. By August 2008, the estimated number of employees will be approximately 10-14.

### *Establishment of Kaupthing Capital Partners II Fund*

In 2007 we launched a third-party private equity fund, Kaupthing Capital Partners II. All private equity opportunities (except those in FIH and Norvestia) arising since the beginning of 2007 have been and will be made available to the fund, which has a

right of first refusal over such investments. If the fund has no interest in acquiring any such investment, the investment opportunity will pass to Kaupthing. The fund's investment focus is on UK and Nordic companies with enterprise values of between £50 million and £500 million or larger with co-investment partners. The fund closed at approximately £525 million. Kaupthing committed £200 million on establishment, and the balance was from third party investors, namely institutions, international high net worth individuals and employees.

#### ***Acquisition of Robeco Bank Belgium***

In October 2007, we entered into an agreement to purchase Robeco Bank Belgium, a small Belgian bank that was founded in 2002 and focuses mainly on private banking and asset management. The bank was acquired by Kaupthing Bank Luxembourg and had an insignificant effect on our financial condition or results of operations. The transaction was completed on December 28, 2007.

#### ***Acquisition of The Derbyshire (Isle of Man) Limited***

In November 2007, we entered into an agreement to acquire the entire issued share capital of the Derbyshire (Isle of Man) Limited, the offshore deposit-taking business of the Derbyshire Building Societies. The Derbyshire (Isle of Man) Limited is a specialised operation that offers a targeted range of fixed and variable rate pounds sterling deposit accounts for its retail and business customers. The transaction will have an insignificant effect on our overall operations. The closing occurred on December 21 2007.

#### ***Sale of the operation in the Faroe Islands***

On December 31, 2007 the operation in the Faroe Islands was sold to Eik Banki P/F. Kaupthing's operation in the Faroe Islands was set up in 2000 and mainly focused on securities trading, asset management, loans and other traditional investment banking activities. The sale had an insignificant effect on our operations and balance sheet.

#### ***Sale of Eik Fasteignafélag hf.***

In April 2007, we completed the sale of our wholly-owned subsidiary, Eik Fasteignafélag hf., a real estate company. For the year ended December 31, 2006, Eik Fasteignafélag hf. had earnings before income tax of ISK 582 million, and had total assets of ISK 14,600 million and total liabilities of ISK 12,475 million at December 31, 2006. The sale of Eik resulted in profit in the second quarter of 2007 of ISK 4,282 million before taxes.

#### ***Acquisition of a 20 per cent. stake in FiNoble Advisors Private Ltd.***

In June 2007, we acquired a 20 per cent. stake in the Indian investment services company FiNoble Advisors Private Ltd. (FiNoble) with an option to acquire the remaining 80 per cent. in the next five years. Founded in 2004, FiNoble operates out of New Delhi and has 25 employees. Its main business is the provision of traditional M&A advisory services, focusing on advising Indian companies on acquisitions in Europe and in the United States and advising non-Indian firms on entry into the Indian market. We believe that this investment creates a foothold for us in the fast growing Indian financial market. FiNoble is treated as an associated company on our accounts.

#### ***The final phase in restructuring of our UK business***

As the final step in the restructuring of our UK business following Kaupthing's acquisition of Singer & Friedlander in 2005, Kaupthing Singer & Friedlander will be exiting its Asset Finance and Commodity Trade Finance businesses. Following the restructuring Kaupthing Singer & Friedlander will be purely focused on providing integrated financial services to small and medium sized businesses and high net worth individuals. Exiting these businesses will have a positive impact on our cost base and will free up liquidity in excess of GBP 1 billion (EUR 1.3 billion) in 2008. After the divestment the Group will no longer have any significant asset finance business.

## SOURCES OF FUNDS

### Liquidity, Capital and Funding

#### Funding

Our principal sources of funding are capital market issuances, deposits and inter-bank borrowings. Historically, we have relied on the capital markets as our principal source of funding, although in recent years we have sought to increase deposits as a source of funds. We have three rated issuing entities in the group: Kaupthing, which has been rated 'A1' by Moody's and 'A' by Fitch, FIH Erhvervsbank, which has been rated 'A1' by Moody's, and Kaupthing Singer & Friedlander, which has been rated 'A' by Fitch. In general, we consider our long-term funding strategy from a liquidity perspective. Thus, our long-term funding strategy is based on our projections and expectations on redemptions and other future outflow and we aim to estimate how much funding is needed to keep our secured liquidity at all times above our liquidity rules to ensure ongoing liquidity.

We rely on continuous access to financial markets for short- and long-term financing. Our ability to raise or access funding may be impaired by factors that are not specific to our operations, such as general market conditions, the sovereign rating of Iceland, severe disruption of the financial markets or negative views about the prospects for the industries to which we provide a large proportion of our loans. An inability on our part to access funds or to access the markets from which we raise funds may put our positions in liquid assets at risk and lead us to be unable to finance our operations adequately. Furthermore, we believe that the other principal Icelandic banks have similar funding requirements and may be competing for funding from a similar class of investors. This also may adversely affect our access to funds and our cost of funding.

In addition, because we receive a portion of our funding from deposits, in particular wholesale deposits, we also are subject to the risk that depositors withdraw their funds at a rate faster than the rate at which borrowers repay their loans, thus causing liquidity strains.

Our credit ratings are also important to our ability to access funding. A reduction in our credit ratings could increase our borrowings costs, limit our access to the capital markets or trigger our obligations under certain bilateral provisions in some of our trading and collateralised financing contracts. Under these provisions, counterparties could be permitted to terminate contracts with us or require us to post additional collateral. Termination of our trading and collateralised financing contracts could cause us to sustain losses and impair our liquidity by requiring us to find other sources of financing or to make significant cash payments or securities movements.

The table below sets out our funding sources, by amount and as a percentage of total funding, at December 31, 2007, 2006, 2005 and 2004.

	<b>At December 31, 2007</b>		<b>2006</b>		<b>At December 31, 2005</b>		<b>2004</b>	
	(ISK millions)	(%)	(ISK millions)	(%)	(ISK millions)	(%)	(ISK millions)	(%)
Credit institutions and central banks.....	339,088	7.4%	110,456	3.2%	69,643	3.1%	32,488	2.6%
Deposits.....	1,381,457	30.0%	750,658	21.6%	486,176	21.9%	202,193	16.0%
Bonds issued.....	1,638,113	35.6%	1,762,483	50.7%	1,158,806	52.3%	779,931	61.9%
Bills issued.....	136,813	3.0%	156,203	4.5%	164,910	7.4%	35,726	2.8%
Money market.....	555,606	12.1%	373,285	10.7%	200,581	9.1%	111,901	8.9%
Other loans.....	285,428	6.2%	107,968	3.1%	32,270	1.5%	40,954	3.2%
Subordinated loans.....	267,289	5.8%	216,030	6.2%	102,688	4.6%	57,623	4.6%
<b>Total.....</b>	<b>4,603,794</b>	<b>100.0%</b>	<b>3,477,083</b>	<b>100.0%</b>	<b>2,215,074</b>	<b>100.0%</b>	<b>1,260,816</b>	<b>100.0%</b>

The table below shows the maturity profile of our long-term borrowings at December 31, 2007.

(ISK millions)	2008	2009	2010	2011	2012 and beyond
Kaupthing .....	155,982	385,908	240,987	170,930	587,635
FIH .....	170,521	151,637	131,714	47,400	106,911
KSF .....			31,668		9,994
<b>Total</b> .....	<b>326,503</b>	<b>537,545</b>	<b>404,369</b>	<b>218,330</b>	<b>704,540</b>

Kaupthing Singer & Friedlander primarily funds its operations through deposits and intra-group borrowings from Kaupthing.

Historically, we have relied primarily on the European markets as our principal source of funding, through issuances under our €12 billion EMTN programme, and more recently through FIH Erhvervsbank's €8 billion EMTN programme.

In recent years, one of our key priorities has been the diversification of our funding sources, both by type and by geography. To this end and to broaden our investor base, we have issued senior unsecured bonds to investors in the United States, Australia, Japan, Canada, Switzerland and Mexico as well as structured covered bonds in Europe. An important step towards further diversifying our funding was the establishment of our \$10 billion Senior/Subordinated Medium Term Note Programme. In April 2006, we issued \$500,000,000 of Senior Floating Rate Notes due 2011 under this programme and in May 2006, we issued \$1,250,000,000 of 7.125 per cent. Fixed Rate Subordinated Notes due 2016. In September 2006, we issued \$3 billion of senior notes under the programme, the largest debt financing by a Nordic bank in the United States at that time. The transaction consisted of three tranches: \$1,000,000,000 Senior Floating Rate Notes due 2010, \$1,500,000,000 5.750 per cent. Senior Notes due 2011 and \$500,000,000 6.125 per cent. Senior Notes due 2016. We established an AUD\$3 billion debt issuance programme in 2005, and in September 2006 we issued AUD\$290 million of Senior Floating Rate Notes due 2013. In November 2006, we issued and sold 66,000,000 new Shares. As a result of this share offering, we received gross proceeds of ISK 55.6 billion and increased our share capital to 740,453,053 Shares with a nominal value of ISK 10 per Share.

The first public bond issue in 2007 was in the Swiss domestic market. Kaupthing and FIH have re-entered this market several times in 2007 and in total raised CHF 850 million in five transactions to date. In February 2007, Kaupthing issued CAD\$500 million 4.7 per cent. notes due 2010 in the Canadian fixed-income market. FIH also diversified its funding sources in the same month by launching a transaction in the Sterling fixed rate market, issuing GBP 300 million 6.0 per cent. notes due 2012. In March 2007, FIH concluded a €200 million six-year (callable after three years) dated Upper Tier II transaction, priced at 3m EURIBOR +40 basis points. In June 2007, we issued our first EUR benchmark since 2005: a €500 million two-year Floating Rate Note transaction. The bond bears a coupon of 3m EURIBOR + 15 basis points. In July 2007, Kaupthing issued a ¥28 billion Samurai bond, which consisted of three tranches: ¥13 billion Floating Rate Notes due 2012, ¥10 billion 1.65 per cent. Note due 2010 and a ¥5 billion 1.99 per cent. Note due 2012. A perpetual €250 million 6.75 per cent. retail Tier I capital transaction was also issued in July 2007, reopening the Euro retail Tier I market. We have an option to call these securities five years after the date of issue. In October 2007, Kaupthing launched a 2.3 billion Mexican peso (\$200 million) bond. The bond has a maturity of five years and pays a coupon of THIE +25 basis points which is approximately equivalent to 3m USD LIBOR +72 basis points. In October 2007, Kaupthing launched its second perpetual retail Tier I capital transaction in 2007 when it issued \$400 million bonds under its EMTN programme. The bonds bear a fixed coupon of 9 per cent. and are callable by us five years after the date of issue. In November we finalised a EUR 300 million syndicated loan with four banks. The loan has a maturity of one year and bears an all in coupon of EURIBOR + 75 basis points.

The group has ISK 326 billion of long term debt maturing in 2008, of which Kaupthing has ISK 156 billion and FIH has ISK 171 billion. The group plans to raise ISK 947 billion in 2008. We expect to raise these amounts with new deposits, bilateral agreements with other financial institutions and with new bond issues. We expect that the recent turbulence in the international capital market will negatively affect our funding cost. The funding spread we expect to pay for new bond issues will depend on our spread in the credit default swap market. The costs of five-year credit

default swaps has risen to 292.6 basis points at December 31, 2007, from 125 basis points at the end of September 2007. We expect that the costs of new funding will reflect the recent rise in costs of credit default swaps

In 2007, the EMTN private placement market (non-syndicated reverse enquiries) continued to play a significant role in our long-term funding. In 2007 the group had issued approximately EUR 2,400 million (or the equivalent in other currencies) of notes in private placements. We continue to place a strong focus on increasing our presence in the structured private placement market by establishing ourselves as a flexible and reliable issuer with the capability of issuing a wide range of structured notes. The structured note market gives us access to diversified funding opportunities, as bonds are commonly placed with banks, treasury portfolios, portfolio managers and private banking networks in Europe and Asia.

We are also exploring other types of funding sources, with particular emphasis on securitisations and other asset-backed issuances in order to increase the diversification of our sources of funding.

Within our group, two securitisation programmes have already been put in place, this ISK 200 billion covered bond programme and a committed securitisation pipeline (collateralised loan obligation, **CLO**) at FIH with a draw down capacity of DKK 15 billion. Two series of Inflation-Linked Annuity Covered Bonds were issued in 2006 under the covered bond programme: Series 1 ISK 21.9 billion Inflation-Linked Annuity Covered Bonds due 2033 and Series 2 ISK 51.1 billion Inflation-Linked Annuity Covered Bonds due 2048. These covered bonds have been assigned an Aaa credit rating by Moody's. Future issuance under these programmes is subject to market conditions.

We have multiple high-quality loan portfolios which have been identified as potential sources for securitisation in addition to the programmes already in place. We are considering issuing collateralised loan obligations by using our loan portfolios in Iceland and commercial mortgage-backed securities (**CMBSs**) by using commercial mortgages in the United Kingdom, Iceland, Sweden and Denmark.

Increased borrowings in 2006, as well as market turbulence related principally to Iceland and the costs of increasing funding diversification and extending debt maturities, led to increased funding costs in 2006. The average funding spread, calculated as basis points over LIBOR for newly raised senior unsecured bond issues in the year 2006, was approximately 38 basis points higher than the average funding spread for newly raised senior unsecured bond issues in 2005. However, in 2007 the average funding spread of newly raised senior unsecured bond issues has decreased by 23 basis points compared to 2006.

We are seeking to reduce our dependence on the capital markets as a source of funding by increasing our deposit base. Deposits at December 31, 2007 amounted to ISK 1,381,457 million compared with ISK 750,658 million at December 31, 2006. We have seen strong organic deposit growth in all our subsidiaries, particularly in the United Kingdom and Iceland. We intend to further increase our deposit base by marketing deposits more aggressively, both directly to our clients and through brokers, and by offering a wider range of deposit products. At December 31, 2007, our deposit to loans to customer ratio was 42 per cent., compared with 30 per cent. at December 31, 2006. Our deposit to loans to customer ratio target is 50 per cent.

The table below shows the maturity profile of our assets and liabilities at December 31, 2007.

	On demand	Up to 3 months	3 – 12 months	1 – 5 years	Over 5 years	Total
	(ISK millions)					
<b>Assets:</b>						
Cash and balances with central banks.....	97,959	0	0	0	0	97,959
Loans to credit institutions .....	222,264	338,345	17,074	7,780	2,978	588,441
Loans to customers .....	246,355	659,348	436,019	1,105,372	857,314	3,304,408
Bonds and debt instruments.....	34,364	69,026	15,555	132,645	115,760	367,350
Shares and equity instruments .....	61,294	99,338	-	-	165	160,797
Derivatives .....	28,735	36,636	11,598	46,479	11,408	134,856
Derivatives used for hedging.....	-	2,845	88	10,047	9,523	22,503
Securities used for hedging.....	159,949	-	-	-	-	159,949
Investments in associates.....	-	-	-	-	83,831	83,831
Intangible assets .....	-	-	-	-	66,774	66,774
Investment property.....	-	-	-	-	28,155	28,155
Property and equipment.....	-	-	-	-	32,714	32,714
Tax assets .....	-	-	1,766	5,133	-	6,899
Other assets .....	239,989	-	52,720	-	-	292,709
<b>Total assets 31.12.2007 .....</b>	<b>1,090,909</b>	<b>1,205,538</b>	<b>534,820</b>	<b>1,307,456</b>	<b>1,208,622</b>	<b>5,347,345</b>
<b>Total assets 31.12.2006 .....</b>	<b>693,178</b>	<b>900,669</b>	<b>394,934</b>	<b>1,033,881</b>	<b>1,032,734</b>	<b>4,055,396</b>
<b>Liabilities:</b>						
Due to credit institutions and central banks .....	15,756	268,668	21,429	31,335	1,900	339,088
Deposits.....	409,995	752,544	151,599	23,237	44,082	1,381,457
Financial liabilities measured at fair value.....	118,443	17,477	19,843	38,114	24,068	217,945
Borrowings .....	62,024	527,799	284,895	1,427,770	313,472	2,615,960
Subordinated loans .....	-	-	337	58,589	208,363	267,289
Tax liabilities .....	-	-	9,637	12,841	-	22,478
Other liabilities .....	64,560	-	79,835	2,302	-	146,697
<b>Total financial liabilities 31.12.2007 .....</b>	<b>670,778</b>	<b>1,566,488</b>	<b>567,575</b>	<b>1,594,188</b>	<b>591,885</b>	<b>4,990,914</b>
<b>Total financial liabilities 31.12.2006 .....</b>	<b>336,083</b>	<b>1,004,574</b>	<b>608,811</b>	<b>1,179,243</b>	<b>591,793</b>	<b>3,720,504</b>
Assets – liabilities 31.12.2007 .....	420,131	(360,950)	(32,755)	(286,732)	616,737	356,431
Assets – liabilities 31.12.2006 .....	357,095	(103,905)	(213,877)	(145,362)	(440,941)	334,892

As at December 31, 2007, we had ISK 2,833,249 million of borrowings and subordinated loans outstanding, of which ISK 521,835 million had a tenor of more than five years, ISK 1,486,359 million had a tenor between one and five years and ISK 875,055 million will mature within one year. Furthermore, at December 31, 2007, approximately 24 per cent. of our total interest-bearing liabilities were deposits that are on demand or with a maturity of less than three months. These can be withdrawn quickly, if depositors form a negative view of our credit or in the event of adverse developments in the capital markets, causing further strains on our liquidity. Further, some of our deposits are placed by deposit brokers and are dependent on both the rate paid and the perceived risk of loss of financial issuers.

### Liquidity

We consider liquidity to be a vital component of our business. Our liquidity could be impaired in several situations, most of which may arise due to circumstances which we are unable to control. Therefore, it is essential that we hold a strong base of liquid assets. Our liquid assets consist of financial assets, such as bonds, listed equities, loans to credit institutions and cash and cash balances with central banks. The table below shows the composition of our liquid assets, by amount and as a percentage of total liquid assets as of December 31, 2007, 2006, 2005 and 2004.

	At December 31, 2007		2006		At December 31, 2005		2004	
	(ISK millions)	(%)	(ISK millions)	(%)	(ISK millions)	(%)	(ISK millions)	(%)
Cash and cash balances with central banks .....	97,959	9%	106,961	11%	34,877	5%	6,290	2%
Loans to credit institutions .....	588,441	52%	485,334	47%	195,594	28%	174,310	41%
Bonds and debt instruments .....	367,350	33%	318,264	31%	390,575	56%	169,666	41%
<b>Total liquid assets</b> .....	<b>1,053,750</b>	<b>94%</b>	<b>910,559</b>	<b>89%</b>	<b>621,046</b>	<b>89%</b>	<b>350,266</b>	<b>84%</b>
Listed equities .....	67,236	6%	111,569	11%	72,596	11%	65,651	16%
<b>Total liquid assets and listed equities</b> .....	<b>1,112,086</b>	<b>100%</b>	<b>1,024,375</b>	<b>100%</b>	<b>693,642</b>	<b>100%</b>	<b>415,917</b>	<b>100%</b>

In addition, at December 31, 2007, we had ISK 513,176 million of committed, undrawn alternative liquidity sources with a maturity of over one year and without material adverse change clauses. These liquidity sources are bilateral and syndicated revolvers, bond and equity repurchase facilities, committed loan portfolio facilities and a securitisation pipeline.

In 2006, we introduced a stricter liquidity measure, called secured liquidity. The primary goal of our liquidity management is to have enough secured (committed) liquidity to repay all maturing obligations for at least 360 days and at the same time maintain a stable level of business without any access to the capital markets. To strengthen our liquidity position, we established new committed alternative liquidity facilities.

### Capital

The management of our capital base is critical to the growth of our loan portfolio and other risk weighted assets. Risk weighted assets have grown from ISK 1,189 billion at December 31, 2004 to ISK 1,945 billion at December 31, 2005, ISK 3,068 billion at December 31, 2006 and ISK 4,113 billion at December 31, 2007. Against this increase, we have sought to increase our capital base, both through the issuance of additional equity and subordinated debt that qualifies as Tier I and Tier II capital. To this end, we completed a EUR 175 million issuance of Tier I subordinated bonds in June 2005, U.S. \$165 million private placement of Tier I subordinated bonds in the United States in December 2005, \$1.25 billion issue of Tier II subordinated bonds under our U.S. MTN programme in May 2006, EUR 250 million issue of Tier I subordinated bonds in June 2007, \$400 million issue of Tier I subordinated bonds in October 2007 and an issuance of 75,900,000 new Shares in November 2006.

THE TABLE BELOW SHOWS THE DEVELOPMENT OF OUR CAPITAL BASE SINCE 2004.

	At December 31, 2007	At December 31,		
	(ISK millions, except percentages)	2006	2005	2004
Total risk weighted assets .....	4,113,432	3,067,640	1,945,272	1,189,171
Equity				
Total Tier I capital .....	395,504	321,433	182,029	137,256
Total Tier II capital .....	90,640	139,393	54,834	31,510
Total capital .....	486,144	460,826	236,863	168,766
CAD ratio .....	11.8%	15.0%	12.2%	14.2%
Tier I capital ratio .....	9.6%	10.5%	9.4%	11.5%

We seek to maintain a CAD ratio of at least 11.0 per cent. Under applicable Icelandic law, we are required to maintain a CAD ratio of at least 8.0 per cent.

In 2007, we reported our capital requirement calculations according to Basel I. For credit risk, we intend to use the advanced approach for retail but initially will use the foundation approach for other credit exposure with eventual full migration to the advanced approach. We will use the standardised approach both for market risk and operational risk. The FME is still processing our application and evaluating our models. Our CAD ratio at December 31, 2007 was 11.8 per cent. according to Basel I.



While we monitor our liquidity position and funding strategies on an ongoing basis, unexpected events, economic or market conditions, unforeseeable declines in our earnings or other situations beyond our control could cause either a short- or long-term crisis.

## PRINCIPAL SHAREHOLDERS

We are a publicly listed company, with our Shares listed on the OMX ICE and the OMX STO. Our total issued Shares are 740,453,053. Our voting Shares outstanding were 723,669,213 at January 31, 2008 since we held 2.27 per cent. of our own Shares as at that date. Our Shares were held by 31,693 shareholders of record on January 31, 2008.

Our largest shareholder is Exista B.V. which at February 25, 2008 held approximately 23.0 per cent. of our total issued Shares. Exista B.V. is a subsidiary of Exista hf. which operates in the field of financial services, and has a particular focus on insurance and asset leasing along with investment operations. Exista hf.'s shares have been listed on the OMX ICE since September 15, 2006. Exista hf.'s largest shareholder is Bakkabraedur Holding B.V. (owned by Mr. Ágúst Guðmundsson and Mr. Lýður Guðmundsson), which held 45.2 per cent. of Exista hf.'s outstanding shares as at December 31, 2007. The 20 largest shareholders in Exista owned 91.45 per cent. of its share capital as at February 25, 2008.

Our second largest shareholder is Egla Invest B.V. which held 9.9 per cent. of our total issued shares as at February 25, 2008. Egla Invest B.V. is a holding company that was founded in June 2007 and is wholly owned by Kjalar ehf, which is majority owned by Mr Ólafur Ólafsson. According to an announcement on June 15, 2007, shares owned by Kjalar Invest B.V. and Egla hf. in Kaupthing were transferred to the newly founded holding company, Egla Invest B.V. Egla hf. was originally founded to hold shares in Búnadarbanki which in 2003 merged with Kaupthing.

No other shareholder held more than 5 per cent. of our total issued Shares or of our voting Shares outstanding at February 25, 2008, and we are not aware of any party, other than those mentioned above, holding directly or indirectly a 5 per cent. or greater interest in our share capital or voting rights.

The table below sets out information regarding our largest shareholders. The list shows largest owners of shares listed in Iceland as per February 21, 2008 and shares listed in Sweden as per January 31, 2008, own shares are excluded. The table sets out the total number of Shares held by each shareholder and the percentage of our total issued shares. We are not aware that any of these shareholders have interests in each other, although we believe that a number of them hold shares in Exista hf.

Shareholder	Shares	%
Exista B.V. <sup>(1)</sup>	170,439,413	23.02%
Egla Invest B.V.	73,153,352	9.88%
Arion safnreikningur	37,805,922	5.11%
Gift fjárfestingafélag ehf.	26,736,954	3.61%
Lífeyrissjóður verslunarmanna	26,379,252	3.56%
Lífeyrissjóður Bankastræti 7	25,625,390	3.46%
Gildi-lífeyrissjóður	23,444,483	3.17%
Holt Investment Group Ltd	17,000,000	2.30%
Kaupthing Bank Luxembourg SA <sup>(2)</sup>	15,040,181	2.03%
Arion Custody Services Nominee <sup>(2)</sup>	14,405,636	1.95%
Raiffeisen Zentralbank Österreich <sup>(2)</sup>	14,035,300	1.90%
Arion Custody Services hf	9,958,833	1.34%
Everest Equities Ltd.	9,482,480	1.28%
Sigurður Einarsson	8,180,423	1.1%
Sund ehf.	7,354,449	0.99%
Hreiðar Már Sigurðsson ehf	7,235,239	0.98%
Kaupþing Ís-15	6,557,528	0.89%
Stafir lífeyrissjóður	6,439,892	0.87%
Glitnir Banki <sup>(2)</sup>	6,310,049	0.85%
Kaldbakur ehf	6,020,000	0.81%

(1) Subsidiaries of Exista hf., other than Exista B.V, hold 0.68% of our shares making the total shareholding of Exista equal to 23.7%.

(2) Shares listed in Stockholm and registered in the Swedish Securities Depository. That list is updated only once a month.

At January 31, 2008, approximately 86 per cent. of our shareholders were residents of Iceland and approximately 14 per cent. were from other countries or placed their Shares in foreign nominee accounts.

The table below shows our shareholder base by type at January 31, 2008:

<b>Type of shareholders:</b>	<b>Percentage of outstanding Shares</b>
Holding Companies & Institutional Investors.....	46.2
Pension Funds.....	13.5
Nominee Holdings.....	13.3
Employees .....	7.8
Financial Institutions .....	4.5
Investment and Mutual Funds.....	2.6
Others .....	12.1
<b>Total of outstanding Shares</b>	<b>100%</b>

## **RISK MANAGEMENT**

We face various types of risks related to our business as a financial institution, which arise from our day-to-day operations. The most significant of these risks are listed below. Management devotes a considerable portion of its time to the management of risk. Effective risk management involves identifying the significant risks, quantifying our exposure to these risks and taking appropriate action to limit these risks by, among other things, constantly monitoring them.

### **Risk Policy**

Our Chief Risk Officer is responsible for coordinating risk management on a group-wide level, both in terms of risk reporting and enforcing adherence to the group's risk policy. The Risk Management division at Kaupthing in Iceland plays a crucial role in gathering information across subsidiaries, analysing and aggregating the information collected and highlighting any risk concentrations and aberrations to our Chief Risk Officer and group management. The information presented in the reports generated for our Chief Risk Officer and/or group management may be detailed or provide a summary of the information collected and analysed, depending on the purpose of the reports. Our Chief Risk Officer or group management may request further explanations or more detailed information after reviewing the reports. Measures aimed at controlling or reducing risk, such as limits on exposures and concentrations of risks, are also often monitored through our Risk Management division, which is responsible for overseeing risk on a group-wide level. Within our subsidiaries, local risk management units operate to further enforce compliance with local risk policies, report to local management and coordinate risk control methods and measures with our Risk Management division or our Chief Risk Officer.

Many risks can adversely affect our business. Banks and other financial institutions must determine the magnitude of risk and limit it with sensible credit and investments in other assets. It is the policy of our board of directors that the various risks be constantly monitored and managed. For these purposes, we operate a centralised Risk Management division. In addition, our internal auditor oversees our operations in order to ensure that our rules and procedures are implemented in accordance with resolutions made by the board of directors.

The board of directors determines our goals in terms of risk by issuing a risk policy. The risk policy defines both the acceptable levels of risk for day-to-day operations, as well as our willingness to incur risk weighed against the expected rewards. Our risk policy is detailed in an Internal Control and Procedural Handbook, which is maintained by the Risk Management division and revised at least annually. Amendments or minor changes can be made more frequently but each change must be approved by our Chief Executive Officer (CEO) before it becomes effective and then must be approved by the board of directors. Significant changes and changes that affect risk limitations are submitted to the board of directors for review and approval before they take effect. Our board of directors reviews and approves the handbook on an annual basis.

The Risk Management division enforces our risk policy by monitoring risk, with the aim of identifying and quantifying significant risk exposures and acting upon them if necessary. To ensure that our decision-making process is properly supervised and that the boundaries set by the board of directors and regulatory authorities are not exceeded, the Risk Management division regularly reports risk exposures, usage of limits and any special concerns to senior management and the board of directors.

### **Types of Risks**

#### ***Credit Risk***

Credit risk is the current or prospective risk to earnings and capital arising from the failure of an obligor to repay principal or interest at the stipulated time or otherwise to perform as agreed. This risk is increased if the assigned collateral only partly covers the claims against the borrower or if its value is variable or uncertain. Credit risk arises whenever we commit our funds, resulting in capital or earnings being dependent on the performance of a counterparty, issuer or borrower. Credit risk includes concentration risk, residual risk, credit risk in securitisation and cross border (or transfer) risk.

#### ***Credit Risk Management***

Carefully monitored credit risk serves as a basis for stable profits. Our main asset is our loan portfolio. To maintain and further improve a healthy loan portfolio it is imperative to scrutinise all applications and weed out potential problem loans during the application phase, as well as constantly monitor the current loan portfolio. While it is not our policy to issue credit only in cases of very low risk, we believe that it is of the utmost importance that the price of issued credit reflects both the risk and the cost incurred. This means that a detailed assessment of individual customers, their financial positions, and any collateral is a prerequisite for granting credit.

The basic elements for the quantification of credit risk are the probability of default, the loss in the event of default and exposure at default. These quantities need to be measured with an effective and accurate credit rating system. Information, both quantitative and qualitative, must be gathered, both specifically with regard to the counterparty and to its general economic situation in order to estimate the counterparty's creditworthiness. Furthermore, a facility rating should be performed to determine the loss parameters in case of a default.

Our policy is to apply sophisticated credit models to monitor credit risk. These credit models are also the foundation for the application of internal rating-based approach to calculate capital requirements. Therefore, the development, implementation and application of these models must be in accordance with our Basel II strategy. The pricing of each credit granted should reflect the risk taken. The client's interests should be guarded at all times, and it must be considered likely that the client will be able to repay a given loan. In particular, the quality of collateral can never be the sole reason for a positive credit decision.

In the long run, our credit strategy aims to have write-offs represent less than 5 per cent. of net interest income. In 2007, our write-offs represented 3.2 per cent. of net interest income. We design and implement all aspects of the credit process with this long-term goal in mind.

Provisions for losses should reflect the expected loss, both for loans for which specific provisions exist as well as for portfolios of performing loans. The collective assessment of such portfolios should be based on default predictions and loss given default parameters.

Day-to-day credit risk is monitored by the Risk Management division. The Risk Management division is responsible for the development and maintenance of credit monitoring and reporting systems. This includes collecting data from all operational systems within our group, data verification and unification. The department also performs numerical analysis of the loan portfolio, e.g. estimating expected loss, concentrations within the loan portfolio and mapping defaults in a systematic way. The proprietary credit models we employ have been developed by the Risk Management division within our parent company and locally within subsidiaries.

### ***Credit Application Process***

We employ a credit decision process as a group and within each subsidiary. The highest authority in the credit process is our group Board Credit Committee, whose members consist of three board members and our CEO. All exposures above €165 million are referred to our group Board Credit Committee for approval. The process structure is based on the hierarchy of the credit committees below the Board Credit Committee, which, depending on the subsidiary, have two or more levels of approval and each with different overall limits depending on the size of the subsidiary. The principle of central management of risk and decision authority is maintained by having Kaupthing's CEO or his deputy as a member of the credit committee at each subsidiary.

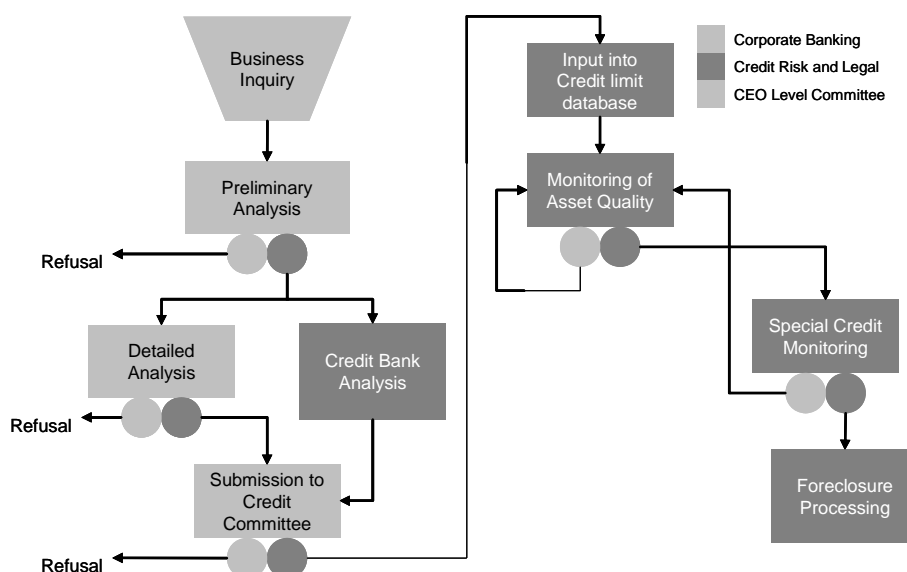
The Management Credit Committee, which has the highest overall credit approval authority, is overseen by our group Board Credit Committee. There are also two lower levels of committees at Kaupthing within corporate and retail banking that have the authority to approve exposures within certain lower limits.

In order to make use of our local expertise, a large part of our credit and collateral risk is evaluated on a local level at our subsidiaries where similar credit committee structures are in place. Each subsidiary's management credit committee may approve exposure only within a fixed limit (which limit varies from subsidiary to subsidiary). Any credit exposures above such a limit are referred to the relevant subsidiary's board credit committee.

We have implemented two measures in order to maintain group-wide oversight of large exposures. As mentioned before, we have established our CEO or his deputy as a member of all subsidiary credit committees as well as of our group's Management Credit Committee. In addition, all exposures and increases in exposure in excess of ISK 500 million must be entered into a database of large exposures maintained by our Risk Management division. If the aggregated exposure to a single entity, or a number of financially related entities, across the group exceeds €165 million of the group's risk capital (which is an estimate of the maximum transfer loss within a certain time period on a portfolio of assets given a certain confidence level), the exposure must be referred to our group Board Credit Committee.

This structure gives us the ability to incorporate much needed local expertise, while at the same time managing risk on a global level. Local credit committees of our subsidiaries are able to grant credits, but the total of the exposure to any applicant and financially related counterparties is limited, most commonly by the subsidiary's capital. All applications that would lead to exposures exceeding the set limit are referred to the group Board Credit Committee.

The diagram below illustrates the principal parts of our credit process.



If a preliminary analysis by an account manager in Corporate Banking indicates that a business inquiry merits further scrutiny, it is then analysed in greater detail. If it passes the detailed analysis it is then submitted to the credit committee along with a standard credit risk analysis of the borrower (i.e. a credit rating).

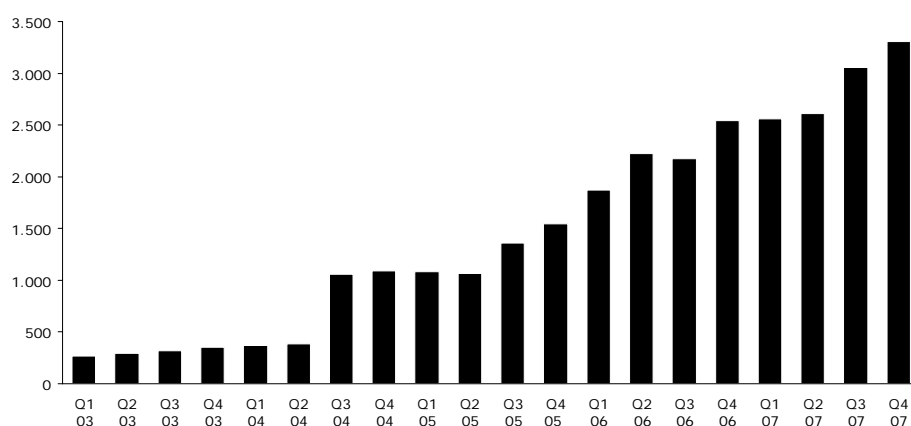
The standard credit evaluation process is based both on quantitative figures from the financial statements and on an array of qualitative factors. Factual information on the borrower is collected as well as pertinent macroeconomic data, such as an outlook for the relevant sector. These subjective factors are assessed by answering predetermined questions. The analyst cannot rely solely on his quantitative skills, but must also have extensive knowledge of the inner workings of the company in question and be in close contact with its management. Furthermore, a facility rating of the collateral is performed to determine the loss parameter in the case of default.

The credit rating of the counterparty plays a fundamental role in the final decision of the committee as well as in the terms being offered if the application is accepted. If the client accepts the terms offered, then the loan becomes part of our loan portfolio, where long-term monitoring takes place with regard to limits and the credit quality of the client. In particular, the client is re-rated using the standard credit rating at least once a year. If weakened credit quality or other signs become evident, such as breach of loan covenants or a missed payment, then the loan is placed under special credit monitoring. If conditions improve, the loan may be removed from the special monitoring, but in some cases the loan may eventually end in foreclosure.

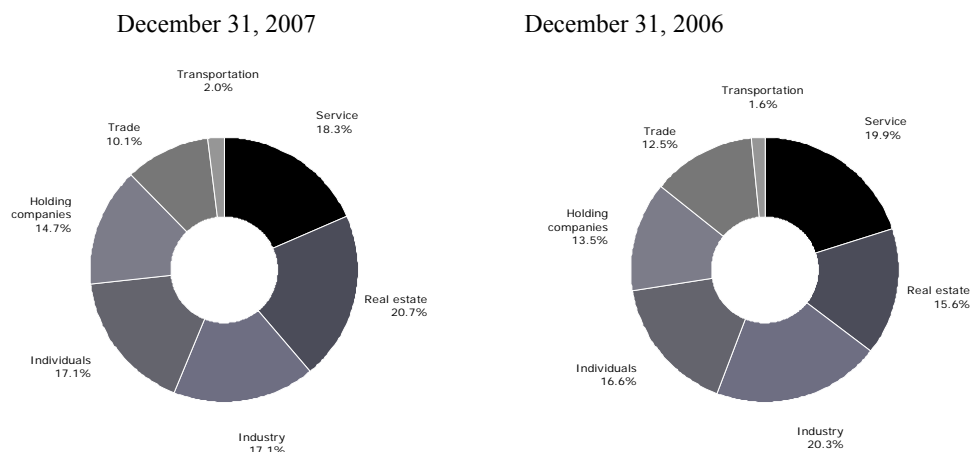
### ***Credit Exposure***

At December 31, 2007 we had five large exposures exceeding 10 per cent. of our risk capital. At December 31, 2007, total loans to customers net of provisions for losses amounted to ISK 3,304 billion. Corporate loans totalled ISK 2,739 billion, and loans to individuals totalled ISK 565 billion. The loan portfolio increased by approximately 30 per cent. during 2007. We believe that our portfolio is well diversified. Our largest exposures are to companies within the real estate sector, which constitute around 21 per cent. of our portfolio, followed by the service sector at approximately 18 per cent., industry sector and individuals both at approximately 17 per cent., holding companies (investment companies) at approximately 15 per cent., trade at approximately 10 per cent. and transportation at approximately 2 per cent. At the end of 2006, total loans to customers net of provisions for losses amounted to ISK 2,539 billion. The loan portfolio increased by approximately 30 per cent. in 2007. At the end of 2007, corporate loans totalled ISK 2,739 billion, up from ISK 2,116 billion in 2006, and loans to individuals totalled ISK 565 billion, up from ISK 422 billion in 2006.

The chart below illustrates the growth of our loan portfolio on a quarterly basis since the end of 2002.



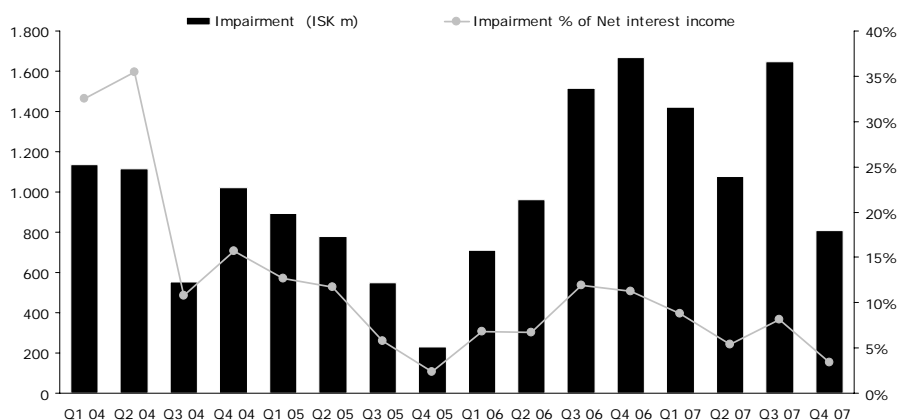
The charts below illustrate the distribution of our loan portfolio to customers, net of loan loss provisions, by sector at December 31, 2007, which totalled ISK 3,304 billion and at December 31, 2006, which totalled ISK 2,539 billion.



### Credit defaults

Since 2003, we have made significant efforts to improve the quality of our loan portfolio. Stricter rules and procedures when issuing credit were introduced and certain loans that were considered doubtful were accelerated on default.

The chart below illustrates the development of our provisions on a quarterly basis since 2004, both in absolute amounts and as a percentage of net interest income.

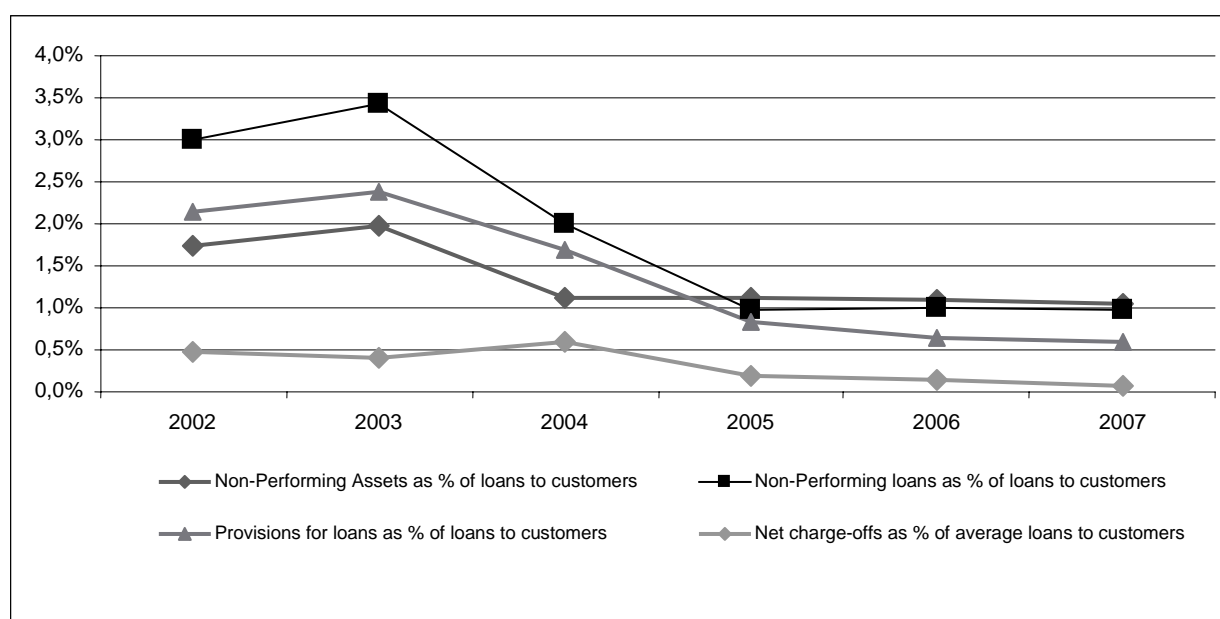


We believe that our efforts have generally improved the quality of the group's loan portfolio. During 2007 and 2006, provisions were approximately 6 per cent. and 9 per cent. of net interest income, respectively, down from over 30 per cent. in the first half of 2004, reflecting the improved quality of our loan portfolio, aided by the performance of FIH's higher quality loan portfolio, which has historically experienced fewer loan losses than the rest of the group's portfolio.

### ***Asset Quality Ratios***

We look at our asset quality in several ways to assess the quality of our loan portfolio and how it changes over time. Given the rapid growth of our portfolio over the past few years, we calculate these measures as a percentage to make the comparison meaningful over multiple time periods. The table and chart below show non-performing assets as a percentage of loans to customers, non-performing loans as a percentage of loans to customers, provisions for loans as a percentage of loans to customers and net write-offs as a percentage of average outstanding loans to customers.

	2002	2003	2004	2005	2006	2007
Non-performing assets as % of loans to customers	1.750%	1.970%	1.130%	1.120%	1.100%	1.039%
Non-performing loans as % of loans to customers	3.008%	3.430%	1.990%	0.980%	1.005%	0.984%
Provisions for loans as % of loans to customers	2.140%	2.365%	1.683%	0.839%	0.653%	0.587%
Net write-offs as % of average loans to customers	0.481%	0.400%	0.600%	0.200%	0.126%	0.081%



### ***Market Risk***

Market risk is the current or prospective risk to earnings and capital arising from adverse movements in bond prices, security and commodity prices and foreign exchange rates in the trading book. Market risk arises from market making, dealing, and position-taking in bonds, securities, currencies, commodities and derivatives.

### ***Market Risk Management and Control***

Our market risk policy is designed to monitor closely the risks embedded in our investments and operations and to make sure that all risks are identified, monitored and reported, both on a group and local level.

Trades and positions exposed to market risk are recorded in a central database, controlled and managed according to the group's market risk policy. This enables the Risk Management division to monitor intra-day trades and overnight holdings for



different trading units and for the group. The Risk Management division sends a daily report covering the performance and risk exposures of all trading desks. The daily report is sent to the managing director of the Risk Management division, the head of trading, the managing director of the Treasury division and our CEO.

Each trading unit within the group adheres to the general rules set by our board of directors. Moreover, each trading unit has its own set of working procedures and rules that further specify its targets, limits and scope in trading.

Position limits, or any changes to them, are proposed by the managing director of Capital Markets and then must be approved by the managing director of the Risk Management division and reviewed by our CEO. The size of each position limit is based on, among other things, underlying liquidity, our appetite for risk, as well as legal limitations on individual positions imposed by the relevant authorities. For example, in August 2006 our maximum equity exposure, both in listed and unlisted equity, was set at 35 per cent. of our risk capital (which does not include off-balance sheet exposures) based on a decision by our board of directors. Transactions that meet certain criteria are reviewed and approved by our board of directors. As at year end, 2007, our total equity exposure was ISK 161 billion, representing 33.1 per cent. of our risk capital and 3.0 per cent. of our total assets.

### ***Measurement Methods***

Risk measures are generated by proprietary systems that utilise the counterparty, market data and trade databases generated and used by our trade systems. Additionally, the risk management systems are enhanced by various third party solutions. Models employed in evaluating these measures include position-based models (which provide details on exposure to market risk, profit and loss and sensitivities such as durations), volatility based models (which are based on the volatility of market variables and their related co-variance) and scenario-based models (in which the frequency of a severe loss is estimated by repeating random scenarios with certain statistical properties that have generally been estimated from historical data).

All trades and intra-day profit or loss are reported continuously to the managing director of the Risk Management division through a position monitoring system. The managing director of the Risk Management division appoints a person and a backup person who are responsible for monitoring the intra-day positions in different trading units within the group and alerting the managing director of the Risk Management division if any deviations or exceptions are observed.

Our Risk Management division sends a daily report on profit and loss and turnover to the managing director of the Risk Management division, the head of the Trading division, the managing director of Treasury and our CEO. The division also sends a weekly risk assessment report to the head of Trading, our CEO and the board of directors, detailing volatility-based and scenario-based measures such as Value-at-Risk (**VAR**) and stress tests based on current exposure. VaR is a commonly used technique to estimate the probability of portfolio losses based on statistical analysis of historical prices and their volatility. We use 10-day VaR with 99 per cent. confidence level, which means that losses over a 10-day period are expected to exceed the VaR once every 100 10-day periods.

### ***Market Risk Analysis***

The table below sets out our VaR in absolute amounts and as a percentage of total risk capital at the dates shown:

	2007	At December 31,		
		2006	2005	2004
In ISK millions	5,400	5,476	3,602	1,932
As a percentage of total risk capital	1.1%	1.20%	1.51%	1.15%

In general, our VaR has increased in recent years due to the growth in our trading portfolio. Our VaR at December 31, 2007 decreased from our VaR at December 31, 2006, however, because of a decrease in our equity exposure due principally to the reclassification of Storebrand as an associate.

### ***Liquidity Risk***

Access to liquid funds is essential to our business. Liquidity risk is the risk that we will not be able to meet our short-term liabilities as they become due. It arises from the inability to manage unplanned changes in funding sources. Our liquidity could be impaired by an inability to access debt markets, an inability to access funds from our subsidiaries or an inability to sell assets. This situation might arise due to circumstances beyond our control, such as general market disruption or an operational incident that affects either third parties or us. Accordingly, we have developed a comprehensive set of liquidity and funding policies that are intended to maintain significant flexibility to address firm-specific and broader industry or market liquidity events. Our objective is to have access to sufficient sources of funding and to enable our core business to continue to generate revenues, even under adverse market conditions.

Up until the third quarter of 2006, we had three key liquidity targets: we sought to have enough available secured liquidity to enable us to serve and repay maturing debt for at least 180 days without accessing the capital markets; we sought to have a minimum of 360 days of sufficient unsecured liquidity (which consists of secured liquidity plus available amounts under our euro-commercial paper programme and unused money market lines) to cover our liabilities over that period; and we sought to cover short-term liabilities for 390 days with unsecured liquidity together with liquid assets (listed and liquid securities).

In the beginning of the third quarter in 2006, we enhanced our liquidity policy. Since then, we have used one fundamental liquidity measure which focuses on secured liquidity and is used to closely monitor our liquidity position. This liquidity measure replaces the three less stringent liquidity measures described above. Under this new secured liquidity measure, the goal is to have sufficient secured (committed) liquidity to repay all maturing obligations for at least 360 days and at the same time maintain stable level of business without any access to capital markets. Eligible secured assets under the new secured liquidity calculations consist of deposits, bonds eligible for repurchase transactions, unused committed revolving credit facilities with maturities over one year without material adverse change clauses, and backup facilities with maturities over one year without material adverse change clauses.

Our liquidity risk is monitored centrally, with the exception of FIH, which monitors liquidity locally but in coordination with the group.

The table below shows our secured liquidity (maturing assets in excess of maturing liabilities) at December 31, 2007 and December 31, 2006.

	Up to 1 month	1-3 months	3-6 months	6-12 months	1-2 years
	(ISK billions)				
Secured liquidity at December 31, 2007.....	647	420	247	102	(566) <sup>(1)</sup>
Secured liquidity at December 31, 2006.....	856	573	360	121	(373)

(1) Only measured at year end.

We maintain a contingency funding plan which specifies an approach to analysing and responding to liquidity events and crises. Our plan provides a framework to estimate the likelihood of a liquidity event at Kaupthing and to determine its possible severity. The plan is part of our Internal Control and Procedural Handbook.

### **Interest Rate Risk**

Our operations are subject to the risk of interest rate fluctuations to the extent that interest-earning assets (including investments) and interest-bearing liabilities mature or reprice at different times or in differing amounts. In the case of floating rate assets and liabilities, we are also exposed to basis risk, which is the difference in repricing characteristics of various floating rate indices, such as the savings rate and six-month LIBOR. Our risk management activities are aimed at optimising net interest income, given market interest rate levels consistent with our business strategies. Interest rate risk is monitored centrally with duration reports and yield-curve stress testing for each currency.

The table below shows our interest rate risk by currency and maturity at year ended December 31, 2007. Risk is measured by assuming a 1 per cent. simultaneous increase in all yield curves in the relevant maturity band, measured in millions of Icelandic króna. Trading interest rate risk refers to exposures on the trading book where positions are marked-to-market and pre-tax profit or loss is recognised immediately. Banking interest rate risk refers to exposure on the banking book where pre-tax profit or loss is realised over the lifetime of the exposure.

		At December 31, 2007					
		Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
		(ISK millions)					
<b>Currency:</b>							
Icelandic króna .....	Trading	(1)	127	251	454	(579)	252
	Banking	13	(68)	(682)	1,724	(17,957)	(16,970)
Danish krone.....	Trading	36	70	116	(1,113)	(3,673)	(4,564)
	Banking	26	91	(12)	479	(1,679)	(1,095)
Euro .....	Trading	(111)	(112)	298	505	351	931
	Banking	65	139	349	648	(57)	1,144
Pounds Sterling.....	Trading	9	(85)	(14)	(15)	5	(101)
	Banking	40	185	(666)	(72)	(84)	(597)

		At December 31, 2007					
		Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
		(ISK millions)					
United States Dollar.....	Trading	(29)	(66)	(77)	(285)	125	(332)
	Banking	25	24	4	964	(115)	902
Swiss Franc.....	Trading	80	(7)	(193)	(11)	63	(68)
	Banking	(1)	213	(51)	2,022	(2,701)	(518)

At December 31, 2007, the total amount of the group's ISK-denominated inflation-linked assets was ISK 339,670 million and the total amount of the group's ISK-denominated inflation-linked liabilities was ISK 192,554 million.

In analysing net interest income, we have calculated net interest income under several different rate scenarios over a 12 month period. Our calculations include a case in which interest rates remain flat and cases with variations that occur when rates immediately increase 100 basis points and when rates immediately decrease 100 basis points. These rates also assume an immediate shift in all yield curves. The effect that a 100 basis point change in interest rates would have on our operating income as projected for the next twelve months beginning December 31, 2007 using a static balance sheet is estimated to be an ISK 3,852 million decrease in our operating income, assuming an instantaneous shift in all yield curves and static foreign exchange rates.

Interest rate risk increased significantly at the end of 2004 following the introduction of fixed-interest mortgage products in the retail market in Iceland. Those products remain the main source of interest rate risk within our group, and the risk has increased in recent years in line with the growth of the Icelandic mortgage portfolio. However, this is a hold-to-maturity portfolio in the banking book and therefore this interest rate risk will not be realised through the income statement.

### ***Operational Risk***

Operational risk is the risk of direct or indirect loss, or damage to our reputation. It can result from inadequate or failed internal processes or systems, human error, actions or omissions, or external events that affect our image, operations or share price. Strategic risk, reputation risk, legal risk, including litigation risk, and compliance risk are all types of operational risk. Operational risk is inherent in all activities within the group.

It is our policy to reduce the frequency and impact of operational risks in a cost-effective manner. We seek to achieve this by fostering internal controls, quality management, leadership skills and a well-educated, qualified staff. Our main process for identifying and monitoring operational risk is through the self-assessment of risk and control and through the recording of loss events, near misses and operational incidents. Each business unit regularly assesses its own risk and relevant controls and evaluates the possible impacts. If risk exceeds acceptable limits, then our internal controls and the quality and efficiency of the internal processes are re-evaluated to bring the risk within acceptable limits.

Our operational risk framework sets out the roles and responsibilities in relation to management and supervision, as well as the tools and methods we use to identify, measure, monitor and control operational risk. *Sound Practices for the Management and Supervision of Operational Risk*, published by the Basel Committee for Banking Supervision, provided us with guidance for the development of our operational risk framework to ensure rigorous and effective management and supervision.

The implementation of the operational risk framework is divided into five levels:

- documenting, reviewing and improving upon operational working processes, policies and internal rules;
- self-assessment of risk and control;
- identifying and then monitoring key risk indicators;
- collecting data regarding loss events and near misses; and
- analysis and reporting.

Each of our business units holds the primary responsibility for managing its own operational risk. However, the operational risk department is responsible for developing and maintaining our operational risk framework and providing guidance and support to our business units during the implementation of this framework. The operational risk department acts as a source of information on the development of operational risk. This department also tracks each unit's operational risk, and if any unit should exceed predefined risk limits, the head of the relevant unit would be notified. The operational risk department monitors the situation until the risk has been eliminated or reduced to acceptable levels.

The operational risk department works closely with each unit to ensure the management, identification, measurement and monitoring of our operational risk. The internal audit department conducts independent reviews of each business unit and provides an overview of the evaluation methods for operational risk. The department is responsible for evaluating our internal controls and procedures and ensuring that our operations are carried out in accordance with the policies and instructions of the

board of directors. We monitor operational risk through a system of internal controls established at different levels within the group. These controls are set out in our Internal Control and Procedural Handbook.

IT systems and information security are important components of operational risk management. In mid 2005, we started the implementation of ISO/IEC 27001:2005, the international standard for information security management promulgated by the International Organisation for Standardisation. We maintain this security policy to help ensure that our policies, processes, rules and controls over information, information systems and communication channels are sound and in accordance with best practice.

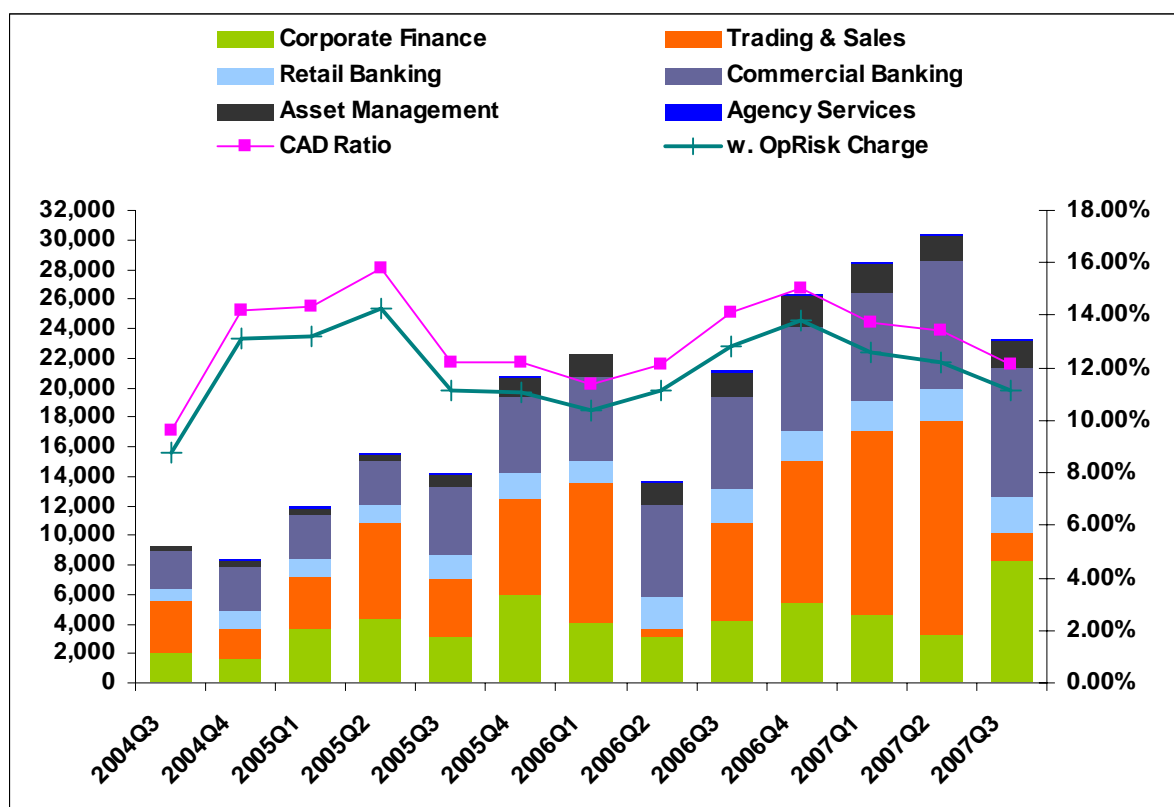
We have a specially appointed security committee responsible for implementing and maintaining this security policy, ensuring our compliance with the ISO/IEC 27001:2005 standard. We also have an information security officer, who is responsible for the day-to-day supervision of matters relating to our security policy, ensuring that IT systems, processes and internal rules comply with ISO/IEC 27001:2005 standards.

In addition, we have a crisis management plan to increase our resilience to disruptions in business arising from internal and/or external events. The crisis management plan seeks to reduce the impact of crises on our operations, reputation, profitability, clients, shareholders and our other stakeholders.

We have also taken out various insurance policies to cover major operational risk events.

## Operational Risk Analysis

We evaluate the capital charge due to operational risk applicable to us according to the Standardised Approach outlined in the new Capital Requirements Directive (CRD) of Basel II. However, at a later stage we intend to implement advanced methods for more risk-sensitive quantification of operational risk. In order to estimate the operational risk capital charge, our business segments are mapped onto the following six business lines according to Basel II standards: Corporate Finance refers to our Investment Banking segment, Trading and Sales refers to our Treasury and Capital Market segments, Retail Banking and Commercial Banking together refer to our Banking segment, Asset Management refers to our Asset Management and Private Banking segment and Agency Services refers to our Arion Custody Services (our subsidiary). According to the CRD, our Payment & Settlement and Retail Brokerage are included in the Trading and Sales business line. The chart below shows operational risk for each business line, according to the Basel II Standardised Approach described below.



## Basel II

The Basel II rules are a set of new, more risk-sensitive rules for capital requirement calculations that came into effect as of January 1, 2007. The Basel II rules define the minimum capital that a financial institution must hold for unexpected events. These rules also provide minimum qualitative standards and risk management practices that a financial institution should have in place. The current Basel II rules include capital requirements for operational risk in addition to credit risk and market risk, which are already covered in the Basel I rules.

The Basel II rules were developed by the Basel Committee for Banking Supervision to replace the Basel I rules. The committee's first proposal for revising the capital adequacy framework was published in June 1999. In November, 2005, the revised framework, the International Convergence of Capital Measurement and Capital Standards, was published. Based on the recommendations of the revised framework, the Basel II rules were ratified by the European Union in Directive 2006/48/EC, published in June 2006. The rules will be applicable to us beginning January 1, 2008.

The Basel II rules are represented by three "Pillars": Pillar I addresses the calculation of minimum regulatory capital requirements for credit, market and operational risk. Pillar II addresses the supervisory review process, the financial institution's capital adequacy assessment including other risks not addressed under Pillar I and the strategy for maintaining capital levels. Pillar III addresses market discipline and requirements regarding market disclosure of risk-related information.

Under Pillar I, financial institutions can choose from three approaches for the calculation of the credit risk capital: the Standardised method (which is similar to the Basel I rules), Foundation Internal Ratings-Based Approach (**IRB**) and Advanced IRB — the difference being the sophistication of the capital requirement calculations. Under Foundation IRB and Advanced IRB, the financial institution uses its own calculation of risk-related variables that serve as the input in the calculation of capital requirement. For operational risk, financial institutions can also choose from three approaches: the Basic Indicator approach, the Standardised Approach and the Advanced Measurement Approach (**AMA**) — the difference being the sophistication of methods and the processes required for operational risk monitoring and quantification.

We have applied to the FME for permission to use the Foundation IRB approach to determine our capital requirements for credit risk. We believe that the Foundation IRB approach will have minimal impact on our capital requirements. Under the Foundation IRB approach, a decrease in our loan portfolio risk will eliminate the increase in cost due to operational risk. Our aim is to begin using the Foundation IRB approach for calculation of risk weighted assets from 2008 by using our own estimation of probability of default parameters. We will start to use loss given default parameters (**LGD**) and credit conversion factors (**CCF**) as given in the CRD for all exposures except retail, where internal LGD and CCF will be used. We aim to have implemented all necessary internal models for credit risk calculation according to the Foundation IRB approach in the near future, and then apply for use of the Advanced IRB approach as soon as possible.

The FME is currently carrying out its supervisory review of the credit models we propose to use for Pillar I as well as various Pillar II requirements such as stress testing. Since the review has not yet been concluded, we cannot at this time quantify how the revised guidelines will affect our requirements for capital and the impact these changes will have on our capital position.

We have been fully involved in implementing Basel II rules since late 2004. However, the first rating models were introduced into part of our portfolio in December 2003. The focus in 2007 has been on application to the FME for the IRB Foundation approach method and fulfillment of Basel II requirements. A great deal of work has been expended on data preparation and collection of historical statistical analysis and model construction. With regard to operational risk, we have implemented the Standardised Approach, and aim towards the AMA in the future.

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

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

### **Board**

#### **Directors**

Sigurður Einarsson – Chairman of the Board of Directors. Born in 1960. Graduated as an economist from the University of Copenhagen in 1987. Joined Kaupthing Bank in 1994 and was appointed Executive Chairman in May 2003.

Hjörleifur Thor Jakobsson – Deputy Chairman of the Board of Directors. Born in 1957. Graduated from the Mechanical and Industrial Engineering department of the University of Iceland in 1981 and received his MSc in engineering from Oklahoma State University in 1982. Mr. Jakobsson currently acts as the CEO of Kjarlar hf which fully owns, through other subsidiaries, Egla Invest B.V. Elected to the board in 2003.

Niels de Coninck-Smith – Born in 1956. Graduated with a MSc in 1980 from the Copenhagen School of Economics and later received a masters in business administration from the Wharton School of the University of Pennsylvania in 1982. CEO of Ferrosan A/S. Elected to the board in 2005.

Brynja Halldórsdóttir – Born in 1957. Graduated with a degree in business administration from the University of Iceland in 1981. CFO of Norvik hf. Elected to the board in 2004.

Bjarnfredur H. Ólafsson – Born in 1967. Graduated with a Cand. Juris degree from the University of Iceland in 1993 and received a masters of law in comparative law from the University of Miami School of Law in 1997 and a degree in international business administration from Nova Southeastern University School of Business & Entrepreneurship in 1998. Attorney to the District Court of Iceland. He is a partner in Logos Legal Services and head of the tax division. Elected to the board in 2003.

Gunnar Páll Pálsson – Born in 1961. Graduated with a degree in business administration from the University of Iceland in 1987. CEO of Commercial Worker's Union of Reykjavik (VR). Elected to the board in 2001.

Tommy Persson – Born in 1948. CEO of Lansforsakringar AB and Chairman of the Swedish Insurance Federation and the Swedish Insurance Employers' Association. Elected to the board in 2002.

Ásgeir Thoroddsen – Born in 1942. Graduated with a Cand. Juris. degree from the University of Iceland in 1967 and received a degree in public administration from New York University in 1971. Attorney to the Supreme Court of Iceland. Elected to the board in 2003.

Antonios P. Yerole mou – Born in 1942, studied business administration at West London College of Commerce. He was the founder and CEO of Katsouris Fresh Foods Ltd. from 1982 to 2002. Mr Yerole mou currently serves as a non-executive director for a number of companies, including Bakkavör Group hf. Elected to the board in 2007.

#### **Alternative Directors**

Gudný Arna Sveinsdóttir – Born in 1966. Graduated with a degree in business administration from the University of Iceland in 1991 and received a MSc in finance and accounting from the University of Uppsala in 1996. Joined Kaupthing Bank in 2001 and serves now as Chief Financial Officer (CFO).

Hildur Árnadóttir – Born in 1966, she holds a business degree (Cand. oecon) from the University of Iceland from 1991 and became a certified public accountant in 1995. She is the Chief Financial Officer of Bakkavör Group hf.

Jónas Guðbjörnsson – Born in 1962, graduated with a degree in business administration (cand. oecon.) from the University of Iceland in 1987 and has been a certified public accountant since 1994. Mr. Guðbjörnsson joined Kjarlar hf. as a CFO in the beginning of 2007.

Kristin Pétursdóttir – Born in 1965, she has a B.Sc degree in economics and an MBA in international business. She recently left her executive position at Kaupthing after ten years and is now the CEO and co-founder of Audur Capital ehf.

Margeir Rúnar Danielsson – Born in 1941, graduated with the degree "Diplom Volkswirt" from the University of Kiel in 1970. He was the managing director of the pension fund Samvinnulífeyrissjóðurinn for 22 years and retired in 2006. He currently acts as a part time financial adviser to the pension fund Stafir.

María Sólbergisdóttir – Born in 1964, graduated with a degree in business administration from the University of Iceland in 1987 and received a license as a certified public accountant in 1993. Recently, Ms. Sólbergisdóttir joined Auður Capital hf as a chief operating officer after working for Kaupthing for 10 years.

Marta Eiríksdóttir – Born in 1957, graduated with a degree in Economics and Business Administration from the University of Iceland. Prior to that, she finished a B.Ed. degree from the University College of Education in Iceland. Ms. Eiríksdóttir is the CEO of Lítill heimur ehf. and Head of Marketing and Business Relations for Landsnet, which is the transmission service operator of electricity in Iceland.

Panikos Joannou Katsouris – Born in 1950, studied Economics at Southampton University in the UK, where he received a BSc in 1974. Mr. Katsouris is Managing Director of Katsouris Brothers Ltd, London. Mr. Katsouris is a member of the board of directors of several companies including Skipti ehf. and Síminn hf.

Thórdur Magnússon – Born in 1949, graduated with a business degree from the University of Iceland in 1974 and holds an MBA from the University of Minnesota. Mr. Magnússon is the CEO of Des fjárfestingarfélag ehf., chairman of the board of directors of Eyrir Invest ehf., Calidris ehf., Handtölvur – Gagnatækni ehf. and Marorka ehf. He is member of the board of various other companies including Byko hf., Össur hf. and Norvik hf.

The business address of each of the above persons is Borgartún 19, 105 Reykjavík, Iceland.

### **Senior Management**

Set forth below are details about our senior management. The business address of each is Borgartún 19, 105 Reykjavík, Iceland.

Hreidar Már Sigurdsson – Chief Executive Officer (**CEO**). Born in 1970. Graduated with a degree in business administration from the University of Iceland in 1994 and joined Kaupthing Bank later that year. Appointed CEO in 2003.

Gudný Arna Sveinsdóttir – Chief Financial Officer (**CFO**). – See biography above under "*—Board*"

Steingrímur Kárason – Chief Risk Officer. Born in 1968. Graduated with a degree in mechanical engineering from the University of Iceland in 1991 and received a MSc in engineering in 1993 and a Ph.D. in 1997, both from the Massachusetts Institute of Technology. Joined Kaupthing Bank in 1997.

Ásgrímur Skarphédinsson – Chief Information Officer. Born in 1958. Graduated with a degree in electrical engineering from Odense Teknikum in Denmark in 1982. Joined Kaupthing Bank in 1997.

Gudni Niels Adalsteinsson – Group Treasurer. Born in 1967. Graduated with a degree in economics from the University of Iceland in 1991 and received a MSc in business administration from Cambridge University in 1998. Joined Kaupthing Bank in 2005.

Jónas Sigurgeirsson – Chief Communications Officer (**CCO**). Born in 1968. Graduated with a degree in history from the University of Iceland in 1992 and received a MSc in business administration from the University of Tampa in 2000. Joined Kaupthing Bank in 2000.

Bjarki H. Diego – Chief Credit Officer. Mr Diego, born 1968, graduated with a Cand. Juris degree in Law from the University of Iceland in 1993 and later received an LL.M degree in International Business Law from the University College of London in 1999. Mr Diego joined Kaupthing Bank in 2000, he became our Chief Credit Officer in 2007.

### **CEOs of our Operational Units in Iceland and Denmark**

Set forth below are details about the CEO of Kaupthing Iceland and the CEO of FIH, but they are heads of the only operational units comprising more than 25per cent. of our equity or our profits. The business address of the CEO of Kaupthing Iceland in Iceland is Borgartún 19, 105 Reykjavík, Iceland and of the CEO of FIH Erhvervsbank A/S is Langelinie Allé 43, 2100 Copenhagen Ø, Denmark. .

Ingólfur Helgason—CEO of Kaupthing Bank hf. in Iceland. Born in 1967. Graduated with a degree in business administration from the University of Iceland in 1993, and became a licensed stockbroker in 1998. Joined Kaupthing Bank in 1993, assumed his current position in 2005.



Lars Johansen—CEO of FIH Erhvervsbank A/S. Born in 1945. Graduated with a masters degree in economics from the University of Copenhagen in 1970, followed by a PMD from Harvard Business School in 1984. Since 1998, Mr. Johansen has served as the CEO in FIH Erhvervsbank A/S.

As stated on page 35 our annual report 2007 which contains the auditor's report and the audited consolidated financial statements for the financial year ended 31 December 2007 is incorporated by reference into this Prospectus. Note 55 to the financial statements sets out the salaries, stock options and shareholdings at the end of 2007 of each member of our board of directors, senior management and CEO of our operating units in Iceland and Denmark.

### ***Potential Conflicts of Interest***

Except as described in this Prospectus, there are no potential conflicts of interest between any duties to our group of any member of the board of directors, our CEO, the CEO of Kaupthing Iceland or the CEO of FIH and their private interests or other duties, which includes any arrangement or understanding with major shareholders, customers, suppliers or others pursuant to which any of those persons was selected as a member of our group's administrative, management or supervisory bodies or a member of our senior management.

### **Internal Auditor**

Lilja Steinhórsdóttir – Internal Auditor. Born in 1949. Graduated with a degree in business administration from the University of Iceland in 1980. State Authorised Public Accountant in 1984. Received an MBA degree from the University of Edinburgh in 1998. She joined Kaupthing Bank in 2006.

### **State Authorised Public Accountants**

The state authorised public accountants of Kaupthing Bank are KPMG hf. and, on their behalf, Saemundur Valdimarsson.

Saemundur Valdimarsson – Born in 1963. State Authorised Public Accountant. Accountant of Kaupthing Bank from 2006.

## SUMMARY CONSOLIDATED FINANCIAL INFORMATION

Set out on the following pages are a two-year summary consolidated profit and loss account, balance sheet and key ratios for the Group prepared in accordance with IRFS.

### TWO-YEAR SUMMARY – THE GROUP

(ISK millions)

#### Income Statement Data

##### Profit and Loss

	<u>2007</u>	<u>2006</u>
Net interest income	80,113	52,362
Other operating income	<u>85,705</u>	<u>114,854</u>
Net operating income	<u>165,818</u>	<u>167,216</u>
Other operating expenses	-78,731	-60,006
Impairment	-6,180	-6,127
Taxes	<u>-9,716</u>	<u>-14,636</u>
<b>Net earnings</b>	<u><b>71,191</b></u>	<u><b>86,447</b></u>

Net shareholders' earnings	70,020	85,302
Minority interest	1,171	1,145

##### Balance Sheet

#### Assets

Cash and balances with central banks	97,959	106,961
Loans to credit institutions	588,441	485,334
Loans to customers	3,304,408	2,538,609
Bonds and debt instruments	367,350	318,264
Shares and equity instruments and financial assets available-for-sale	160,797	159,020
Derivatives	134,856	65,454
Derivatives used for hedging	22,503	6,453
Securities used for hedging	159,949	115,938
Investment in associates	83,831	5,304
Intangible assets	66,774	68,301
Investment property	28,155	31,584
Property and equipment	32,714	30,466
Tax assets	6,899	5,834
Non-current assets held for sale and other assets other assets	<u>292,709</u>	<u>117,874</u>
<b>Total assets</b>	<u><b>5,347,345</b></u>	<u><b>4,055,396</b></u>

#### Liabilities and equity

Deposits	1,381,457	750,657
Other liabilities	3,342,168	2,753,816
Minority interest	10,823	11,382
Subordinated loans	267,289	216,030
Shareholders' equity	<u>345,608</u>	<u>323,510</u>
<b>Total liabilities and equity</b>	<u><b>5,347,345</b></u>	<u><b>4,055,396</b></u>

**Key Ratios**

Cost / income ratio	47.5%	35.9%
Return on shareholders' equity	23.5%	42.4%
Impairment/loans	0.2%	0.2%
Total credit reserves	0.6%	0.6%
Price / earnings	9,2	6.6
Earnings per share, ISK	95,2	127,1
Earnings per share diluted, ISK	93,3	123,4
Average no. of shares outstanding, million	736	671
Avg. no. of shares outstanding diluted, million	751	691
No. of shares at end of year, million	737	732
No. of shares at end of year diluted, million	751	752
Share price at end of year	880	841

## DESCRIPTION OF THE FUND

Kaupthing Mortgages Institutional Investor Fund (the **Fund**) was established in Iceland on March 10, 2006 as an institutional investment fund pursuant to Article 4 of Act No 30/2003 on Undertaking for Collective Investment in Transferable Securities and Investment Funds (the **Act**).

The Fund's registration number is 570106-9610. The registered office of the Fund is at Borgartun 19, 105 Reykjavik, Iceland. The telephone number of the Fund's registered office is +354 444 6000.

The day-to-day operations of the Fund are managed by Kaupthing Bank Asset Management Company hf. (the **Management Company**) pursuant to the Fund's Articles of Association. The Asset Management Company's registration number is 700996-2479. The registered office of the Management Company is at Borgartun 19, 105 Reykjavik, Iceland. The telephone number of the Management Company's registered office is +354 444 6000. The Management Company is incorporated under the laws of Iceland and is a wholly-owned subsidiary of the Issuer. The principal activity of the Management Company consists of the management of the day-to-day operations of funds and other enterprises for mutual investment in transferable securities.

Arion Custody Services hf. has been appointed pursuant to the Fund's Articles of Association to provide certain administration and depository services to the Fund in accordance with a custody agreement entered into by it and the Management Company on behalf of the Fund. The Custody Agent's registration number is 470502-4520, The registered office of the Custody Agent is at Ármúli 13, 105 Reykjavik, Iceland. The telephone number of the Custody Agent's registered office is +354 528-2800.

The Fund has no subsidiaries or employees. Other than the Management Company and the Custody Agent, the Fund is dependent on the Servicer and the Cash Manager to provide certain management and administrative services to it, on the terms of the Transaction Documents.

The principal activities of the Fund are set out in the Fund Deed and include, *inter alia*, the ability to carry on the business of acquiring the Loans and their Related Security pursuant to the terms of the Mortgage Sale Agreement with a view to profit, to borrow money and to do all such things as are incidental or conducive to the carrying on of that business.

The Fund has not traded since the date of its establishment (other than those matters incidental to the establishment of this Programme), nor has it engaged since its establishment, and will not engage whilst the Covered Bonds or any Term Advance remains outstanding, in any material activities other than activities incidental to its establishment, activities contemplated under the Transaction Documents to which it is or will be a party and other matters which are incidental or ancillary to the foregoing.

There are no potential conflicts of interest between, on the one hand, any duties of the directors of the Management Company to the Fund and, on the other hand, their private interests or other duties.

There has been no material adverse change in the prospects of the Fund since December 31, 2006, being the date of its last audited accounts.

The Fund's accounting reference date is December 31, with the first statutory accounts drawn up to December 31, 2006 and its second statutory accounts being drawn up to December 31, 2007.

The Fund's accounts for each six month period from establishment in March 2006 and year end results for 2006 and 2007.

<i>(ISK Millions)</i>	<i>2007</i>	<i>01/01/07- 30/06/07</i>	<i>2006</i>	<i>01/01/06- 30/06/06</i>
<b>Profit and Loss</b>				
Interest income .....	8,160	4,293	5,727	2,769
Interest expenses.....	7,373	3,218	4,721	2,250
Net Interest income.....	787	1,075	1,006	519
Operating expenses.....	12	(12)	53	2
<b>Net earnings</b> .....	799	1,087	953	517
<b>Balance Sheet</b>				
Loans to credit institutions .....	6,471	5,613	3,549	1,288
Loans to customers .....	81,902	80,897	80,616	53,391
<b>Total assets</b> .....	88,374	86,510	84,165	54,679
Liabilities and equity				
Other liabilities .....	18	5	7	4
Subordinated loans .....	80,549	78,410	77,150	50,319
Shareholders' equity .....	7,807	8,095	7,008	4,356
<b>Total liabilities and equity</b> .....	88,374	86,510	84,165	54,679

## SUMMARY OF THE PRINCIPAL DOCUMENTS

**Due to the Fund's status as an institutional investment fund established pursuant to Article 4 of Act No. 30/2003 on Undertaking for Collective Investment in Transferable Securities and Investment Funds, the Management Company will execute each relevant Transaction Document on behalf of the Fund in accordance with the Articles of Association of the Fund.**

### **Representative and Agency Agreement**

The Representative and Agency Agreement, made between the Issuer, the Fund, the Representative and the Paying Agents on the February 29, 2008, is the principal agreement governing the Covered Bonds. The Representative and Agency Agreement contains provisions relating to, *inter alia*:

- the terms and conditions of the Covered Bonds (as more fully set out under *Terms and Conditions of the Covered Bonds* above);
- the forms of the Global Covered Bonds, definitive Covered Bonds, Receipts and Coupons;
- the covenants of the Issuer and the Fund;
- the terms of the Covered Bond Guarantee (as described below);
- the enforcement procedures relating to the Covered Bonds and the Covered Bond Guarantee;
- the appointment, powers and responsibilities of the Representative and the circumstances in which the Representative may resign, or retire or be removed;
- the indemnification of the Representative and its relief from liability in certain circumstances; and
- the ability of the Representative, in certain circumstances, to remove the Management Company and appoint a replacement Management Company.

### **Covered Bond Guarantee**

Under the terms of the Covered Bond Guarantee, if the Issuer defaults in the payment on the due date of any moneys due and payable under or pursuant to the Representative and Agency Agreement or the Covered Bonds or any Receipts or Coupons or if any other Issuer Event of Default occurs (other than by reason of non-payment), and, in either case, if the Representative has served an Issuer Acceleration Notice, the Fund has agreed (subject as described below) to pay or procure to be paid (following service of a Notice to Pay) unconditionally and irrevocably to or to the order of the Representative (for the benefit of the Covered Bondholders) an amount equal to that portion of the Guaranteed Amounts which shall become Due for Payment but would otherwise be unpaid, as of any Due for Payment Date, by the Issuer. Payment by the Fund of the Guaranteed Amounts pursuant to the Covered Bond Guarantee will be made on the later of (a) the day which is two Business Days following service of a Notice to Pay on the Fund and (b) the day on which the Guaranteed Amounts are otherwise Due for Payment (the **Guaranteed Amounts Due Date**). The Representative will be required to serve a Notice to Pay following the occurrence of an Issuer Event of Default and service of an Issuer Acceleration Notice.

Under the Covered Bond Guarantee, the Guaranteed Amounts will become due and payable on any earlier date on which, following the occurrence of a Fund Event of Default, a Fund Acceleration Notice is served in accordance with Condition 10.2. Following service of a Fund Acceleration Notice, the Covered Bonds will (if an Issuer Acceleration Notice has not already been served) become immediately due and payable as against the Issuer and the obligations of the Fund under the Covered Bond Guarantee will be accelerated.

All payments of Guaranteed Amounts by or on behalf of the Fund will be made without withholding or deduction for, or on account of, any present or future taxes or duties of whatever nature, unless the withholding or deduction of such taxes or duties are imposed or levied by or on behalf of any Tax Jurisdiction. If any such withholding or deduction is required, the Fund will pay the Guaranteed Amounts net of such withholding or deduction and shall account to the appropriate tax authority for the amount required to be withheld or deducted. The Fund will not be obliged to pay any amount to the Representative or any holder of Covered Bonds in respect of the amount of such withholding or deduction.

Under the terms of the Covered Bond Guarantee, the Fund has agreed that its obligations under the Covered Bond Guarantee shall be as principal debtor and not merely as surety and shall be absolute and unconditional (subject to Notice to Pay being

given), irrespective of, and unaffected by, any invalidity, irregularity or unenforceability of, or defect in, any provisions of the Representative and Agency Agreement or the Covered Bonds or Receipts or Coupons or the absence of any action to enforce the same or the waiver, modification or consent by the Representative or any of the Covered Bondholders, Receiptholders or Couponholders in respect of any provisions of the same or the obtaining of any judgment or decree against the Issuer or any action to enforce the same or any other circumstances which might otherwise constitute a legal or equitable discharge or defence of a guarantor.

Subject to the grace period specified in Condition 10.2(a) of the Terms and Conditions, failure by the Fund to pay the Guaranteed Amounts which are Due for Payment on the relevant Guaranteed Amounts Due Date will result in a Fund Event of Default.

The Representative and Agency Agreement provides that any Excess Proceeds shall be paid by the Representative on behalf of the Covered Bondholders of the relevant Series to the Fund for its own account, as soon as practicable, and shall be held by the Fund in the GIC Account, to be used in the same manner as all other moneys from time to time standing to the credit of the GIC Account. Any Excess Proceeds received by the Representative shall discharge *pro tanto* the obligations of the Issuer in respect of the Covered Bonds, Receipts and Coupons. However, the obligations of the Fund under the Covered Bond Guarantee are (following service of a Notice to Pay) unconditional and irrevocable and the receipt by the Representative of any Excess Proceeds shall not reduce or discharge any of such obligations.

By subscribing for Covered Bond(s), each Covered Bondholder shall be deemed to have irrevocably directed the Representative to pay the Excess Proceeds to the Fund in the manner as described above.

The Representative and Agency Agreement is governed by Icelandic law.

#### **Intercompany Loan Agreement**

On each Issue Date, the Issuer will lend to the Fund the gross proceeds from the issue by it of Covered Bonds by way of Term Advances that correspond to each Series of Covered Bonds to be issued by the Issuer on the relevant Issue Date pursuant to the Intercompany Loan Agreement. Each Term Advance will be used by the Fund:

- (a) as consideration (in whole or in part) for the acquisition of Loans and their Related Security from the Seller pursuant to the terms of the Mortgage Sale Agreement, as described under – *Mortgage Sale Agreement – Sale by the Seller of the Loans and Related Security*;
- (b) subject to an Asset Coverage Test Breach Notice not having been served (and not revoked) on the relevant Issue Date, to make Unit Distributions to Holders by way of a distribution of each Holder's holding of Units in the Fund in an amount equal to the ISK Equivalent of the Term Advance or any part thereof;
- (c) to invest in Substitution Assets in an amount not exceeding the prescribed limit;
- (d) if an existing Series, or part of an existing Series, of Covered Bonds is being refinanced by such issue of Covered Bonds, to repay the Term Advance(s) corresponding to the Covered Bonds being so refinanced; and/or
- (e) to make a deposit in the GIC Account.

Payments in respect of each Term Advance will be the same as on the corresponding Series or Tranche of Covered Bonds.

The Issuer will not be relying on repayment of any Term Advance in order to meet its repayment obligations under the Covered Bonds. The Fund will pay amounts due in respect of Term Advances(s) in accordance with the relevant Priorities of Payments. Prior to service of an Asset Coverage Test Breach Notice (which has not been revoked) or a Notice to Pay on the Fund, amounts due in respect of each Term Advance will be paid by the Fund to, or as directed by, the Issuer on each Interest Payment Date, subject to paying all higher ranking amounts in the Pre-Acceleration Priority of Payments. The Issuer may (but is not required to) use the proceeds of the Term Advance to pay amounts due on the Covered Bonds; any failure by the Fund to pay any amounts due on the Term Advances, however, will not affect the liability of the Issuer to pay the relevant amount due on the Covered Bonds. For so long as an Asset Coverage Test Breach Notice is outstanding and has not been revoked, the Fund may not borrow any new Term Advances from the Issuer under the Intercompany Loan Agreement.

The amounts owed by the Fund to the Issuer under the Term Advances will be reduced by (i) any amounts paid by the Fund under the terms of the Covered Bond Guarantee and (ii) the Principal Amount Outstanding of any Covered Bonds (the proceeds of which were originally applied to make such Term Advances) purchased by the Fund and cancelled in accordance with Condition 7.10.

The Intercompany Loan Agreement is governed by Icelandic law.

## **Mortgage Sale Agreement**

### ***The Seller***

Loans and their Related Security will be sold to the Fund from time to time pursuant to the terms of the Mortgage Sale Agreement entered into on the Programme Date between Kaupthing Bank hf. (in its capacity as Seller), the Fund and the Representative.

### ***Sale by the Seller of the Loans and Related Security***

The Portfolio will consist of the Loans and their Related Security sold from time to time by the Seller to the Fund in accordance with the terms of the Mortgage Sale Agreement. The types of Loans forming the Portfolio will vary over time provided that the Eligibility Criteria (as described below) in respect of such Loans are met on the relevant Assignment Date. Accordingly, the Portfolio may, at any time, include Loans with different characteristics from Loans that were included in the Portfolio or being offered to Borrowers on previous Assignment Dates.

Prior to the occurrence of an Issuer Event of Default and service of an Issuer Acceleration Notice or a Fund Event of Default and service of a Fund Acceleration Notice, the Fund will acquire the Loans and their Related Security from the Seller in certain circumstances, including the three circumstances described below.

- (a) *First*, in relation to the issue of Covered Bonds from time to time in accordance with the Programme, the Issuer will make Term Advances to the Fund, the proceeds of which may be applied in whole or in part by the Fund to acquire Loans and their Related Security from the Seller.
- (b) *Second*, the Fund will, in certain circumstances, use the Available Receipts to acquire New Loans and their Related Security from the Seller and/or Substitution Assets (in respect of any Substitution Assets up to the prescribed limit) on each Fund Payment Date.
- (c) *Third*, the Fund and the Seller are required to ensure that the Portfolio is maintained at all times in compliance with the Asset Coverage Test (as determined by the Cash Manager on each Calculation Date). If on any Calculation Date there is a breach of the Asset Coverage Test, the Seller will use all reasonable endeavours to offer to sell sufficient New Loans and their Related Security to the Fund on or before the next Calculation Date to ensure compliance with the Asset Coverage Test as at the next Calculation Date.

If an Issuer Event of Default has occurred but no liquidator or administrator has been appointed to the Seller, Loans and their Related Security may only be acquired from the Seller if the Seller has provided a solvency certificate to the Fund and the Representative.

In exchange for the sale of the Loans and their Related Security to the Fund, the Seller will receive an amount equal to the Outstanding Principal Balance of those Loans sold by it as at the Assignment Date, which will be satisfied by a combination of:

- (i) a cash payment to be made by the Fund from the ISK Equivalent of the proceeds of the relevant Term Advance and/or from Available Receipts; and/or
- (ii) the Seller being treated as having made an Equity Contribution in Kind in an amount up to the difference between the aggregate Outstanding Principal Balance of the Loans sold by the Seller as at the relevant Assignment Date and the cash payment (if any) made by the Fund in accordance with (i) above.

If Selected Loans and their Related Security are sold by or on behalf of the Fund as described below under *Fund Deed – Sale of Selected Loans and their Related Security following service of an Asset Coverage Test Breach Notice* and *Sale of Selected Loans and their Related Security following service of a Notice to Pay*, the obligations of the Seller insofar as they relate to those Selected Loans and their Related Security will cease to apply.

The Seller will also be required to repurchase Loans and their Related Security sold to the Fund in the circumstances described below under – *Repurchase of Loans*.



### ***Eligibility Criteria***

The sale of Loans and their Related Security to the Fund will be subject to various conditions (the **Eligibility Criteria**) being satisfied on the relevant Assignment Date. These are as follows:

- (a) there shall have been neither an Issuer Event of Default and service of an Issuer Acceleration Notice nor a Fund Event of Default and service of a Fund Acceleration Notice as at the relevant Assignment Date;
- (b) the Fund, acting on the advice of the Cash Manager, is not aware, and could not reasonably be expected to be aware, that the proposed purchase by the Fund of the Loans and their Related Security on the relevant Assignment Date would adversely affect the then current ratings assigned to the Covered Bonds by Moody's;
- (c) no Loan that is proposed to be sold to the Fund on the relevant Assignment Date has a loan-to-value ratio of more than 80 per cent.;
- (d) no Loan that is proposed to be sold to the Fund on the relevant Assignment Date has an Outstanding Principal Balance of more than ISK 50,000,000;
- (e) no Loan that is proposed to be sold to the Fund on the relevant Assignment Date relates to a Property which is not a residential Property and each Property is the primary residence of each Borrower and is owner-occupied;
- (f) no Loan that is proposed to be sold to the Fund on the relevant Assignment Date is in default for 90 days or more; and
- (g) the Seller has, since the making of each Loan, kept or procured the keeping of full and proper accounts, books and records showing clearly all transactions, payments, receipts, proceedings and notices relating to such Loan.

On the relevant Assignment Date, the Representations and Warranties (described below in – *Representations and Warranties*) will be given by the Seller in respect of the Loans and their Related Security sold by the Seller to the Fund.

### ***Transfer of Title to the Loans to the Fund***

The assignment, assignation or transfer (as appropriate) of the Loans and their Related Security as contemplated by the Mortgage Sale Agreement shall be perfected by the Seller on the relevant Assignment Date. Such perfection shall be effected by annotation by the Seller of the Mortgage Document. Notice of such assignment, assignation or transfer (as appropriate) will be given to the Borrower following the occurrence of certain circumstances.

### ***Representations and Warranties***

Neither the Fund nor the Representative has made or has caused to be made on its behalf any enquiries, searches or investigations in respect of the Loans and their Related Security to be sold to the Fund. Instead, each is relying entirely on the Representations and Warranties by the Seller contained in the Mortgage Sale Agreement. The parties to the Mortgage Sale Agreement may, with the prior written consent of the Representative (which consent will only be given if the Representative is satisfied, acting reasonably, that there will be no adverse effect on the then current ratings of the Covered Bonds as a result thereof), amend or waive the Representations and Warranties in the Mortgage Sale Agreement. The material Representations and Warranties are as follows and are given on the relevant Assignment Date in respect of the Loans and Related Security to be sold to the Fund only on that date:

- each Loan was originated by the Seller in ISK and is denominated in ISK;
- no Loan has an Outstanding Principal Balance of more than ISK 50,000,000;
- each Loan was originated on or after August 20, 2004;
- each Loan matures for repayment no later than January 1, 2049;
- prior to the making of each advance under a Loan, the Lending Criteria and all preconditions to the making of that Loan were satisfied in all material respects subject only to exceptions as would be acceptable to a Reasonable, Prudent Mortgage Lender;
- prior to the making of each advance under a Loan, the requirements of the relevant Standard Documentation were met, so far as applicable to that Loan;

- other than with respect to Monthly Payments, no Borrower is, in material breach of any obligation owed in respect of the relevant Loan or under the Related Security and currently no steps have been taken by the Seller to enforce any Related Security;
- the total amount of Arrears of Interest or arrears of principal, together with any fees, commissions and premiums payable at the same time as such interest payment or principal repayment, on any Loan is not on the relevant Assignment Date in respect of such Loan three or more times the Monthly Payment payable in respect of such Loan in respect of the month in which that Assignment Date falls;
- all of the Borrowers are individuals and were aged 18 years or older at the date of entering into the relevant Loan and its Related Security;
- each Borrower has made at least one Monthly Payment;
- interest on each Loan is charged in accordance with the Standard Documentation;
- interest on each Loan is payable monthly in arrears;
- each Loan complies fully with the Consumer Credit Act No.121 from 1994;
- the whole of the Outstanding Principal Balance on each Loan and any Arrears of Interest and all Accrued Interest is secured by a Mortgage;
- each Mortgage constitutes a valid and subsisting first charge by way of legal mortgage or first ranking standard security over the relevant Property and may also constitute a valid and subsisting second charge by way of legal mortgage over a Property in the Portfolio over which a first charge is also taken;
- each Loan and its Related Security is valid and binding and enforceable in accordance with its terms;
- all of the Properties are residential properties situated in Iceland;
- except (a) in the case of certain Loans which have a low loan-to-value ratio (being about 50 per cent.) and (b) where the valuation of the relevant Property is easily determined by using publicly available sources, not more than six months (or such longer period as would be acceptable to a Reasonable, Prudent Mortgage Lender) prior to the grant of each Mortgage, the Seller received a Valuation Report on the relevant Property (or such other form of report concerning the valuation of the relevant Property as would be acceptable to a Reasonable, Prudent Mortgage Lender), the contents of which were such as would be acceptable to a Reasonable, Prudent Mortgage Lender;
- the benefit of all Valuation Reports, any other valuation report referred to above (if any) can be validly assigned to the Fund without obtaining the consent of the relevant valuer;
- insurance cover for each Property is or will at all times be available under a policy arranged by the Borrower in accordance with the relevant Mortgage Conditions;
- the Seller has, since the making of each Loan, kept or procured the keeping of full and proper accounts, books and records showing clearly all transactions, payments, receipts, proceedings and notices relating to such Loan;
- neither the Seller nor any of its agents has received written notice of any litigation or dispute (subsisting, threatened or pending) in respect of any Borrower, Property or Mortgage which might have a material adverse effect on a Loan or its Related Security;
- there are no authorisations, approvals, licences or consents required as appropriate for the Seller to enter into or to perform the obligations under the Mortgage Sale Agreement or to make the Mortgage Sale Agreement legal, valid, binding, enforceable and admissible in evidence;
- the Seller has good title to, and is the absolute unencumbered legal owner of, all interests, rights and benefits agreed to be sold by the Seller to the Fund pursuant to the Mortgage Sale Agreement free and clear of all mortgages, securities, charges, liens, encumbrances, claims and equities.

### ***Repurchase of Loans***

If the Seller receives a Loan Repurchase Notice from the Fund identifying a Loan or its Related Security in the Portfolio which did not, as at the relevant Assignment Date, materially comply with the Representations and Warranties set out in the

Mortgage Sale Agreement, then the Seller will be required to repurchase (a) any such Loan and its Related Security and (b) any other Loan secured or intended to be secured by that Related Security or any part of it. The repurchase price payable upon the repurchase of any such Loan is an amount (not less than zero) equal to the Outstanding Principal Balance thereof and all Arrears of Interest and Accrued Interest relating thereto plus any amounts deducted from the amounts outstanding under such Loan in accordance with the Mortgage Sale Agreement as at the relevant repurchase date. The repurchase proceeds received by the Fund will be applied (other than Accrued Interest and Arrears of Interest) in accordance with the Pre-Acceleration Priority of Payments; see *Cashflows* below.

#### ***General ability to repurchase***

Prior to the occurrence of an Issuer Event of Default and service of an Issuer Acceleration Notice or a Fund Event of Default and service of a Fund Acceleration Notice, the Seller may from time to time offer to repurchase a Loan and its Related Security from the Fund for a purchase price of not less than the aggregate Outstanding Principal Balance of the relevant Loan and all Arrears of Interest and Accrued Interest relating thereto. The Fund may accept such offer at its discretion. If an Issuer Event of Default has occurred but no liquidator or administrator has been appointed to the Seller, the Seller's right to repurchase Loans and their Related Security will be conditional upon the delivery by the Seller of a solvency certificate to the Fund and the Representative.

#### ***Defaulted Loans***

Defaulted Loans will be attributed a reduced weighting in the calculation of the Asset Coverage Test as at the relevant Calculation Date. Prior to the occurrence of an Issuer Event of Default and service of an Issuer Acceleration Notice or a Fund Event of Default and service of a Fund Acceleration Notice, the Seller may, at its option, offer to repurchase a Defaulted Loan for an amount equal to its Outstanding Principal Balance and all Arrears of Interest and Accrued Interest relating thereto as at the date of repurchase. The Fund may accept such offer at its discretion. If an Issuer Event of Default has occurred but no liquidator or administrator has been appointed to the Seller, the Seller's right to repurchase Defaulted Loans and their Related Security will be conditional upon the delivery by the Seller of a solvency certificate to the Fund and the Representative.

#### ***Right of Pre-emption***

Under the terms of the Mortgage Sale Agreement, the Seller has a right of pre-emption in respect of any sale, in whole or in part, of Selected Loans and their Related Security.

The Fund will serve on the Seller a Selected Loan Offer Notice offering to sell those Selected Loans and their Related Security for an offer price at least equal to (a) where the Selected Loan Offer Notice is given following the service of an Asset Coverage Test Breach Notice but prior to the service of a Notice to Pay, the then Outstanding Principal Balance of the Selected Loans and all Arrears of Interest and Accrued Interest relating thereto and (b) where the Selected Loan Offer Notice is given following the service of a Notice to Pay, the greater of the then Outstanding Principal Balance of the Selected Loans and all Arrears of Interest and Accrued Interest relating thereto and the Required Redemption Amount, in each case subject to the offer being accepted by the Seller within ten Business Days. If an Issuer Event of Default has occurred but no liquidator or administrator has been appointed to the Seller, the Seller's right to accept the offer (and therefore its right of pre-emption) will be conditional upon the delivery by the Seller of a solvency certificate to the Fund and the Representative. If the Seller rejects the Fund's offer or fails to accept it in accordance with the foregoing, the Fund will offer to sell the Selected Loans and their Related Security to other Purchasers (as described under – *Fund Deed – Sale of Selected Loans in the Portfolio following the service of a Notice to Pay* below).

If the Seller validly accepts the Fund's offer to sell the Selected Loans and their Related Security, the Fund will, within three Business Days of such acceptance, serve a Selected Loan Repurchase Notice on the Seller. The Seller will sign and return a duplicate copy of the Selected Loan Repurchase Notice and will repurchase from the Fund the relevant Selected Loans and their Related Security (and any other Loan secured or intended to be secured by that Related Security or any part of it) referred to in the relevant Selected Loan Repurchase Notice. Completion of the purchase of the Selected Loans and their Related Security by the Seller will take place on the Fund Payment Date next occurring after receipt of the Selected Loan Repurchase Notice or such date as the Fund may direct in the Selected Loan Repurchase Notice (provided that, where a Notice to Pay has been served, such date is not later than the earlier to occur of the date which is (a) ten Business Days after receipt by the Fund of the returned Selected Loan Repurchase Notice and (b) the Final Maturity Date of the Earliest Maturing Covered Bonds).

### ***New Sellers***

In the future, it is expected that New Sellers may accede to the Programme and sell loans and their related security to the Fund. Any such New Seller will be required to enter into a New Mortgage Sale Agreement, which will be in substantially the same form and contain substantially the same provisions as the Mortgage Sale Agreement entered into on the Programme Date between the Seller, the Fund and the Representative. The sale of New Seller Loans and their Related Security by New Sellers to the Fund will be subject to certain conditions, including the following:

- each New Seller accedes to the terms of the Fund Deed (with such subsequent amendments as may be agreed by the parties thereto) so that it has, in relation to those New Seller Loans and their Related Security to be sold by the relevant New Seller, substantially the same rights and obligations as the Seller had in relation to those Loans and their Related Security comprised in each New Portfolio under the Fund Deed;
- each New Seller enters into a New Mortgage Sale Agreement with the Fund and the Representative, in each case so that it has, in relation to those New Seller Loans and their Related Security to be sold by the relevant New Seller, substantially the same rights and obligations as the Seller had in relation to those Loans and their Related Security comprised in each New Portfolio under the Mortgage Sale Agreement entered into on the Programme Date between the Seller, the Fund and the Representative;
- each New Seller accedes to such Transaction Documents and enters into such other documents as may be required by the Representative, the Fund and/or the Cash Manager (in each case acting reasonably) to give effect to the addition of a New Seller to the transactions contemplated under the Programme;
- any New Seller Loans and their Related Security sold by a New Seller to the Fund comply with the Eligibility Criteria set out in the New Mortgage Sale Agreement;
- either the Servicer services the New Seller Loans and their Related Security sold by a New Seller on the terms set out in the Servicing and Custody Agreement (with such subsequent amendments as may be agreed by the parties thereto) or the New Seller (or its nominee) enters into a servicing agreement with the Fund and the Representative which sets out the servicing obligations of the New Seller (or its nominee) in relation to the New Seller Loans and their Related Security and which is on terms substantially similar to the terms set out in the Servicing and Custody Agreement (provided that the fees payable to the Servicer or the New Seller (or its nominee) acting as servicer of such New Seller Loans and their Related Security would be determined on or around the date of the accession of the New Seller to the Programme); and
- the Representative is satisfied that any modifications to the Transaction Documents in order to accommodate the accession of a New Seller to the Programme will not be materially prejudicial to the interests of any of the Covered Bondholders and has received a Rating Agency Confirmation that the then current ratings of the Existing Covered Bonds will not be adversely affected by the accession of a New Seller.

If the above conditions are met, the consent of Covered Bondholders will not be required in relation to the accession of a New Seller to the Programme.

The Mortgage Sale Agreement is governed by Icelandic law.

### **Servicing and Custody Agreement**

Pursuant to the terms of the Servicing and Custody Agreement entered into on the Programme Date between the Seller, the Fund, the Servicer, the Custody Agent and the Representative, the Servicer has agreed to service, on behalf of the Fund, the Loans and their Related Security comprised in the Portfolio and the Custody Agent has agreed to provide the services specified in Article 20 of Act No 30/2003 on Undertakings for Collective Investments in Transferable Securities and Investment Funds (the Act). For the avoidance of doubt, the Servicer shall not provide any services which the Management Company or the Custody Agent is obliged to provide to the Fund as a matter of Icelandic law and/or pursuant to the terms of the Articles of Association of the Fund.

The Servicer will be required to administer the Loans and their Related Security in accordance with the Servicing and Custody Agreement:

- (a) as if the Loans and their Related Security sold by the Seller to the Fund had not been sold to the Fund but remained with the Seller; and

- (b) in accordance with the Seller's administration, arrears and enforcement policies and procedures forming part of the Seller's Policy from time to time as they apply to those Loans.

The Servicer's actions in servicing the Loans in accordance with its procedures will be binding on the Fund, the Seller and the Covered Bondholders.

The Servicer will have the power to exercise the rights, powers and discretions and to perform the duties of the Fund and the Seller (according to their respective estates and interests) in relation to the Loans and their Related Security that it is servicing pursuant to the terms of the Servicing and Custody Agreement, and to do anything which it reasonably considers necessary, convenient or incidental to the administration of the Loans and their Related Security.

#### ***Right of delegation by the Servicer***

The Servicer may from time to time sub-contract or delegate the performance of its duties under the Servicing and Custody Agreement, provided that it will nevertheless remain responsible for the performance of those duties to the Fund and the Representative and, in particular, will remain liable at all times for servicing the Loans and their Related Security and for the acts or omissions of any delegate or subcontractor. Any such sub-contracting or delegation may be varied or terminated at any time by the Servicer.

#### ***Undertakings of the Servicer***

Pursuant to the terms of the Servicing and Custody Agreement, the Servicer will undertake in relation to those Loans and their Related Security that it is servicing, *inter alia*, to:

- keep records and books of account on behalf of the Fund in relation to the Loans and their Related Security;
- keep the Customer Files in its possession in safe custody and maintain records necessary to enforce each Mortgage and to provide the Fund, the Representative and the Custody Agent with access to the Customer Files and other records relating to the administration of the Loans and their Related Security in its possession;
- keep and maintain records in respect of the Portfolio for the purposes of identifying amounts paid by each Borrower, any amount due from a Borrower and the Outstanding Principal Balance of each Loan and such other records as would be kept by a Reasonable, Prudent Mortgage Lender;
- provide to the Fund, the Representative and Moody's a report on a monthly basis containing information about the Loans and their Related Security comprised in the Portfolio;
- provide to each beneficial owner of any Covered Bonds issued under the Programme a monthly report in the same form as that provided above to the Fund, the Representative and the Rating Agency;
- assist the Cash Manager in the preparation of a Monthly Asset Coverage Report in accordance with the Cash Management Agreement;
- take all reasonable steps to recover all sums due to the Fund, including instituting proceedings and enforcing any relevant Loan or its Related Security using the discretion of a Reasonable, Prudent Mortgage Lender in applying the enforcement procedures forming part of the Seller's policy; and
- enforce any Loan which is in default in accordance with the Seller's enforcement procedures or, to the extent that such enforcement procedures are not applicable having regard to the nature of the default in question, with the procedures that would be undertaken by a Reasonable, Prudent Mortgage Lender on behalf of the Fund.

The Servicer also undertakes that, on the Servicer ceasing to be assigned a long-term, unsecured, unguaranteed and unsubordinated debt obligation rating by Moody's of at least Baa2, it will use reasonable endeavours to enter into a new or a master servicing agreement (in such form as the Fund and the Representative shall reasonably require) with a third party within 60 days under which such third party will undertake the servicing obligations in relation to the Portfolio.

#### ***Remuneration***

The Fund shall pay to the Servicer an administration fee (inclusive of applicable taxes) for its services. Such administration fee shall be calculated in relation to each Calculation Period shall be payable to the Servicer in arrear on each Fund Payment Date.

### ***Removal or resignation of the Servicer***

The Fund and the Representative may, upon written notice to the Servicer, terminate the Servicer's appointment under the Servicing and Custody Agreement if any of the following events (each a **Servicer Termination Event** and, each of the first three events set out below, a **Servicer Event of Default**) occurs and while such event continues:

- the Servicer defaults in the payment on the due date of any amount due and payable by it under the Servicing and Custody Agreement and does not remedy that default for a period of three Reykjavik Business Days after the earlier of the Servicer becoming aware of the default or receipt by the Servicer of written notice from the Representative or the Fund requiring the default to be remedied;
- the Servicer defaults in the performance or observation of any of its other covenants and obligations under the Servicing and Custody Agreement, which default in the reasonable opinion of the Representative is materially prejudicial to the interests of the Covered Bondholders, and does not remedy that default within five Reykjavik Business Days after the earlier of the Servicer becoming aware of the default or receipt by the Servicer of written notice from the Fund and the Representative requiring the default to be remedied, provided however that where the relevant default occurs as a result of a default by any person to whom the Servicer has sub-contracted or delegated part of its obligations under the Servicing and Custody Agreement, such default shall not constitute a Servicer Termination Event if, within such period of five Reykjavik Business Days of receipt of such notice from the Fund and the Representative, the Servicer terminates the relevant sub-contracting or delegation arrangements and takes such steps as the Fund and the Representative may specify to remedy such default or to indemnify the Fund against the consequences of such default;
- an Insolvency Event occurs in relation to the Servicer;
- neither the Servicer nor a directly or indirectly wholly-owned subsidiary of the Servicer is servicing the Portfolio pursuant to the Servicing and Custody Agreement; or
- an Insolvency Event occurs in relation to any person to whom the Servicer has sub-contracted or delegated part of its obligations and the Servicer has not subsequently terminated such subcontracting or delegation within five Reykjavik Business Days.

Subject to the fulfilment of a number of conditions, the Servicer may voluntarily resign by giving not less than six months' written notice to the Representative and the Fund provided that a substitute servicer with capability of administering residential mortgages in Iceland has been appointed and enters into a servicing and custody agreement with the Fund, the Representative and the Custody Agent substantially on the same terms as the Servicing and Custody Agreement. The resignation of the Servicer is conditional on the resignation having no adverse effect on the then current ratings of the Covered Bonds unless the Covered Bondholders agree otherwise by Extraordinary Resolution.

If the appointment of the Servicer is terminated, the Servicer must deliver the Customer Files relating to the Loans comprised in the Portfolio in its possession to, or at the direction of, the Fund. The Servicing and Custody Agreement will terminate at such time as the Fund has no further interest in any of the Loans or their Related Security serviced under the Servicing and Custody Agreement that have been comprised in the Portfolio.

The Representative shall not be obliged to act as servicer in any circumstances.

### ***Custody Agent Services***

The Custody Agent will be required to provide certain services to the Fund as detailed in Article 20 of the Act. In providing such services the Custody Agent may, subject to certain requirements being satisfied, use a Central Securities Depository and/or subcontract or delegate the performance of its duties under the Servicing and Custody Agreement, provided that it will nevertheless remain responsible for the performance of those duties to the Fund and the Representative.

The Fund shall pay, on each Fund Payment Date, to the Custody Agent a fee as agreed upon in writing from time to time by the Custody Agent and the Fund, such fee previously being agreed by the Representative.

The Fund and the Representative may, upon written notice to the Custody Agent, terminate the Custody Agent's appointment under the Servicing and Custody Agreement if any of the events set out above as Servicer Termination Events occur in respect of the Custody Agent. Subject to the fulfilment of a number of conditions the Custody Agent may voluntarily resign by giving not less than six months' written notice to the Representative and the Fund provided that a substitute custody agent with

capability of performing the services required to be performed by the Custody Agent has been appointed and enters into a servicing and custody agreement with the Fund, the Representative and the Servicer substantially on the same terms of the Servicing and Custody Agreement.

The Servicing and Custody Agreement is governed by Icelandic law.

### **Asset Monitor Agreement**

Under the terms of the Asset Monitor Agreement entered into on the Programme Date between the Asset Monitor, the Fund, the Cash Manager, the Issuer and the Representative, the Asset Monitor has agreed, subject to due receipt of the information to be provided by the Cash Manager to the Asset Monitor, to conduct tests in respect of the arithmetical accuracy of the calculations performed by the Cash Manager, prior to service of a Notice to Pay or a Fund Acceleration Notice, on the Calculation Date immediately prior to each anniversary of the Programme Date with a view to confirmation of compliance by the Fund with the Asset Coverage Test on that Calculation Date. If and for so long as the short-term, unsecured, unsubordinated and unguaranteed debt obligations rating of the Cash Manager or the Issuer are below P-1 by Moody's, or following the service of an Asset Coverage Test Breach Notice (which has not been revoked), the Asset Monitor will, subject to receipt of the relevant information from the Cash Manager, be required to conduct such tests following each Calculation Date.

Following a determination by the Asset Monitor of any errors in the arithmetical accuracy of the calculations performed by the Cash Manager such that the Asset Coverage Test has been failed on the applicable Calculation Date (where the Cash Manager had recorded it as being satisfied) or the Adjusted Aggregate Loan Amount is mis-stated by an amount exceeding one per cent. of the Adjusted Aggregate Loan Amount (as at the date of the relevant Asset Coverage Test), the Asset Monitor will be required to conduct such tests following each Calculation Date for a period of six months thereafter.

The Asset Monitor is entitled, except in certain limited circumstances, to assume that all information provided to it by the Cash Manager for the purpose of conducting such tests is true and correct and not misleading, and is not required to conduct a test or otherwise take steps to verify the accuracy of any such information. The Asset Monitor Report will be delivered to the Cash Manager, the Fund, the Issuer and the Representative.

As at the Programme Date, the Fund will pay to the Asset Monitor a fee in an amount estimated to be equal to ISK 1,000,000 excluding VAT per test for the tests to be performed by the Asset Monitor.

The Fund may, at any time, but subject to the prior written consent of the Representative, terminate the appointment of the Asset Monitor by giving at least 90 days' prior written notice to the Asset Monitor, provided that such termination may not be effected unless and until a replacement asset monitor has been found by the Fund (such replacement to be approved by the Representative (such approval to be given if the replacement is an accountancy firm of national standing)) which agrees to perform the duties of the Asset Monitor set out in the Asset Monitor Agreement (or substantially similar duties).

The Asset Monitor may, at any time, resign by giving at least 90 days' prior written notice to the Fund and the Representative, and may resign by giving immediate notice in the event of a professional conflict of interest caused by the action of any recipient of its reports.

Upon giving notice of resignation, the Fund shall immediately use its reasonable endeavours to appoint a replacement (such replacement to be approved by the Representative) which agrees to perform the duties of the Asset Monitor set out in the Asset Monitor Agreement. If a replacement is not appointed by the date which is 90 days prior to the date when tests are to be carried out in accordance with the terms of the Asset Monitor Agreement, then the Fund shall use all reasonable endeavours to appoint an accountancy firm of national standing to carry out the relevant tests on a one-off basis, provided that such appointment is approved by the Representative.

The Representative shall not be obliged to act as Asset Monitor in any circumstances.

The Asset Monitor Agreement is governed by Icelandic law.

### **Fund Deed**

#### ***Equity Contributions***

From time to time the Seller (in its capacity as a Holder) will make Equity Contributions to the Fund. Equity Contributions may be made in cash or in kind (e.g. through a contribution of Loans to the Fund). The Equity Contributions of the Seller shall be calculated in ISK on each Calculation Date as the difference between (a) the Outstanding Principal Balance of Loans

in the Portfolio as at the last day of the preceding Calculation Period plus Revenue Receipts standing to the credit of the Revenue Ledger on the GIC Account plus the principal amount of Substitution Assets and Authorised Investments as at the last day of the preceding Calculation Period and (b) the ISK Equivalent of the aggregate Principal Amount Outstanding under the Covered Bonds as at the last day of the preceding Calculation Period. The Fund Deed does not impose any limit on the amount of Equity Contributions the Seller (in its capacity as a Holder) may make to the Fund from time to time. Cash Equity Contributions will normally be credited to the Revenue Ledger or the GIC Account and be applied as Available Receipts. However, the Seller shall be entitled to require that the Fund Transfer Cash Transfer Equity Contributions to the Reserve Ledger of the GIC Account so that they may be applied as Available Receipts.

Equity Contributions or Unit Distributions shall only be paid to Holders after the Fund has paid or, as applicable, provided for all higher ranking amounts in the relevant Priority of Payments.

#### **Asset Coverage Test**

Under the terms of the Fund Deed, the Fund must ensure that on each Calculation Date, the Adjusted Aggregate Loan Amount is in an amount at least equal to the ISK Equivalent of the aggregate Principal Amount Outstanding of the Covered Bonds as calculated on the relevant Calculation Date.

If on any Calculation Date the Adjusted Aggregate Loan Amount is less than the ISK Equivalent of the aggregate Principal Amount Outstanding of all Covered Bonds as calculated on the relevant Calculation Date, then the Fund (or the Cash Manager on its behalf) will notify the Seller and the Representative thereof and the Seller will use all reasonable endeavours to sell sufficient further Loans and their Related Security to the Fund in accordance with the Mortgage Sale Agreement (see *Summary of the Principal Documents – Mortgage Sale Agreement – Sale by Seller of Loans and their Related Security*) or provide Equity Contributions to ensure that the Asset Coverage Test is met on the next following Calculation Date. If the Adjusted Aggregate Loan Amount is less than the ISK Equivalent of the aggregate Principal Amount Outstanding of all Covered Bonds on the next following Calculation Date, the Asset Coverage Test will be breached and the Representative will serve an Asset Coverage Test Breach Notice on the Fund. The Representative shall revoke an Asset Coverage Test Breach Notice if, on any Calculation Date falling on or prior to the second Calculation Date following the service of an Asset Coverage Test Breach Notice the Asset Coverage Test is subsequently satisfied and neither a Notice to Pay nor a Fund Acceleration Notice has been served.

Following service of an Asset Coverage Test Breach Notice (which has not been revoked):

- (a) the Fund will be required to sell Selected Loans (as described further under *Fund Deed – Sale of Selected Loans and their Related Security following service of an Asset Coverage Test Breach Notice*);
- (b) prior to the occurrence of an Issuer Event of Default and service of an Issuer Acceleration Notice or, if earlier, the occurrence of a Fund Event of Default and service of a Fund Acceleration Notice, the Pre-Acceleration Priority of Payments will be modified as more particularly described in *Allocation and distribution of Available Receipts following service of an Asset Coverage Test Breach Notice* below; and
- (c) the Issuer will not be permitted to make to the Fund, and the Fund will not be permitted to borrow from the Issuer, any new Term Advances under the Intercompany Loan Agreement.

If an Asset Coverage Test Breach Notice has been served and not revoked on or before the second Calculation Date after service of such Asset Coverage Test Breach Notice, then an Issuer Event of Default shall occur and the Representative shall be entitled (and, in certain circumstances may be required) to serve an Issuer Acceleration Notice. Following service of an Issuer Acceleration Notice, the Representative will be required to serve a Notice to Pay on the Fund.

For the purposes hereof:

**Adjusted Aggregate Loan Amount** means the amount calculated on each Calculation Date as follows:

$$\propto A + B + C + D - W$$

where,

A = the sum of the **Adjusted Outstanding Principal Balance** of each Loan in the Portfolio as at the relevant Calculation Date, which shall be the lower of:



- (i) the actual Outstanding Principal Balance of the relevant Loan in the Portfolio (but, for this purpose, not including any principal payment relating to any such Loan which is scheduled for repayment at any time after the date on which there are no outstanding Covered Bonds), as adjusted for changes in the Icelandic consumer price index, as calculated on the relevant Calculation Date; and
- (ii) the Collateral Valuation relating to that Loan multiplied by M (where for all Loans that are not in default, M = 0.80, for all Loans that have been in default for less than 30 days and have an Outstanding Principal Balance to Collateral Valuation ratio of less than or equal to 80 per cent., M = 0.60, for all Loans that have been in default for more than 30 days but less than 90 days and have an Outstanding Principal Balance to Collateral Valuation ratio of less than or equal to 80 per cent., M = 0.35) and for all other Loans, M = 0,

*minus*

the aggregate sum of the following deemed reductions to the aggregate Adjusted Outstanding Principal Balance of the Loans in the Portfolio if any of the following occurred during the previous Calculation Period:

- (1) a Loan or its Related Security was, in the immediately preceding Calculation Period, in breach of the Representations and Warranties contained in the Mortgage Sale Agreement or subject to any other obligation of the Seller to repurchase the relevant Loan and its Related Security, and in each case the Seller has not repurchased the Loan or Loans of the relevant Borrower and its or their Related Security to the extent required by the terms of the Mortgage Sale Agreement. In this event, the aggregate Adjusted Outstanding Principal Balance of the Loans in the Portfolio (as calculated on the relevant Calculation Date) will be deemed to be reduced by an amount equal to the Adjusted Outstanding Principal Balance of the relevant Loan or Loans (as calculated on the relevant Calculation Date) of the relevant Borrower; and/or
- (2) the Seller, in the preceding Calculation Period, was in breach of any other material warranty under the Mortgage Sale Agreement and/or the Servicer was, in the preceding Calculation Period, in breach of a material term of the Servicing and Custody Agreement. In this event, the aggregate Adjusted Outstanding Principal Balance of the Loans in the Portfolio (as calculated on the relevant Calculation Date) will be deemed to be reduced by an amount equal to the expected financial loss incurred by the Fund in the immediately preceding Calculation Period (such financial loss to be calculated by the Cash Manager without double counting and to be reduced by any amount paid (in cash or in kind) to the Fund by the Seller to indemnify the Fund for such financial loss);

B = the aggregate amount of any Revenue Receipts on the Loans in the Portfolio up to the end of the immediately preceding Calculation Period (as recorded in the Revenue Ledger) which have not been applied as at the relevant Calculation Date to acquire further Loans and their Related Security or otherwise applied in accordance with the Fund Deed and/or the other Transaction Documents (including, for the avoidance of doubt, any amount then standing to the credit of the GIC Account and any Authorised Investments (but without double counting));

C = the aggregate amount of any Cash Equity Contributions made by the Holders (as recorded in the Unit Account Ledger of each Holder) or the proceeds of Term Advances which have not been applied as at the relevant Calculation Date to acquire further Loans and their Related Security or otherwise applied in accordance with the Fund Deed and/or the other Transaction Documents;

D = the aggregate principal amount of any Substitution Assets as at the relevant Calculation Date;

W = (i) whilst the short-term rating assigned by Moody's to the Issuer is at least P-1, 50 per cent. of an amount equal to the aggregate cash deposits held in the name of any Borrower with the Issuer, or (ii) whilst the short-term rating assigned by Moody's to the Issuer is lower than P-1, 100 per cent. of an amount equal to the aggregate cash deposits held in the name of any Borrower with the Issuer. Such amount shall be calculated by reference to the aggregate cash deposits held in the name of any Borrower with the Issuer on the 15th calendar day in the month preceding the relevant Calculation Date; and

∞ = the Asset Percentage.

**Asset Percentage** means the over-collateralisation asset percentage figure as determined from time to time in accordance with the terms of the Fund Deed. On the Calculation Date falling in January, April, July and October of each year, the Fund (or the Cash Manager on its behalf) will calculate the over-collateralisation for the Portfolio as a whole or a random selection of the

Loans in the Portfolio, such calculations to be made on the same basis throughout unless agreed otherwise by Moody's or such other Rating Agency which has assigned a rating to any Existing Covered Bond.

The over-collateralisation (or other relevant figures) so calculated will be input by the Cash Manager to one or more cashflow models. Such models, which test the credit enhancement required in various cashflow scenarios, will indicate, on the basis of the latest over-collateralisation figures (or other relevant figures), the Asset Percentage needed in order to provide over-collateralisation to cover all such cashflow scenarios.

The Asset Percentage will be adjusted to ensure that sufficient credit enhancement will be maintained, provided that the Asset Percentage may not, at any time, exceed 95 per cent.

Any breach of the Asset Coverage Test arising as a result of the assumption of an Asset Percentage applied in accordance with the cashflow model supplied by Moody's will not constitute an Issuer Event of Default. However, in such circumstances, prior to the service of a Notice to Pay on the Fund, Available Receipts will be deposited in the GIC Account in accordance with the Pre-Acceleration Priority of Payments.

***Sale of Selected Loans and their Related Security following service of an Asset Coverage Test Breach Notice***

After service of an Asset Coverage Test Breach Notice (which has not been revoked) but prior to service of a Notice to Pay, the Fund will be obliged to sell Selected Loans and their Related Security in the Portfolio in accordance with the Fund Deed (as described below), subject to the rights of pre-emption in favour of the Seller to buy the Selected Loans and their Related Security pursuant to the Mortgage Sale Agreement and subject to any Cash Equity Contributions made by the Holders. The proceeds from any such sale will be credited to the GIC Account and applied as set out in *Allocation and distribution of Available Receipts following service of an Asset Coverage Test Breach Notice* below.

***Sale of Selected Loans and their Related Security following service of a Notice to Pay***

After service of a Notice to Pay on the Fund, but prior to service of a Fund Acceleration Notice, the Fund will be obliged to sell Selected Loans and their Related Security in the Portfolio in accordance with the Fund Deed (as described below), subject to the rights of pre-emption in favour of the Seller to buy the Selected Loans and their Related Security pursuant to the Mortgage Sale Agreement. The proceeds from any such sale will be credited to the GIC Account and applied as set out in the Guarantee Priority of Payments.

***Method of Sale of Selected Loans***

If the Fund is required to sell Selected Loans and their Related Security to Purchasers following either the service of an Asset Coverage Test Breach Notice (if not revoked) or a Notice to Pay, the Fund will be required to ensure that before offering Selected Loans for sale:

- (a) the Selected Loans have been selected from the Portfolio on a random basis as described in the Fund Deed; and
- (b) the Selected Loans have an aggregate Outstanding Principal Balance in an amount (the **Required Outstanding Principal Balance Amount**) which is as close as possible to the amount calculated as follows:
  - (i) following the service of an Asset Coverage Test Breach Notice (but prior to service of a Notice to Pay), such amount that would ensure that, if the Selected Loans were sold at their Outstanding Principal Balance plus the Arrears of Interest and Accrued Interest thereon, the Asset Coverage Test would be satisfied on the next Calculation Date taking into account the payment obligations of the Fund on the Payment Date following that Calculation Date (assuming for this purpose that the Asset Coverage Test Breach Notice is not revoked on the next Calculation Date); or
  - (ii) following service of a Notice to Pay:

$$N \times \frac{\text{Outstanding Principal Balance of all Loans in the Portfolio}}{\text{the ISK Equivalent of the Required Redemption Amount in respect of each Series of Covered Bonds then outstanding}}$$

where N is an amount equal to the ISK Equivalent of the Required Redemption Amount of the Earliest Maturing Covered Bonds less amounts standing to the credit of the GIC Account and the principal amount of any Substitution Assets or Authorised Investments (excluding all amounts to be applied on the next following Fund Payment Date to repay higher ranking amounts in the Guarantee Priority of Payments and

those amounts that are required to repay any Series of Covered Bonds which mature prior to or on the same date as the relevant Series of Covered Bonds).

For the purposes hereof:

**Required Redemption Amount** means, in respect of a Series of Covered Bonds, the amount calculated as follows:

$$\frac{\text{the Principal Amount Outstanding of the relevant Series of Covered Bonds}}{\text{the relevant Series of Covered Bonds/365}} \times 1 + \text{Negative Carry Factor} \times (\text{days to maturity of the relevant Series of Covered Bonds/365})$$

The Fund will offer the Selected Loans and their Related Security for sale to Purchasers for the best price reasonably available but in any event:

- (i) following the service of an Asset Coverage Test Breach Notice (but prior to service of a Notice to Pay), for an amount not less than the Outstanding Principal Balance of the Selected Loans plus the Arrears of Interest and Accrued Interest thereon; and
- (ii) following service of a Notice to Pay, for an amount not less than the Required Redemption Amount.

Following service of the Notice to Pay, if the Selected Loans have not been sold (in whole or in part) in an amount equal to the Required Redemption Amount within six months following the date of the service of the Notice to Pay but not later than the date which is six months prior to the Final Maturity Date of the Earliest Maturing Covered Bonds, then the Fund will offer the Selected Loans for sale for the best price reasonably available notwithstanding that such amount may be less than the Required Redemption Amount.

Following service of a Notice to Pay, in addition to offering Selected Loans for sale to Purchasers in respect above-mentioned six months period the Fund (subject to the rights of pre-emption enjoyed by the Seller pursuant to the Mortgage Sale Agreement) is permitted to offer for sale a portfolio of Selected Loans, in accordance with the provisions summarised above, in respect of other Series of Covered Bonds.

The Fund is also permitted to offer for sale to Purchasers a Partial Portfolio. Where a Notice to Pay has been served, except in circumstances where the portfolio of Selected Loans is being sold within six months of the Final Maturity Date of the Earliest Maturing Covered Bonds, the sale price of the Partial Portfolio (as a proportion of the Required Redemption Amount) shall be at least equal to the proportion that the Partial Portfolio bears to the relevant portfolio of Selected Loans.

The Management Company on behalf of the Fund will appoint a portfolio manager of recognised standing on a basis intended to incentivise the portfolio manager to achieve the best price for the sale of the Selected Loans (if such terms are commercially available in the market) and to advise it in relation to the sale of the Selected Loans to Purchasers (except where the Seller is buying the Selected Loans in accordance with its right of pre-emption in the Mortgage Sale Agreement). The terms of the agreement giving effect to the appointment in accordance with such tender shall be approved by the Representative.

In respect of any sale of Selected Loans and their Related Security following service on the Fund of an Asset Coverage Test Breach Notice (if not revoked) or a Notice to Pay, the Fund will instruct the portfolio manager to use all reasonable endeavours to procure that Selected Loans are sold as quickly as reasonably practicable (in accordance with the recommendations of the portfolio manager) taking into account the market conditions at that time and, where relevant, the scheduled repayment dates of the Covered Bonds and the terms of the Fund Deed.

The terms of any sale and purchase agreement with respect to the sale of Selected Loans (which shall give effect to the recommendations of the portfolio manager) will be subject to the prior written approval of the Representative.

Following service of a Notice to Pay, if Purchasers accept the offer or offers from the Fund so that some or all of the Selected Loans and their Related Security shall be sold prior to the Final Maturity Date of the Earliest Maturing Covered Bonds, then the Fund will, subject to the foregoing paragraph, enter into a sale and purchase agreement with the relevant Purchasers which will require *inter alia* a cash payment from the relevant Purchasers. Any such sale will not include any representations and warranties from the Fund or the Seller (or the applicable New Seller) in respect of the Loans and their Related Security unless expressly agreed by the Representative or otherwise agreed with the Fund and the Seller (or the applicable New Seller).

### ***Limit on Investing in Substitution Assets and Authorised Investments***

Prior to service of an Asset Coverage Test Breach Notice (if not revoked) or a Notice to Pay on the Fund, the Fund will be permitted to invest Available Receipts and the proceeds of Term Advances in Substitution Assets, provided that the aggregate amount so invested in such Substitution Assets does not exceed 10 per cent. of the total assets at any one time and provided that such investments are made in accordance with the terms of the Cash Management Agreement. Placing such amounts in any Fund Account will not constitute an investment in Substitution Assets for these purposes.

Following service of an Asset Coverage Test Breach Notice (if not revoked) or a Notice to Pay on the Fund, all Substitution Assets must be sold by the Fund (or the Cash Manager on its behalf) as quickly as reasonably practicable and the proceeds credited to the GIC Account and the Fund will be permitted to invest all available moneys in Authorised Investments, provided that such investments are made in accordance with the terms of the Cash Management Agreement.

There is no limit on the amounts that the Fund shall be entitled to invest in Authorised Investments.

### ***Other Provisions***

The allocation and distribution of Revenue Receipts and all other amounts received by the Fund is described under *Cashflows* below.

The Fund Deed is governed by Icelandic law.

### **Cash Management Agreement**

The Cash Manager will provide certain cash management services to the Fund pursuant to the terms of the Cash Management Agreement entered into on the Programme Date between the Fund, Kaupthing Bank hf. in its capacity as the Cash Manager and the Representative.

The Cash Manager's services include but are not limited to:

- (a) maintaining the Ledgers on behalf of the Fund;
- (b) distributing the Revenue Receipts in accordance with the Priorities of Payment described under *Cashflows* below;
- (c) determining whether the Asset Coverage Test is satisfied on each Calculation Date in accordance with the Fund Deed, as more fully described under *Credit Structure – Asset Coverage Test* below; and
- (d) preparation of Investor Reports for the Covered Bondholders, the Rating Agency and the Representative.

In certain circumstances the Fund and the Representative will each have the right to terminate the appointment of the Cash Manager and to appoint a substitute (the identity of which will be subject to the Representative's written approval). Any substitute cash manager will have substantially the same rights and obligations as the Cash Manager (although the fee payable to the substitute cash manager may be higher).

The Cash Management Agreement is governed by Icelandic law.

### **Bank Account Agreement**

Pursuant to the terms of the Bank Account Agreement entered into on the Programme Date between the Fund, the Account Bank, the Cash Manager and the Representative, the Fund will maintain with the Account Bank the GIC Account described below, which will be operated in accordance with the Cash Management Agreement and the Fund Deed.

All amounts received from Borrowers in respect of Loans in the Portfolio will be paid into the GIC Account and credited to the Revenue Ledger. On each Fund Payment Date, as applicable, amounts required to meet the claims of the Fund's various creditors and amounts to be distributed to the Holders under the Fund Deed will be transferred from the Revenue Ledger, the Reserve Ledger or the Unit Account Ledger, as applicable, to the Payment Ledger on the GIC Account and applied by the Cash Manager in accordance with the Priorities of Payments described below under *Cashflows*.

The GIC Account will be transferred to an alternative bank which has a short-term, unsecured, unsubordinated and unguaranteed debt obligation rating of P-1 by Moody's, in certain circumstances, including if the ratings assigned to the short-term, unsecured, unsubordinated and unguaranteed debt obligations of the relevant Account Bank fall below P-1 by Moody's.

The Bank Account Agreement is governed by Icelandic law.

**Guaranteed Investment Contract**

The Fund has entered into a Guaranteed Investment Contract (or **GIC**) with the GIC Provider, the Cash Manager and the Representative on the Programme Date, pursuant to which the GIC Provider has agreed to pay interest on the moneys standing to the credit thereof at specified rates determined in accordance with the GIC.

The Guaranteed Investment Contract is governed by Icelandic law.

## CREDIT STRUCTURE

The Covered Bonds will be direct, unsecured, unconditional obligations of the Issuer. The Fund has no obligation to pay the Guaranteed Amounts under the Covered Bond Guarantee until service of a Notice to Pay on the Fund following service by the Representative of an Issuer Acceleration Notice or, if earlier, following the occurrence of a Fund Event of Default and service by the Representative of a Fund Acceleration Notice. The Issuer will not be relying on payments by the Fund in respect of the Term Advances or receipt of Revenue Receipts from the Portfolio in order to pay interest or repay principal under the Covered Bonds.

There are a number of features of the Programme which enhance the likelihood of timely and, as applicable, ultimate payments to Covered Bondholders, as follows:

- the Covered Bond Guarantee provides credit support to the Issuer;
- the Asset Coverage Test is intended to test the asset coverage of the Fund's assets in respect of the Covered Bonds outstanding at all times;
- if the Issuer's short-term ratings fall below P-1 by Moody's, Available Receipts will be trapped in the Reserve Fund; and
- under the terms of the Guaranteed Investment Contract, the GIC Provider has agreed to pay a variable rate of interest on all amounts held by the Fund in the GIC Account at a rate of 0.5 per cent. for one-month ISK deposits or such greater amount as the Fund and the GIC Provider may agree from time to time.

Certain of these factors are considered more fully in the remainder of this section.

### Covered Bond Guarantee

The Covered Bond Guarantee provided by the Fund under the Representative and Agency Agreement guarantees payment of Guaranteed Amounts when the same become Due for Payment in respect of all Covered Bonds issued under the Programme. The Covered Bond Guarantee will not guarantee any amount becoming payable for any other reason, including any accelerated payment pursuant to Condition 10 (*Events of Default, Acceleration and Enforcement*) following the service of a Notice to Pay. In this circumstance (and until a Fund Event of Default occurs and a Fund Acceleration Notice is served), the Fund's obligations will only be to pay the Guaranteed Amounts as they fall Due for Payment. However, should any payments made by the Fund under the Covered Bond Guarantee be subject to any withholding or deduction for or on account of any present or future taxes or duties of whatever nature imposed or levied by or on behalf of any Tax Jurisdiction, the Fund will not be obliged to pay any additional amount as a consequence.

See further *Summary of the Principal Documents – Covered Bond Guarantee* as regards the terms of the Covered Bond Guarantee. See further *Cashflows – Guarantee Priority of Payments* as regards the payment of amounts payable by the Fund to Covered Bondholders following service of a Notice to Pay.

### Asset Coverage Test

The Asset Coverage Test is intended to ensure that the Fund can meet its obligations under the Covered Bond Guarantee. Under the Fund Deed, the Fund must ensure that on each Calculation Date the Adjusted Aggregate Loan Amount will be in an amount equal to or in excess of the ISK Equivalent of the aggregate Principal Amount Outstanding of the Covered Bonds as calculated on the relevant Calculation Date. If the Adjusted Aggregate Loan Amount is not equal to, or greater than, the ISK Equivalent of the aggregate Principal Amount Outstanding of the Covered Bonds on the next following Calculation Date, the Asset Coverage Test will be breached and the Representative will serve an Asset Coverage Test Breach Notice on the Fund. The Asset Coverage Test is a formula which adjusts the Outstanding Principal Balance of each Loan in the Portfolio and has further adjustments to take account of set-off on a Borrower's current or deposit accounts held with the Seller and failure by the Seller, in accordance with the Mortgage Sale Agreement, to repurchase Defaulted Loans or Loans that do not materially comply with the Representations and Warranties on the relevant Assignment Date. See further *Summary of the Principal Documents – Fund Deed – Asset Coverage Test*, above.

An Asset Coverage Test Breach Notice will be revoked if, on any Calculation Date falling on or prior to the second Calculation Date following the service of the Asset Coverage Test Breach Notice, the Asset Coverage Test is satisfied and neither a Notice to Pay nor a Fund Acceleration Notice has been served.

If an Asset Coverage Test Breach Notice has been served and not revoked on or before the second Calculation Date after service of such Asset Coverage Test Breach Notice, then an Issuer Event of Default shall occur and the Representative shall be entitled (and, in certain circumstances may be required) to serve an Issuer Acceleration Notice. Following service of an Issuer Acceleration Notice, the Representative must serve a Notice to Pay on the Fund.

### **Reserve Fund**

If at any time prior to the occurrence of an Issuer Event of Default, the Issuer's short-term, unsecured, unsubordinated and unguaranteed debt obligations cease to be rated P-1 by Moody's, the Fund will be required to credit Available Receipts to the Reserve Fund up to an amount equal to the Reserve Fund Required Amount. The Fund will not be required to maintain the Reserve Fund following the occurrence of an Issuer Event of Default and service of an Issuer Acceleration Notice.

The Reserve Fund Required Amount will be funded from the proceeds from any Term Advances and from Available Receipts after the Fund has paid all of its obligations in respect of items ranking higher than the Reserve Ledger in the Pre-Acceleration Priority of Payments on each Fund Payment Date.

The **Reserve Fund Required Amount** means, if the Issuer's short-term, unsecured, unsubordinated and unguaranteed debt obligations are rated at least P-1 by Moody's, nil or such other amount as Kaupthing Bank hf. shall direct the Fund from time to time and otherwise, an amount equal to the ISK Equivalent of the interest due on the Covered Bonds for X months together with an amount equal to one-twelfth of the anticipated aggregate annual amount payable in respect of the items specified in paragraphs (a) to (b) of the Pre-Acceleration Priority of Payments plus ISK 10,000,000 or such higher amount as Kaupthing Bank hf. shall direct the Fund from time to time

where,

X = the number of months between the Interest Payment Dates in relation to the Covered Bonds;

A Reserve Ledger will be maintained by the Cash Manager to record the balance from time to time of the Reserve Fund. Following the occurrence of an Issuer Event of Default, service of an Issuer Acceleration Notice and service of a Notice to Pay on the Fund, amounts standing to the credit of the Reserve Ledger will be added to certain other income of the Fund in calculating Available Receipts.

The Seller may also direct the Fund to credit any Cash Equity Contributions it makes to the Fund to the Reserve Ledger. The balance on the Reserve Ledger in excess of the Reserve Fund Required Amount will form part of Available Receipts and be applied accordingly.

## CASHFLOWS

As described above under *Credit Structure*, until a Notice to Pay is served on the Fund, the Covered Bonds will be obligations of the Issuer only. The Issuer is liable to make payments when due on the Covered Bonds, whether or not it has received any corresponding payment from the Fund.

This section summarises the Priorities of Payments of the Fund, as to the allocation and distribution of amounts standing to the credit of the Fund Accounts and their order of priority:

- (a) prior to service on the Fund of an Asset Coverage Test Breach Notice, a Notice to Pay or a Fund Acceleration Notice;
- (b) following service of an Asset Coverage Test Breach Notice (and for so long as it has not been revoked);
- (c) following service of a Notice to Pay; and
- (d) following service of a Fund Acceleration Notice.

### **Allocation and distribution of Available Receipts prior to service of an Asset Coverage Test Breach Notice (which has not been revoked), a Notice to Pay or a Fund Acceleration Notice**

Prior to service of an Asset Coverage Test Breach Notice (which has not been revoked), a Notice to Pay or a Fund Acceleration Notice on the Fund, Available Receipts will be allocated and distributed as described below.

On the Calculation Date immediately preceding each Fund Payment Date, the Fund, or the Cash Manager on its behalf, shall calculate the amount of Available Receipts available for distribution on the immediately following Fund Payment Date and the Reserve Fund Required Amount (if applicable).

### ***Pre-Acceleration Priority of Payments***

On each Fund Payment Date, the Fund or the Cash Manager on its behalf will transfer Available Receipts from the Revenue Ledger and the Reserve Ledger, as applicable, to the Payment Ledger on the GIC Account, in an amount equal to the lower of (a) the amount required to make the payments described below and (b) the amount of Available Receipts standing to the credit of the GIC Account.

Prior to service on the Fund of an Asset Coverage Test Breach Notice (which has not been revoked), a Notice to Pay or a Fund Acceleration Notice, Available Receipts will be applied by or on behalf of the Fund on each Fund Payment Date in making the following payments and provisions (the **Pre-Acceleration Priority of Payments**) (in each case only if and to the extent that payments or provisions of a higher priority have been made in full):

- (a) *first*, in or towards payment of any amounts due and payable by the Fund to the Representative, each Agent, the Management Company, the Custody Agent and to other third parties and incurred without breach by the Fund of the Transaction Documents to which it is a party (and for which payment has not been provided elsewhere in this Pre-Acceleration Priority of Payments) and to provide for any such amounts expected to become due and payable by the Fund in the immediately succeeding Fund Payment Period and to discharge any liability of the Fund for taxes and/or other official levies;
- (b) *second*, in or towards payment *pro rata* and *pari passu* according to the respective amounts thereof of:
  - (i) any remuneration then due and payable to the Servicer and any costs, charges, liabilities and expenses then due or to become due and payable to the Servicer under the provisions of the Servicing and Custody Agreement in the immediately succeeding Fund Payment Period, together with applicable amounts in respect of taxes thereon as provided therein;
  - (ii) amounts due and payable to the Asset Monitor pursuant to the terms of the Asset Monitor Agreement together with applicable amounts in respect of taxes thereon as provided therein;
  - (iii) any remuneration then due and payable to the Cash Manager and any costs, charges, liabilities and expenses then due or to become due and payable to the Cash Manager under the provisions of the Cash Management Agreement in the immediately succeeding Fund Payment Period, together with applicable amounts in respect of taxes thereon as provided therein; and



- (iv) amounts (if any) due and payable to the Account Banks (including any costs, charges, liabilities and expenses) pursuant to the terms of the Bank Account Agreement, together with applicable amounts in respect of taxes thereon as provided therein.
- (c) *third*, in or towards payment of any amounts due or to become due and payable on such Fund Payment Date (whether in respect of principal, interest or any other amount due) under the Intercompany Loan Agreement, *pro rata* and *pari passu* in respect of each relevant Term Advance;
- (d) *fourth*, if a Servicer Event of Default has occurred, all remaining Available Receipts to be credited to the GIC Account (with a corresponding credit to the Revenue Ledger) until such Servicer Event of Default is either remedied or waived by the Representative or a new servicer is appointed to service the Portfolio (or the relevant part thereof);
- (e) *fifth*, in or towards a credit to the Reserve Ledger on the GIC Account of an amount required to ensure that the Reserve Fund is funded to the Reserve Fund Required Amount as calculated on the immediately preceding Calculation Date; and
- (f) *sixth*, towards payment *pro rata* and *pari passu* to the Holders (as specified in the Fund Deed).

#### **Allocation and distribution of Available Receipts following service of an Asset Coverage Test Breach Notice**

At any time after service on the Fund of an Asset Coverage Test Breach Notice (which has not been revoked), but prior to service of a Notice to Pay or service of a Fund Acceleration Notice, all Available Receipts will continue to be applied in accordance with the Pre-Acceleration Priority of Payments save that, whilst any Covered Bonds remain outstanding, no moneys will be applied under paragraph (f) of the Pre-Acceleration Priority of Payments.

#### **Allocation and distribution of Available Receipts following service of a Notice to Pay**

At any time after service of a Notice to Pay on the Fund, but prior to service of a Fund Acceleration Notice, all Available Receipts will be applied as described below under *Guarantee Priority of Payments*.

On each Fund Payment Date, the Fund or the Cash Manager on its behalf will transfer Available Receipts from the Revenue Ledger, the Reserve Ledger or the Unit Account Ledger, as the case may be, to the Payment Ledger on the GIC Account, in an amount equal to the lower of (a) the amount required to make the payments set out in the Guarantee Priority of Payments and (b) the amount of all Available Receipts standing to the credit of such ledgers on the GIC Account.

The Fund will create and maintain ledgers for each Series of Covered Bonds and record amounts allocated to such Series of Covered Bonds in accordance with paragraphs (d) and (e) of the *Guarantee Priority of Payments* below, and such amounts, once allocated, will only be available to pay amounts due under the Covered Bond Guarantee.

#### **Guarantee Priority of Payments**

On each Fund Payment Date on and from the date of service of a Notice to Pay on the Fund (but prior to the occurrence of a Fund Event of Default and service of a Fund Acceleration Notice), the Fund or the Cash Manager on its behalf will apply moneys standing to the credit of the Payment Ledger on the GIC Account to make the following payments and provisions in the following order of priority (the **Guarantee Priority of Payments**) (in each case only if and to the extent that payments or provisions of a higher priority have been made in full):

- (a) *first*, to in or towards payment *pro rata* and *pari passu* according to the respective amounts thereof of all amounts due and payable or to become due and payable to the Representative in the immediately succeeding Fund Payment Period under the provisions of the Representative and Agency Agreement together with interest and applicable amounts in respect of taxes thereon as provided therein;
- (b) *second*, in or towards payment *pro rata* and *pari passu* according to the respective amounts thereof of:
  - (i) any remuneration then due and payable to the Agents under or pursuant to the Representative and Agency Agreement together with applicable amounts in respect of taxes thereon as provided therein; and
  - (ii) any amounts then due and payable by the Fund to third parties (including, for the avoidance of doubt, amounts due and payable to the Management Company and the Custody Agent) and incurred without breach by the Fund of the Transaction Documents to which it is a party (and for which payment has not been provided for elsewhere in this Guarantee Priority of Payments) and to provide for any such amounts

expected to become due and payable by the Fund in the immediately succeeding Fund Payment Period and to pay or discharge any liability of the Fund for taxes and/or other official levies;

- (c) *third*, in or towards payment *pro rata* and *pari passu* according to the respective amounts thereof of:
- (i) any remuneration then due and payable to the Servicer and any costs, charges, liabilities and expenses then due or to become due and payable to the Servicer in the immediately succeeding Fund Payment Period under the provisions of the Servicing and Custody Agreement together with applicable amounts in respect of taxes thereon as provided therein;
  - (ii) amounts due and payable to the Asset Monitor pursuant to the terms of the Asset Monitor Agreement, together with applicable amounts in respect of taxes thereon as provided therein;
  - (iii) any remuneration then due and payable to the Cash Manager and any costs, charges, liabilities and expenses then due or to become due and payable to the Cash Manager in the immediately succeeding Fund Payment Period under the provisions of the Cash Management Agreement, together with applicable amounts in respect of taxes thereon as provided therein;
  - (iv) amounts (if any) due and payable to the Account Banks (including any costs, charges, liabilities and expenses) pursuant to the terms of the Bank Account Agreement, together with applicable amounts in respect of taxes thereon as provided therein.
- (d) *fourth*, in or towards payment on the Fund Payment Date or to provide for payment on such date in the future of such proportion of the relevant payments falling due in the future as the Cash Manager may reasonably determine, of Scheduled Interest that is Due for Payment (or that will become Due for Payment) under the Covered Bond Guarantee in respect of each Series of Covered Bonds to the Representative or (if so directed by the Representative) the Principal Paying Agent on behalf of the Covered Bondholders *pro rata* and *pari passu* in respect of each Series of Covered Bonds;
- (e) *fifth*, in or towards payment on the Fund Payment Date or to provide for payment prior to the next Fund Payment Date, of Scheduled Principal that is Due for Payment (or that will become Due for Payment in the immediately succeeding Fund Payment Period) under the Covered Bond Guarantee in respect of each Series of Covered Bonds to the Representative or (if so directed by the Representative) the Principal Paying Agent on behalf of the Covered Bondholders *pro rata* and *pari passu* in respect of each Series of Covered Bonds;
- (f) *sixth*, to deposit the remaining moneys in the GIC Account for application on the next following Fund Payment Date in accordance with the priority of payments described in paragraphs (a) to (e) (inclusive) above, until the Covered Bonds have been fully repaid or repayment in full of the Covered Bonds has been provided for (such that the Required Redemption Amount has been accumulated in respect of each outstanding Series of Covered Bonds);
- (g) *seventh*, in or towards payment of any amounts due or to become due and payable in the immediately succeeding Fund Payment Period (whether in respect of principal, interest or any other amount) under the Intercompany Loan Agreement, *pro rata* and *pari passu* in respect of each relevant Term Advance; and
- (h) *eighth*, thereafter any remaining moneys will be applied in accordance with the Fund Deed.

#### **Application of moneys received by the Representative following service of a Fund Acceleration Notice**

Under the terms of the Fund Deed, all moneys received or recovered by the Representative will be applied in the following order of priority (the **Post-Enforcement Priority of Payments**) (in each case only if and to the extent that payments or provisions of a higher priority have been made in full):

- (a) *first*, in or towards satisfaction *pro rata* and *pari passu* according to the respective amounts thereof all amounts due and payable or to become due and payable to the Representative under the provisions of the Representative and Agency Agreement together with interest and applicable amounts in respect of taxes thereon as provided therein;
- (b) *second*, in or towards satisfaction of any remuneration then due and payable to the Agents under or pursuant to the Representative and Agency Agreement, the Management Company and the Custody Agent together with applicable taxes thereon as provided therein;

- (c) *third*, in or towards satisfaction *pro rata* and *pari passu* according to the respective amounts thereof of:
  - (i) any remuneration then due and payable to the Servicer and any costs, charges, liabilities and expenses then due or to become due and payable to the Servicer under the provisions of the Servicing and Custody Agreement, together with applicable amounts in respect of taxes thereon as provided therein;
  - (ii) any remuneration then due and payable to the Cash Manager and any costs, charges, liabilities and expenses then due or to become due and payable to the Cash Manager under the provisions of the Cash Management Agreement, together with applicable amounts in respect of taxes thereon as provided therein; and
  - (iii) amounts due to the Account Banks (including any costs, charges, liabilities and expenses) pursuant to the terms of the Bank Account Agreement, together with applicable amounts in respect of taxes thereon as provided therein;
- (d) *fourth*, in or towards satisfaction of the amounts due and payable under the Covered Bond Guarantee, to the Representative or (if so directed by the Representative) the Principal Paying Agent on behalf of the Covered Bondholders *pro rata* and *pari passu* in respect of interest and principal due and payable on each Series of Covered Bonds, provided that if the amount available for distribution under this paragraph (d) would be insufficient to pay the ISK Equivalent of the amounts due and payable under the Covered Bond Guarantee in respect of each Series of Covered Bonds, the shortfall shall be divided amongst all such Series of Covered Bonds on a *pro rata* basis;
- (e) *fifth*, in or towards payment of all amounts outstanding under the Intercompany Loan Agreement *pro rata* and *pari passu* in respect of each relevant Term Advance; and
- (f) *sixth*, in or towards payment to the Holders (as specified in the Fund Deed).

## DESCRIPTION OF INVESTMENT FUNDS IN ICELAND

The primary legislation in Iceland applicable to funds for collective investments is Act No 30/2003 on Undertakings for Collective Investments in Transferable Securities and Investment Funds (the **Act**) which implemented Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (**UCITS**).

The Act essentially deals with different types of funds for collective investments namely:

### **UCITS**

The Act contains detailed provisions on UCITS, being funds covered by the provisions of Directive 85/611/EEC. The scope of Directive 85/611/EEC is limited to undertakings whose sole object is the collective investment in transferable securities and/or other liquid financial assets (as referred to in Article 19(1) of Directive 85/611/EEC) of capital raised from the public and which operate on the principle of risk-spreading and the units of which are, at the request of holders, repurchased or redeemed, directly or indirectly, out of the assets of the relevant undertakings.

### **Other funds for collective investments in Iceland**

Many funds for collective investments are not covered by the terms set out in Directive 85/611/EEC. Member States of the European Economic Area are, therefore, at liberty to establish rules for funds which fall outside the scope of Directive 85/611/EEC.

Such funds need to obtain a special operating licence in all countries in which they are marketed. One of the objectives of the Icelandic authorities in enacting the Act was to increase the competitive edge of Icelandic funds for collective investments. The legislation was intended to create a more favourable environment for operating funds for collective investments in Iceland than was previously the case. One of the methods used to achieve this objective was to authorise additional types of funds, to broaden their investment authorisations and make funds easier and cheaper to operate. Thus the intention was to increase the diversity of Icelandic funds for mutual investments.

Restrictions on investments by funds depend on who is authorised to invest in them. According to the Act, management companies of UCITS are authorised to operate investment funds on the one hand and institutional investment funds on the other hand. In addition to funds for collective investments, the management funds of UCITS have the scope to apply for increased authorisation to carry out asset management, investment advice, custody and management of financial instruments in collective investment.

### *Investment Funds*

The investment authorisation of investment funds is broader than for UCITS. This is largely due to the fact that investment funds can invest to a greater extent in unlisted financial instruments and do not require as much risk distribution.

Investment funds are authorised to invest in unlisted financial instruments. It is therefore possible to operate mixed funds of listed and unlisted financial instruments and also funds which invest chiefly in unlisted financial instruments. Funds which invest chiefly in unlisted financial instruments are often called venture capital funds.

In addition to broader authorisation to invest in unlisted financial instruments, investment funds are authorised to invest up to 35 per cent. of their assets in financial instruments issued by the same obligor, provided that investments exceeding 20 per cent. are only in one issuer.

### *Institutional Investment Funds*

The Act stipulates the exclusive right of UCITS and investment funds to accept funds from members of the public for collective investments in financial instruments and other assets on the basis of spreading risk in accordance with a previously stated investment strategy.

Holding companies, companies in mixed operations and companies which do not operate on the basis of spreading risk are therefore not covered by the Act. These companies would not be considered funds for collective investments. Funds for collective investments other than UCITS and investment funds are therefore primarily funds which accept funds from sources other than the public. Operating companies are authorised to operate such funds pursuant to Article 4 of the Act (cf. Article 27 of the financial undertakings act).

The reason why this exclusive right does not apply to institutional investment funds is because institutional investors are considered to have the necessary expertise and experience to assess the risk inherent in different investments and therefore do not require comparable consumer protection as compared to members of the public. Institutional investment funds can involve considerable risks and therefore members of the public are not permitted to invest in them.

Institutional investment funds neither receive accreditation nor an operating licence from the Financial Supervisory Authority in Iceland and, therefore, are not subject to supervision by the Financial Supervisory Authority in Iceland. However, management companies which operate such funds are required to notify the Financial Supervisory Authority in Iceland when such funds are established, since management companies and all their activities are subject to supervision by the Financial Supervisory Authority.

## TAXATION

### 1. Icelandic Taxation

*The comments below are of a general nature based on the understanding of the Issuer of current law and practice in Iceland and should not be construed as providing legitimate expectations as to the system of taxation being described herein or precluding changes in the applicable rules on taxation in the future. They relate only to the position of persons who are the absolute beneficial owners of Covered Bonds to be issued under the Programme. They may not apply to certain classes of person such as dealers. Prospective holders of Covered Bonds to be issued under the Programme 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.*

#### ***Non-Icelandic tax residents***

As for individuals or legal entities that are not resident, domiciled (or registered in the case of legal entities), or engaged in trade or business through a permanent establishment in Iceland (hereinafter **non-Icelandic tax residents**), 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, interest or any other amount payable on the Covered Bonds.

The Issuer is not required to withhold any taxes in respect of such amounts provided that the Director of Internal Revenue's confirmation of the Paying Agent's and the relevant Dealer's, in case of it being a holder of such Covered Bond, status as non-Icelandic tax residents has been obtained (either by the Paying Agent and the Dealer or by the Issuer on their behalf). At the time of publication of this Prospectus, the Issuer has obtained all the necessary confirmations and is therefore not required to withhold any taxes in respect of such amounts.

However, for the avoidance of doubt, the Issuer or, as the case may be, the Fund will not pay any additional amounts in respect of amounts withheld pursuant to any withholding tax or deduction. This applies to all holders of Covered Bonds.

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 Covered Bonds if, at the time of the death of the holder or the transfer of the Covered Bonds, such holder or transferor is a non-Icelandic tax resident.

#### ***Icelandic tax residents***

Individuals or legal entities that are resident, domiciled (or registered in the case of legal entities), or engaged in trade or business through a permanent establishment in Iceland (hereinafter **Icelandic tax residents**), are subject to income tax in Iceland on their interest income in accordance with Icelandic tax law. The tax rate depends on their tax status. Subject to certain exemptions applicable to, for example, most banks and pension funds, the Issuer is required to withhold a 10 per cent. tax on interest payments to recipients who are Icelandic tax residents. Such withholding is a preliminary tax payment but does not necessarily constitute the final tax liability of the recipient.

### 2. EU Savings Directive

Under EC Council Directive 2003/48/EC on the taxation of savings income, Member States are required 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, including Switzerland, and certain dependent or associated territories of certain Member States have adopted similar measures (either provision of information or transitional withholding) (a withholding system in the case of Switzerland) in relation to payments made by a person within its jurisdiction to, or collected by such a person for, an individual resident in a Member State. In addition, the Member States have entered into reciprocal provision of information or transitional withholding arrangements with certain of those dependent or associated territories in relation to payments made by a person in a Member State to, or collected by such a person for, an individual resident in one of those territories.

### 3. Luxembourg Taxation

The following summary is of a general nature and is included herein solely for information purposes. It is based on the laws at present in force in Luxembourg, though it is not intended to be, nor should it be construed to be, legal or tax advice. Prospective investors in the Covered Bonds should therefore consult their own professional advisers as to the effects of state, local or foreign laws, including Luxembourg tax law, to which they may be subject.

#### Withholding Tax

##### (i) Non-resident holders of Covered Bonds

Under Luxembourg general tax laws currently in force, and subject to the laws of June 21, 2005 (the **Laws**) mentioned below, there is no withholding tax on payments of principal, premium or interest made to non-resident holders of Covered Bonds, nor on accrued but unpaid interest in respect of the Covered Bonds, nor is any Luxembourg withholding tax payable upon redemption or repurchase of the Covered Bonds held by non-resident holders of Covered Bonds.

Under the Laws implementing the EC Council Directive 2003/48/EC of June 3, 2003 on taxation of savings income in the form of interest payments and ratifying the treaties entered into by Luxembourg and certain dependent and associated territories of EU Member States (the **Territories**), payments of interest or similar income made or ascribed by a paying agent established in Luxembourg to or for the immediate benefit of an individual beneficial owner or a residual entity, as defined by the Laws, which is a resident of, or established in, an EU Member State (other than Luxembourg) or one of the Territories, will be subject to a withholding tax unless the relevant recipient has adequately instructed the relevant paying agent to provide details of the relevant payments of interest or similar income to the fiscal authorities of his/her/its country of residence or establishment, or, in the case of an individual beneficial owner, has provided a tax certificate issued by the fiscal authorities of his/her country of residence in the required format to the relevant paying agent. Where withholding tax is applied, it will be levied at a rate of 15 per cent. during the first three-year period starting July 1, 2005, at a rate of 20 per cent. for the subsequent three-year period and at a rate of 35 per cent. thereafter. Responsibility for the withholding of the tax will be assumed by the Luxembourg paying agent. Payments of interest under the Covered Bonds coming within the scope of the Laws would at present be subject to withholding tax of 15 per cent.

##### (ii) Resident holders of Covered Bonds

Under Luxembourg general tax laws currently in force and subject to the law of December 23, 2005 (the **Law**) mentioned below, there is no withholding tax on payments of principal, premium or interest made to Luxembourg resident holders of Covered Bonds, nor on accrued but unpaid interest in respect of Covered Bonds, nor is any Luxembourg withholding tax payable upon redemption or repurchase of Covered Bonds held by Luxembourg resident holders of Covered Bonds.

Under the Law, payments of interest or similar income made or ascribed by a paying agent established in Luxembourg to or for the immediate benefit of an individual beneficial owner who is a resident of Luxembourg will be subject to a withholding tax of 10 per cent. Such withholding tax will be in full discharge of income tax if the beneficial owner is an individual acting in the course of the management of his/her private wealth. Responsibility for the withholding of the tax will be assumed by the Luxembourg paying agent. Payments of interest under the Covered Bonds coming within the scope of the Law would be subject to withholding tax of 10 per cent.

## SUBSCRIPTION AND SALE

The Dealers have pursuant to an amended and restated programme agreement (as the same may be amended and/or supplemented and/or restated from time to time, the **Programme Agreement**) dated February 29, 2008, agreed with the Issuer and the Fund a basis upon which such Dealers or any of them may from time to time agree to purchase Covered Bonds. Any such agreement for any particular purchase by a Dealer will extend to those matters stated under *Form of the Covered Bonds* and *Terms and Conditions of the Covered Bonds* above. In the Programme Agreement, the Issuer has agreed to reimburse and indemnify the Dealers for certain of their expenses and liabilities in connection with the establishment and any future update of the Programme and the issue of Covered Bonds under the Programme and to indemnify the Dealers against certain liabilities incurred by them in connection therewith.

### United States

The Covered Bonds and the Covered Bond Guarantee have not been and will not be registered under the Securities Act and Covered Bonds 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. Terms used in this paragraph have the meanings given to them by Regulation S under the Securities Act.

The Covered Bonds 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, as amended, 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 any Covered Bonds (a) as part of its distribution at any time or (b) otherwise until 40 days after the distribution, as determined and certified by the relevant Dealer or, in the case of an issue of Covered Bonds on a syndicated basis, the relevant lead manager, of all Covered Bonds of the Tranche of which such Covered Bonds 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 Covered Bonds during the distribution compliance period a confirmation or other notice setting forth the restrictions on offers and sales of the Covered Bonds 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 Covered Bonds, an offer or sale of such Covered Bonds within the United States by any dealer (who is 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 Variable Interest Covered Bonds 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 Covered Bonds, which additional selling restrictions shall be set out in the applicable Final Terms.

### Public Offer Selling Restriction under the Prospectus Directive

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 Member State (the **Relevant Implementation Date**) it has not made and will not make an offer of Covered Bonds which are the subject of the offering contemplated by this Prospectus as contemplated by the final terms in relation thereto 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 such Covered Bonds to the public in that Relevant Member State:

- (a) if the final terms in relation to the Covered Bonds specify that an offer of those Covered Bonds may be made other than pursuant to Article 3(2) of the Prospectus Directive in that Relevant Member State (a **Non-exempt Offer**), following the date of publication of a prospectus in relation to such Covered Bonds which has been approved by the competent authority in that Relevant Member State or, where appropriate, approved in another Member State and notified to the competent authority in that Relevant Member State, provided that any such prospectus has subsequently been completed by the final terms contemplating such Non-exempt Offer all in accordance with the



Prospectus Directive, in the period beginning and ending on the dates specified in such prospectus or final terms, as applicable;

- (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 turnover of more than €50,000,000, as shown in its last annual or consolidated accounts;
- (d) at any time to fewer than 100 natural or legal persons (other than qualified investors as defined in the Prospectus Directive) subject to obtaining the prior consent of the relevant Dealer or Dealers nominated by the Issuer for any such offer; or
- (e) at any time in any other circumstances falling within Article 3(2) of the Prospectus Directive,

provided that no such offer of Covered Bonds referred to in (b) to (e) above shall require the Issuer or any Dealer to publish a prospectus pursuant to Article 3 of the Prospectus Directive or supplement a prospectus pursuant to Article 16 of the Prospectus Directive.

For the purposes of this provision, the expression **offer of Covered Bonds to the public** in relation to any Covered Bonds 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 Covered Bonds to be offered so as to enable an investor to decide to purchase or subscribe the Covered Bonds, 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:

- (a) in relation to any Covered Bonds 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 Covered Bonds 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 Covered Bonds would otherwise constitute a contravention of Section 19 of the FSMA by the Issuer;
- (b) 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 Covered Bonds in circumstances in which Section 21(1) of the FSMA does not apply to the Issuer or the Fund; and
- (c) it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to any Covered Bonds in, from or otherwise involving the United Kingdom.

#### **Iceland**

Each Dealer has agreed, and each further Dealer appointed under the Programme will be required to agree, that it will not offer Covered Bonds to the public or any other entity in Iceland, except in compliance with the Icelandic Act on Securities Transactions and any applicable laws or regulations of Iceland.

#### **Japan**

The Covered Bonds have not been and will not be registered under the Financial Instruments and Exchange Law of Japan (Law No. 25 of 1948, as amended; the **FIEL**) 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 Covered Bonds, 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, or for the benefit of, a resident of Japan except pursuant to an exemption from the registration requirements of, and otherwise in compliance with, the FIEL and any other applicable laws, regulations and ministerial guidelines of Japan.

### **The Republic of Italy**

The offering of the Covered Bonds has not been registered pursuant to Italian securities legislation and, accordingly, no Covered Bonds may be offered, sold or delivered, nor may copies of the Prospectus or of any other document relating to the Covered Bonds be distributed, in the Republic of Italy, except:

- (i) to qualified investors (*investitori qualificati*), as defined pursuant to Article 100 of Legislative Decree No. 58 of February 24, 1998, as amended (the **Financial Services Act**) and the relevant implementing CONSOB regulations, as amended from time to time, and in Article 2 of the Prospectus Directive; or
- (ii) in other circumstances which are exempted from the rules on public offering pursuant to Article 100 of the Financial Services Act and Article 33, first paragraph, of CONSOB Regulation No. 11971 of May 14, 1999, as amended (**Regulation No. 11971**).

Any offer, sale or delivery of the Covered Bonds or distribution of copies of the Prospectus or any other document relating to the Covered Bonds 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, CONSOB Regulation No. 16190 of October 29, 2007 (as amended from time to time) and Legislative Decree No. 385 of September 1, 1993, as amended (the **Banking Act**);
- (b) in compliance with Article 129 of the Banking Act, as amended, and the implementing guidelines of the Bank of Italy, as amended from time to time, pursuant to which the Bank of Italy may request information on the issue or the offer of securities in the Republic of Italy; and
- (c) in compliance with any other applicable laws and regulations or requirements imposed by CONSOB or other Italian authority.

*Please note that in accordance with Article 100-bis of the Financial Services Act, where no exemption from the rules on public offerings applies under (i) and (ii) above, the subsequent distribution of the Covered Bonds on the secondary market in Italy must be made in compliance with the public offer and the prospectus requirement rules provided under the Financial Services Act and Regulation No. 11971. Failure to comply with such rules may result in the sale of such Covered Bonds being declared null and void and in the liability of the intermediary transferring the financial instruments for any damages suffered by the investors.*

### **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 Covered Bonds or possesses or distributes this Prospectus and will obtain any consent, approval or permission required by it for the purchase, offer, sale or delivery by it of Covered Bonds 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 none of the Issuer, the Fund, the Representative or any other Dealer shall have any responsibility therefor.

None of the Issuer, the Fund, the Representative or any of the Dealers represents that Covered Bonds 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 any such sale.

With regard to each Tranche, the relevant Dealer will be required to comply with any additional 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 Covered Bonds were duly authorised by a resolution of the Board of Directors of the Issuer dated October 28, 2005 and its update by a resolution dated July 26, 2007. The giving of the Covered Bond Guarantee was duly authorised by a resolution of the directors of the Management Company on behalf of the Fund dated March 10, 2006 and February 21, 2008.

### Listing of Covered Bonds

Application has been made to the OMX Nordic Exchange Iceland hf. to approve this document as a base prospectus for the purposes of Article 5.4 of the Prospectus Directive and application will be made to the OMX Nordic Exchange Iceland hf. for Covered Bonds issued under the Programme to be admitted to trading on the regulated market of the OMX Nordic Exchange Iceland hf. The regulated market of the OMX Nordic Exchange Iceland hf. is a regulated market for the purposes of the Markets in Financial Instruments Directive.

### Documents for Display

For the period of 12 months following the date of this Prospectus, copies of the following documents will, when published, be available for inspection from the registered office of the Issuer and from the specified office of the Principal Paying Agent for the time being in London:

- (a) the articles of association (with an English translation thereof) of each of the Issuer and the Fund;
- (b) the audited financial statements of the Issuer in respect of the financial years ended December 31, 2007 and December 31, 2006 in each case together with the audit reports prepared in connection therewith;
- (c) 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;
- (d) the forms of the Global Covered Bonds, the Definitive Covered Bonds, the Receipts, the Coupons and the Talons;
- (e) a copy of this Prospectus;
- (f) any future prospectuses, information memoranda and supplements (including Final Terms save that a Final Terms relating to a Covered Bond which is neither admitted to trading on a regulated market in the European Economic Area nor offered in the European Economic Area in circumstances where a prospectus is required to be published under the Prospective Directive will only be available for inspection by a holder of such Covered Bond and such holder must produce evidence satisfactory to the Issuer and the Paying Agent as to its holding of Covered Bonds and identity) to this Prospectus and any other documents incorporated herein or therein by reference;
- (g) in the case of each issue of Covered Bonds admitted to trading on the regulated market of the OMX Nordic Exchange Iceland hf. subscribed pursuant to a subscription agreement, the subscription agreement (or equivalent document); and
- (h) each Transaction Document.

The documents referred to under items (a), (b), (c) and (e) can also be obtained from the Issuer websites ([www.kaupthing.is](http://www.kaupthing.is) and [www.kaupthing.com](http://www.kaupthing.com)).

### Clearing Systems

The Covered Bonds 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 Covered Bonds 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 42 Avenue JF Kennedy, L-1855, Luxembourg. If the Covered Bonds 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 Covered Bonds 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 Group and there has been no material adverse change in the prospects of the Issuer or the Group, since December 31, 2007.

There has been no significant change in the financial or trading position, and there has been no material adverse change in the prospects, of the Fund since December 31, 2007.

**Litigation**

None of the Issuer, any of its subsidiaries or the Fund 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 or the Fund 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, the Group or the Fund.

**Takeover Bids**

No public takeover bids for our Shares have been made by any third party to date during the current financial year or the two prior financial years.

**Arranger**

The Issuer is the Arranger under this Programme.

**Legal Advisers**

Allen & Overy LLP, London, has provided legal advice in relation to the establishment of the Programme and drafting of the Transaction Documents. LM Attorneys, Reykjavik, has assisted in respect of all Icelandic law matters.

**Auditors**

The auditors of the Issuer and the Fund are KPMG 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 December 31, 2007 and December 31, 2006. The auditors of the Issuer have no material interest in the Issuer.

**Post-Issuance Information**

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

**Reports**

The Representative and Agency Agreement provides that the Representative may rely on reports or other information from professional advisers or other experts in accordance with the provisions of the Representative and Agency Agreement, whether or not any such report or other information, or engagement letter or other document entered into by the Representative and the relevant person in connection therewith, contains any monetary or other limit on the liability of the relevant person.

## GLOSSARY

<b>Account Banks</b>	Kaupthing Bank hf. and any other financial institution which accedes to the Bank Account Agreement as an Account Bank
<b>Accrual Period</b>	In accordance with Condition 5.8(c)(i)(A), 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
<b>Accrual Yield</b>	In relation to a Zero Coupon Covered Bond, the meaning given in the applicable Final Terms
<b>Accrued Interest</b>	In relation to a Loan as at any date, the interest accrued but not yet due and payable on the Loan from (and including) the Monthly Payment Day immediately preceding the relevant date to (but excluding) the relevant date
<b>Act</b>	Act No. 30/2003 on UCITS and Investment Funds
<b>Actual/360</b>	The meaning given in Condition 5.8(c)(v)
<b>Actual/365 (Fixed)</b>	The meaning given in Condition 5.8(c)(iii)
<b>Actual/365 (Sterling)</b>	The meaning given in Condition 5.8(c)(iv)
<b>Actual/Actual (ISDA)</b>	The meaning given in Condition 5.8(c)(ii)
<b>Actual/Actual (ISMA)</b>	The meaning given in Condition 5.8(c)(i)
<b>Additional Business Centre</b>	The meaning (if any) given in the applicable Final Terms
<b>Adjusted Aggregate Loan Amount</b>	The meaning given on page 144
<b>Adjusted Outstanding Principal Balance</b>	The meaning given on page 144
<b>Agents</b>	The Paying Agents and any Calculation Agent
<b>Amortised Face Amount</b>	The meaning given in Condition 7.6(b)
<b>Annuity Amount</b>	The meaning given in Condition 6.1
<b>Annuity Covered Bonds</b>	Covered Bonds which will be redeemed in Annuity Amounts (subject to adjustment for indexation in accordance with the provisions specified in the applicable Final Terms) on one or more Interest Payment Dates as specified in the applicable Final Terms
<b>Arrears of Interest</b>	In relation to a Loan as at any date, the aggregate of all interest and expenses which are due and payable and unpaid on that date
<b>Asset Coverage Test</b>	The test as to whether the Adjusted Aggregate Loan Amount is at least equal to the ISK Equivalent of the aggregate Principal Amount Outstanding of the Covered Bonds as calculated on the relevant Calculation Date
<b>Asset Coverage Test Breach Notice</b>	The notice required to be served by the Representative if the Adjusted Aggregate Loan Amount is less than the ISK Equivalent of the aggregate Principal Amount Outstanding of the Covered Bonds on two consecutive Calculation Dates
<b>Asset Monitor</b>	A reputable institution appointed pursuant to the Asset Monitor Agreement
<b>Asset Monitor Agreement</b>	The asset monitor agreement entered into on the Programme Date between the Asset Monitor, the Fund, the Cash Manager, the Issuer and the Representative (as amended and/or supplemented and/or restated from time to time)

<b>Asset Monitor Report</b>	The results of the tests conducted by the Asset Monitor in accordance with the Asset Monitor Agreement, to be delivered to the Cash Manager, the Fund, the Issuer and the Representative
<b>Asset Percentage</b>	Such percentage figure as determined from time to time in accordance with the terms of the Fund Deed
<b>Assignment Date</b>	Each of the First Assignment Date and each other date on which a New Portfolio is assigned to the Fund in accordance with the terms of the Mortgage Sale Agreement
<b>Authorised Investments</b>	ISK deposits, certificate of deposit and short-term debt obligations (including commercial paper) provided that in all cases such investments have a maturity date falling no later than the next following Fund Payment Date and that the short-term unsecured, unguaranteed and unsubordinated debt obligations of the issuing or guaranteeing entity or the entity with which the deposits are made (being an authorised Financial Institution under Act. 161/2002) are rated at least P-1 by Moody's or its equivalents by one other internationally recognised rating agency
<b>Available Receipts</b>	<p>On a relevant Calculation Date, an amount equal to the aggregate of (without double counting):</p> <ul style="list-style-type: none"> <li>(a) the amount of Revenue Receipts received during the immediately preceding Calculation Period and credited to the Revenue Ledger on the GIC Account;</li> <li>(b) any other amount standing to the credit of the Revenue Ledger including (i) the proceeds of any Term Advance (where such proceeds have not been applied to acquire New Portfolios, refinance an existing Term Advance or invest in Substitution Assets), (ii) any Cash Equity Contributions received from a Holder (other than those Cash Equity Contributions credited to the Reserve Ledger on the GIC Account) and (iii) the proceeds from any sale of Loans (including, but not limited to, Selected Loans) pursuant to the terms of the Fund Deed or the Mortgage Sale Agreement to the extent that such proceeds represent principal;</li> <li>(c) other net income of the Fund including all amounts of interest received on the Fund Accounts, the Substitution Assets and any Authorised Investments in the preceding Calculation Period and the proceeds from any sale of Loans (including, but not limited to, Selected Loans) pursuant to the terms of the Fund Deed or the Mortgage Sale Agreement to the extent that such proceeds comprise Accrued Interest and Arrears of Interest or other interest amounts;</li> <li>(d) amounts standing to the credit of the Reserve Fund in excess of the Reserve Fund Required Amount;</li> <li>(e) any other revenue receipts not referred to in paragraphs (a) to (d) (inclusive) above received during the previous Calculation Period and standing to the credit of the Revenue Ledger on the GIC Account; and</li> </ul>

- (f) following service of a Notice to Pay or an Asset Coverage Test Breach Notice (if not revoked), amounts standing to the credit of the Reserve Fund

<b>Bank Account Agreement</b>	The bank account agreement entered into on the Programme Date between the Fund, the Account Banks, the Cash Manager and the Representative (as amended and/or supplemented and/or restated from time to time)
<b>Borrower</b>	In relation to a Loan, each individual specified as such in the relevant Mortgage Terms together with each individual (if any) who assumes from time to time an obligation to repay such Loan or any part of it
<b>Broken Amount</b>	In respect of Fixed Rate Covered Bonds, the meaning (if any) given in the applicable Final Terms
<b>Business Day</b>	The meaning given in Condition 5.8(a)
<b>Business Day Convention</b>	In respect of a Tranche of Covered Bonds and either the Specified Periods or the Interest Payment Dates, the business day convention specified in the applicable Final Terms and determined in accordance with Condition 5.8(b)
<b>Calculation Agent</b>	In relation to one or more Series of Variable Interest Covered Bonds and Inflation Linked Annuity Covered Bonds, the person initially appointed as calculation agent in relation to such Covered Bonds by the Issuer and the Fund pursuant to the Representative and Agency Agreement or, if applicable, any successor calculation agent in relation to such Covered Bonds
<b>Calculation Date</b>	The third Business Day prior to each Fund Payment Date
<b>Calculation Period</b>	The period from (and including) one Calculation Date to (but excluding) the next following Calculation Date, except that the first Calculation Period shall commence on (and include) the first Issue Date under the Programme and end on (but exclude) the next following Calculation Date
<b>Cash Equity Contribution</b>	An equity contribution to the Fund made in cash by way of a loan or otherwise funded by the Seller as a Holder
<b>Cash Management Agreement</b>	The cash management agreement entered into on the Programme Date between the Fund, the Cash Manager and the Representative (as amended and/or supplemented and/or restated from time to time)
<b>Cash Manager</b>	Kaupthing Bank hf. in its capacity as cash manager, or any successor cash manager appointed from time to time
<b>Clearing Systems</b>	Euroclear and/or Clearstream, Luxembourg
<b>Clearstream, Luxembourg</b>	Clearstream Banking, <i>société anonyme</i> or its successors
<b>Common Depositary</b>	Deutsche Bank AG, London Branch, in its capacity as the common depositary for Euroclear and Clearstream, Luxembourg
<b>Couponholders</b>	The holders of the Coupons (which expression shall, unless the context otherwise requires, include the holders of the Talons)
<b>Coupons</b>	Interest coupons in respect of Definitive Covered Bonds
<b>Covered Bond</b>	Each covered bond issued or to be issued pursuant to the Programme Agreement, which covered bond may be represented by a Global Covered Bond or any Definitive Covered Bond and includes any replacements for a Covered Bond issued pursuant to Condition 11

<b>Covered Bond Guarantee</b>	An unconditional and irrevocable guarantee by the Fund in the Representative and Agency Agreement for the payment (following service of a Notice to Pay) of Guaranteed Amounts in respect of the Covered Bonds when the same shall become Due for Payment
<b>Covered Bondholders</b>	The holders for the time being of the Covered Bonds
<b>Credit Linked Interest Covered Bonds</b>	Covered Bonds in respect of which payments of interest will be calculated by reference to the creditworthiness of, performance of obligations by or some other factor relating to one or more Reference Entities, as set out in the applicable Final Terms
<b>Custody Agent</b>	Arion Custody Services hf. or such custody agent appointed by the Fund pursuant to its Articles of Association
<b>Customer Files</b>	<p>The file or files relating to each Loan and its Related Security containing, <i>inter alia</i>:</p> <ul style="list-style-type: none"> <li>(a) all material correspondence relating to that Loan; and</li> <li>(b) the completed mortgage documentation applicable to the Loan including the Mortgage Document and, if applicable, the Valuation Report,</li> </ul> <p>whether original documentation, in electronic form or otherwise</p>
<b>Day Count Fraction</b>	The applicable meaning given in Condition 5.8(c)
<b>Dealer</b>	Each dealer appointed from time to time in accordance with the Programme Agreement, which appointment may be for a specific issue or on an ongoing basis. References in this Prospectus to the <b>relevant Dealer</b> shall, in the case of an issue of Covered Bonds being (or intended to be) subscribed for by more than one Dealer, be to all Dealers agreeing to subscribe for such Covered Bonds
<b>Defaulted Loan</b>	Any Loan in the Portfolio which is three months or more in arrears
<b>Definitive Covered Bond</b>	A Covered Bond in definitive form issued or, as the case may require, to be issued by the Issuer in accordance with the provisions of the Programme Agreement or any other agreement between the Issuer and the relevant Dealer and the Representative and Agency Agreement in exchange for either a Temporary Global Covered Bond or part thereof or a Permanent Global Covered Bond (all as indicated in the applicable Final Terms), such Covered Bond in definitive form being in the form or substantially in the form set out in Part 3 of Schedule 4 to the Representative and Agency Agreement with such modifications (if any) as may be agreed between the Issuer, the Principal Paying Agent, the Representative and the relevant Dealer or Lead Manager (in the case of syndicated issues) and having the Terms and Conditions endorsed thereon or, if permitted by the relevant stock exchange, incorporating the Terms and Conditions by reference as indicated in the applicable Final Terms and having the relevant information supplementing, replacing or modifying the Terms and Conditions appearing in the applicable Final Terms endorsed thereon or attached thereto and (except in the case of a Zero Coupon Covered Bond in bearer form) having Coupons and, where appropriate, Receipts and/or Talons attached thereto on issue
<b>Designated Maturity</b>	The meaning given in the ISDA Definitions
<b>Determination Date</b>	The meaning given in the applicable Final Terms



<b>Determination Period</b>	The meaning given in Condition 5.8(d)
<b>Directors</b>	The directors for the time being of the Issuer or the Management Company, as the case may be
<b>Dual Currency Interest Covered Bond</b>	A Covered Bond in respect of which payments of interest will be made in such currencies, and based on such rates of exchange, as the Issuer and the relevant Dealer may agree, such currencies and rates of exchange to be specified in the applicable Final Terms
<b>Due for Payment</b>	<p>The requirement by the Fund to pay any Guaranteed Amount:</p> <p>(a) following service of a Notice to Pay but prior to service of a Fund Acceleration Notice on the date on which the Scheduled Payment Date in respect of such Guaranteed Amount is reached or such other Interest Payment Date(s) specified in the applicable Final Terms (the <b>Due for Payment Date</b>).</p> <p>For the avoidance of doubt, Due for Payment does not refer to any earlier date upon which payment of any Guaranteed Amounts may become due under the guaranteed obligations, by reason of prepayment, acceleration of maturity, mandatory or optional redemption or otherwise; or</p> <p>(b) following service of a Fund Acceleration Notice, on the date on which the Fund Acceleration Notice is served on the Issuer and the Fund</p>
<b>Due for Payment Date</b>	The meaning given in paragraph (a) of the definition of Due for Payment
<b>Earliest Maturing Covered Bonds</b>	At any time, the Series of the Covered Bonds (other than any Series which is fully collateralised by amounts standing to the credit of the GIC Account) that has or have the earliest Final Maturity Date as specified in the applicable Final Terms (ignoring any acceleration of amounts due under the Covered Bonds prior to service of a Fund Acceleration Notice)
<b>Early Redemption Amount</b>	The amount calculated in accordance with Condition 7.6
<b>Eligibility Criteria</b>	The meaning given on page 137
<b>Equity Contribution</b>	In relation to each Holder, the aggregate of the capital contributed by that Holder to the Fund from time to time by way of Cash Equity Contributions and Equity Contributions in Kind as determined on each Calculation Date in accordance with the formula set out in the Fund Deed
<b>Equity Contribution</b>	A Cash Equity Contribution and/or and Equity Contribution in Kind
<b>Equity Contributions in Kind</b>	A contribution of Loans and their Related Security to the Fund in an amount equal to (a) the Outstanding Principal Balance of those Loans as at the relevant Assignment Date minus (b) any cash payment (in ISK) paid by the Fund for the Loans and their Related Security on that Assignment Date
<b>Equity Linked Interest Covered Bonds</b>	Covered Bonds in respect of which payments of interest will be calculated by reference to the price, value, performance or some other factor relating to one or more Reference Assets, as set out in the applicable Final Terms
<b>Established Rate</b>	The meaning given in Condition 4
<b>EU</b>	European Union
<b>EURIBOR</b>	Euro-zone inter-bank offered rate

<b>Euroclear</b>	Euroclear Bank S.A./N.V. or its successor
<b>Excess Proceeds</b>	In accordance with Condition 10.1, moneys received (following service of an Issuer Acceleration Notice) by the Representative from the Issuer or any administrator, administrative or other receiver, manager or other similar officer appointed in relation to the Issuer
<b>Exchange Date</b>	On or after the date which is 40 days after a Temporary Covered Bond is issued
<b>Exchange Event</b>	The meaning given on page 39
<b>Exchange Notice</b>	The meaning given in Condition 4
<b>Excluded Indebtedness</b>	The meaning given in Condition 3
<b>Excluded Scheduled Interest Amounts</b>	The meaning given in the definition of Scheduled Interest
<b>Excluded Scheduled Principal Amounts</b>	The meaning given in the definition of Scheduled Principal
<b>Existing Covered Bonds</b>	In accordance with Condition 7.12, the Covered Bonds of all Series then outstanding
<b>Extraordinary Resolution</b>	A resolution of the Covered Bondholders passed as such under the terms of the Representative and Agency Agreement
<b>Final Maturity Date</b>	The Interest Payment Date on which a Series of Covered Bonds will be redeemed at the Final Redemption Amount in accordance with the Terms and Conditions
<b>Final Redemption Amount</b>	The meaning given in the relevant Final Terms
<b>Final Terms</b>	The final terms supplement to be prepared with respect to each Tranche of Covered Bonds
<b>First Assignment Date</b>	The date on which the first New Portfolio is assigned to the Fund pursuant to the terms of the Mortgage Sale Agreement
<b>Fixed Coupon Amount</b>	In respect of Fixed Rate Covered Bonds, the meaning given in the applicable Final Terms
<b>Fixed Rate Covered Bonds</b>	Covered Bonds that pay a fixed rate of interest on such date or dates as may be agreed between the Issuer and the relevant Dealer and on redemption calculated on the basis of such Day Count Fraction as may be agreed between the Issuer and the relevant Dealer
<b>Floating Rate</b>	The meaning given in the ISDA Definitions
<b>Floating Rate Convention</b>	The meaning given in Condition 5.8(b)(i)
<b>Floating Rate Covered Bonds</b>	<p>Covered Bonds which bear interest at a rate determined:</p> <ul style="list-style-type: none"> <li>(a) 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 ISDA Definitions; or</li> <li>(b) on the basis of a reference rate appearing on the agreed screen page of a commercial quotation service; or</li> <li>(c) on such other basis as may be agreed between the Issuer and the relevant Dealer,</li> </ul> <p>as set out in the applicable Final Terms</p>
<b>Floating Rate Option</b>	The meaning given in the ISDA Definitions

<b>Following Business Day Convention</b>	The meaning given in Condition 5.8(b)(ii)
<b>FSMA</b>	Financial Services and Markets Act 2000, as amended
<b>Fund</b>	Kaupthing Mortgages Institutional Investor Fund
<b>Fund Acceleration Notice</b>	The meaning given in Condition 10.2
<b>Fund Accounts</b>	The GIC Account and any additional or replacement accounts opened in the name of the Fund
<b>Fund Deed</b>	The deed entered into on the Programme Date between the Fund, the Seller and the Representative (as amended and/or supplemented and/or restated from time to time)
<b>Fund Event of Default</b>	The meaning given in Condition 10.2
<b>Fund Payment Date</b>	The 15th day of each month or if not a Business Day the next following Business Day
<b>GIC Account</b>	The account in the name of the Fund held with Kaupthing Bank hf. and maintained subject to the terms of the Guaranteed Investment Contract and the Bank Account Agreement or such additional or replacement account as may for the time being be in place with the prior consent of the Representative and designated as such
<b>GIC Provider</b>	Kaupthing Bank hf., in its capacity as GIC provider or any successor GIC provider appointed from time to time
<b>Global Covered Bond</b>	A Temporary Global Covered Bond and/or a Permanent Global Covered Bond, as the context may require
<b>Global Covered Bonds</b>	Global Covered Bonds comprising Temporary Global Covered Bonds and Permanent Global Covered Bonds
<b>Government Entities</b>	The meaning given in Condition 3
<b>Group</b>	The Issuer and its Subsidiaries
<b>Guaranteed Amounts</b>	Prior to service of a Fund Acceleration Notice, with respect to any Due for Payment Date, the sum of Scheduled Interest and Scheduled Principal, in each case, payable on that Due for Payment Date, or after service of a Fund Acceleration Notice, an amount equal to the relevant Early Redemption Amount as specified in the Terms and Conditions plus all accrued and unpaid interest and all other amounts due and payable in respect of the Covered Bonds, including all Excluded Scheduled Interest Amounts, all Excluded Scheduled Principal Amounts (whenever the same arose) and all amounts payable by the Fund under the Representative and Agency Agreement
<b>Guaranteed Amounts Due Date</b>	The later of (a) the date which is two Business Days following service of a Notice to Pay on the Fund, and (b) the date on which the Guaranteed Amounts are otherwise Due for Payment
<b>Guaranteed Investment Contract or GIC</b>	The guaranteed investment contract between the Fund, the GIC Provider, the Representative and the Cash Manager dated the Programme Date
<b>Guarantee Priority of Payments</b>	The meaning given on page 153
<b>Holder</b>	A holder of unit shares issued by the Fund
<b>Icelandic GAAP</b>	Generally acceptable accounting principles in Iceland
<b>ICP Handbook</b>	The internal control and procedural handbook for the Issuer

<b>IFRS</b>	International Financial Reporting Standards
<b>Index Linked Interest Covered Bonds</b>	Covered Bonds in respect of which payments of interest will be calculated by reference to such index and/or formula or to changes in the prices of such securities or commodities or to such other factors as the Issuer and the relevant Dealer may agree
<b>Inflation Linked Annuity Covered Bonds</b>	Covered Bonds that pay an Annuity Amount on such dates or dates as agreed between the Issuer and the relevant Dealer
<b>Insolvency Event</b>	<p>In respect of the Seller, the Servicer, the Custody Agent or the Cash Manager:</p> <ul style="list-style-type: none"> <li>(a) an order is made by any competent court or an effective resolution passed for the liquidation or winding up or dissolution of the relevant entity except for the purposes of a reconstruction, amalgamation or merger or following the transfer of all or substantially all of the assets of the relevant entity, the terms of which have been approved by an Extraordinary Resolution of the Covered Bondholders; or</li> <li>(b) the relevant entity 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 Covered Bondholders or for the purposes of a reconstruction, amalgamation or merger between the Issuer and the relevant entity or following the transfer of all or substantially all of the assets of the Issuer to the relevant entity or of the relevant entity to the Issuer or the relevant entity 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</li> <li>(c) an encumbrancer takes possession or a receiver, administrator, administrative receiver or other similar officer is appointed to the whole or any material part of the undertaking, property or assets of the relevant entity, or a distress, diligence or execution or other process is levied, enforced upon, sued out or put in force against the whole or any material part of the chattels or property of the relevant entity and, in the case of the foregoing events, is not discharged within 30 days</li> </ul>
<b>Instalment Amounts</b>	In respect of Instalment Covered Bonds, each amount specified as such in the applicable Final Terms
<b>Instalment Covered Bonds</b>	Covered Bonds which will be redeemed in Instalment Amounts and on the Instalment Dates specified in the applicable Final Terms
<b>Instalment Dates</b>	In respect of Instalment Covered Bonds, each date specified as such in the applicable Final Terms
<b>Intercompany Loan Agreement</b>	The term loan agreement dated the Programme Date between the Issuer, the Fund, the Cash Manager and the Representative
<b>Interest Amount</b>	The amount of interest payable on the Floating Rate Covered Bonds or Variable Interest Covered Bonds in respect of each Specified Denomination for the relevant Interest Period, as calculated in accordance with Condition 5.3(d)

<b>Interest Commencement Date</b>	In the case of interest-bearing Covered Bonds, the date specified in the applicable Final Terms from (and including) which the relevant Covered Bonds will accrue interest
<b>Interest Determination Date</b>	In respect of Floating Rate Covered Bonds to which Screen Rate Determination is applicable, the meaning given in the applicable Final Terms
<b>Interest Payment Date</b>	In respect of Fixed Rate Covered Bonds, the meaning given in the applicable Final Terms and in respect of Floating Rate Covered Bonds and Variable Interest Covered Bonds, the meaning given in Condition 5.3(a)
<b>Interest Period</b>	In accordance with Condition 5.8(e), the period from (and including) an Interest Payment Date (or the Interest Commencement Date) to (but excluding) the next (or first) Interest Payment Date
<b>Investor Report</b>	The monthly report made available to the Covered Bondholders, the Representative and the Rating Agency detailing, <i>inter alia</i> , compliance with the Asset Coverage Test
<b>Investor's Currency</b>	The currency or currency unit that an investor's financial activities are denominated in, other than the Specified Currency
<b>ISDA</b>	International Swaps and Derivatives Association, Inc.
<b>ISDA Definitions</b>	The meaning given in Condition 5.3(b)(i)
<b>ISDA Determination</b>	If specified as applicable in the applicable Final Terms Document, the manner in which the Rate of Interest on Floating Rate Covered Bonds is to be determined in accordance with Condition 5.3(b)(i)
<b>ISDA Rate</b>	The meaning given in Condition 5.3(b)(i)
<b>ISK Equivalent</b>	In relation to a Term Advance or a Series of Covered Bonds (including any calculations of the Required Redemption Amount of such Series of Covered Bonds) which is denominated in (a) a currency other than ISK, the ISK equivalent of such amount ascertained using the exchange rate specified in the swap agreement entered into in respect of the relevant Covered Bonds, or the applicable spot rate and (b) ISK, the applicable amount in ISK
<b>ISK or Icelandic króna or krónur</b>	The lawful currency of Iceland
<b>Issue Date</b>	Each date on which the Issuer issues a Tranche of Covered Bonds under the Programme, as specified in the applicable Final Terms
<b>Issue Price</b>	The price, generally expressed as a percentage of the nominal amount of the Covered Bonds, at which a Tranche of Covered Bonds will be issued
<b>Issuer</b>	Kaupthing Bank hf.
<b>Issuer-ICSD Agreement</b>	The Issuer-ICSD Agreement entered into on February 29, 2008 between the Issuer, Clearstream, Luxembourg and Euroclear
<b>Issuer Acceleration Notice</b>	The meaning given in Condition 10.1
<b>Issuer Call</b>	If specified as applicable in the applicable Final Terms, the provision by which the Issuer may redeem a Series of Covered Bonds in accordance with Condition 7.3
<b>Issuer Event of Default</b>	The meaning given in Condition 10.1
<b>Ledger</b>	Each of the Revenue Ledger, the Reserve Ledger, the Unit Account Ledger and the Payment Ledger

<b>Legislative Exchange</b>	The meaning given in Condition 7.12
<b>Lending Criteria</b>	The lending criteria of the Seller from time to time, or such other criteria as would be acceptable to a Reasonable, Prudent Mortgage Lender
<b>LIBOR</b>	London inter-bank offered rate
<b>Loan</b>	Each mortgage loan referenced by its mortgage loan identifier number and comprising the aggregate of all principal sums, interest, costs, charges, expenses and other moneys due or owing with respect to that mortgage loan under the relevant Mortgage Terms by a borrower on the security of a Mortgage from time to time outstanding or, as the context may require, the borrower's obligations in respect of the same
<b>Loan Repurchase Notice</b>	A notice in substantially the form set out in the Mortgage Sale Agreement served by the Fund on the Seller in relation to the repurchase of Loans in the Portfolio by the Seller in accordance with the terms of the Mortgage Sale Agreement
<b>Long Maturity Covered Bond</b>	A Fixed Rate Covered Bond (other than a Fixed Rate Covered Bond which on issue had a Talon attached) whose nominal amount on issue is less than the aggregate interest payable thereon provided that such Covered Bond shall cease to be a Long Maturity Covered Bond on the Interest Payment Date on which the aggregate amount of interest remaining to be paid after that date is less than the Principal Amount Outstanding of such Covered Bond
<b>Management Company</b>	Kaupthing Bank Asset Management Company hf. or such other management company appointed pursuant to the Fund's Articles of Association
<b>Margin</b>	In respect of a Floating Rate Covered Bond, the percentage rate per annum (if any) specified in the applicable Final Terms
<b>Markets in Financial Instruments Directive</b>	Directive 2004/39/EC
<b>Master Definitions and Construction Agreement</b>	The amended and restated master definitions and construction agreement made between the parties to the Transaction Documents on February 29, 2008 (as the same may be amended and/or supplemented and/or restated from time to time)
<b>Maximum Rate of Interest</b>	In respect of Floating Rate Covered Bonds or Variable Interest Covered Bonds, the percentage rate per annum (if any) specified in the applicable Final Terms
<b>Maximum Redemption Amount</b>	The amount specified as such in the applicable Final Terms
<b>Member State</b>	A state which is a member of the European Economic Area
<b>Minimum Rate of Interest</b>	In respect of Floating Rate Covered Bonds or Variable Interest Covered Bonds, the percentage rate per annum (if any) specified in the applicable Final Terms
<b>Minimum Redemption Amount</b>	The amount specified as such in the applicable Final Terms
<b>Modified Following Business Day Convention</b>	The meaning given in Condition 5.8(b)(iii)
<b>Monthly Asset Coverage Report</b>	The report substantially in the form set out in Schedule 3 to the Cash Management Agreement
<b>Monthly Payment</b>	The amount which the relevant Mortgage Terms require a Borrower to pay on each Monthly Payment Day in respect of that Borrower's Loan

<b>Monthly Payment Day</b>	The date on which the Monthly Payment is due to be paid by a Borrower on a Loan or, if any such day is not a Business Day, the next following Business Day
<b>Moody's</b>	Moody's Investors Service Limited or its successors
<b>Mortgage</b>	The legal charge, mortgage, standard security or charge securing a Loan
<b>Mortgage Conditions</b>	The terms and conditions applicable to the Loans as contained in the Seller's Standard Documentation
<b>Mortgage Document</b>	The document evidencing the Mortgage
<b>Mortgage Pool</b>	The mortgages owned from time to time by the Fund
<b>Mortgage Sale Agreement</b>	The mortgage sale agreement entered into on the Programme Date between the Seller, the Fund and the Representative (as amended and/or supplemented and/or restated from time to time) and, where the context so requires, including any New Mortgage Sale Agreement entered into from time to time between any New Seller, the Fund and the Representative
<b>Mortgage Terms</b>	All of the terms and conditions applicable to a Loan, including, without limitation, the applicable Mortgage Conditions
<b>New Covered Bonds</b>	The meaning given in Condition 7.12
<b>New Loan</b>	Loans which the Seller may assign or transfer to the Fund pursuant to the Mortgage Sale Agreement
<b>New Mortgage Sale Agreement</b>	Any new mortgage sale agreement entered into between any New Seller, the Fund and the Representative (as amended and/or supplemented and/or restated from time to time), which shall be substantially in the same form and contain substantially the same provisions as the mortgage sale agreement entered into on the Programme Date between the Seller, the Fund and the Representative (as amended and/or supplemented and/or restated from time to time)
<b>New Portfolio</b>	Each portfolio of Loans and their Related Security (other than any Loans and their Related Security which have been redeemed in full prior to the relevant Assignment Date or which do not otherwise comply with the terms of the Mortgage Sale Agreement as at the relevant Assignment Date), particulars of which are set out in the relevant New Portfolio Notice or in a document stored upon electronic media (including, but not limited to, a CD-Rom)
<b>New Portfolio Notice</b>	A notice in the form set out in the Mortgage Sale Agreement served in accordance with the terms of the Mortgage Sale Agreement
<b>New Seller</b>	Any entity that accedes to the relevant Transaction Documents and sells New Seller Loans and their Related Security to the Fund in the future pursuant to a New Mortgage Sale Agreement
<b>New Seller Loans</b>	Loans originated by a New Seller
<b>NGN</b>	A Temporary Global Covered Bond in the form set out in Part 1 of Schedule 4 of the Representative and Agency Agreement or a Permanent Global Covered Bond in the form set out in Part 2 of Schedule 4 of the Representative and Agency Agreement, in either case where the applicable Final Terms specify that the Covered Bonds are in NGN form
<b>Notice to Pay</b>	The meaning given in Condition 10.1
<b>OMX ICE</b>	OMX Nordic Exchange Iceland hf.

<b>Optional Redemption Amount</b>	The meaning (if any) given in the applicable Final Terms
<b>Optional Redemption Date</b>	The meaning (if any) given in the applicable Final Terms
<b>Outstanding Principal Balance</b>	In relation to a Loan at any date, the aggregate of any amounts advanced to a Borrower and any interest or expenses owed by a Borrower less any prepayment, repayment or payment of the foregoing made on or prior to the determination date
<b>Partial Portfolio</b>	Part of any portfolio of Selected Loans
<b>Partly-Paid Covered Bonds</b>	Covered Bonds which are only partly paid up on issue, in respect of which interest will accrue in accordance with Condition 5.5 on the paid-up amount of such Covered Bonds or on such other basis as may be agreed between the Issuer and the relevant Dealer and indicated in the applicable Final Terms
<b>Paying Agents</b>	The Principal Paying Agent and any other paying agent appointed pursuant to the terms of the Representative and Agency Agreement
<b>Payment Day</b>	The meaning given in Condition 6.6
<b>Payment Ledger</b>	The ledger on the GIC Account of such name maintained by the Cash Manager pursuant to the Cash Management Agreement to record the credits and debits of Available Receipts and for application in accordance with the relevant Priority of Payments
<b>Permanent Global Covered Bond</b>	The meaning given on page 39
<b>Permitted Security Interest</b>	The meaning given in Condition 3
<b>Portfolio</b>	Each New Portfolio acquired by the Fund but excluding Loans which have been redeemed in full or repurchased by the Seller or a New Seller or otherwise sold by the Fund
<b>Post-Enforcement Priority of Payments</b>	The meaning given on page 154
<b>Potential Fund Event of Default</b>	The meaning given in Condition 15
<b>Potential Issuer Event of Default</b>	The meaning given in Condition 15
<b>Pre-Acceleration Priority of Payments</b>	The meaning given on page 152
<b>Preceding Business Day Convention</b>	The meaning given in Condition 5.8(b)(iv)
<b>Principal Amount Outstanding</b>	In accordance with Condition 5.8(f), in respect of a Covered Bond on any day, the principal amount of that Covered Bond on the relevant Issue Date thereof less principal amounts received by the relevant Covered Bondholder in respect thereof on or prior to that day
<b>Principal Paying Agent</b>	Deutsche Bank AG, London Branch, and any successor principal paying agent
<b>Principal Subsidiary</b>	The meaning given in Condition 10.1
<b>Priorities of Payments</b>	The orders of priority for the allocation and distribution of amounts standing to the credit of the Fund Accounts in different circumstances
<b>Programme</b>	ISK 200,000,000,000 covered bond programme established by the Issuer on the Programme Date
<b>Programme Agreement</b>	The amended and restated programme agreement entered into on February 29, 2008 between the Issuer, the Fund and the Dealers (as amended and/or supplemented and/or restated from time to time)
<b>Programme Date</b>	March 29, 2006



<b>Programme Resolution</b>	Any Extraordinary Resolution to direct the Representative to accelerate the Covered Bonds pursuant to Condition 10 or to direct the Representative to take any enforcement action pursuant to Condition 10
<b>Property</b>	A residential property in Iceland which is subject to a Mortgage
<b>Prospectus Directive</b>	Directive 2003/71/EC
<b>Purchaser</b>	Any third party or the Seller to whom the Fund offers to sell Selected Loans
<b>Rate of Interest</b>	In respect of a Series of interest-bearing Covered Bonds, the rate of interest payable from time to time in respect of such Covered Bonds determined in accordance with the Terms and Conditions and the applicable Final Terms
<b>Rating Agency</b>	Moody's or such other rating agency which has assigned a rating to the Covered Bonds as requested by the Issuer from time to time
<b>Rating Agency Confirmation</b>	A confirmation in writing by the Rating Agency that the then current ratings of the Covered Bonds will not be adversely affected by or withdrawn as a result of the relevant event or matter
<b>Reasonable, Prudent Mortgage Lender</b>	A lender acting within the policy applied by the Seller and/or the Servicer, as applicable, from time to time to the originating, underwriting and servicing of mortgage loans beneficially owned by the Seller outside the Mortgage Pool
<b>Receiptholders</b>	The holders of the Receipts
<b>Receipts</b>	Receipts for the payment of instalments of principal and indexation amounts (other than the final instalment) attached on issue to Definitive Covered Bonds repayable in instalments
<b>Redeemed Covered Bonds</b>	The meaning given in Condition 7.3
<b>Redenomination Date</b>	The meaning given in Condition 4
<b>Reference Assets</b>	In respect of Equity Linked Interest Covered Bonds, shares or other securities, as indicated in the applicable Final Terms
<b>Reference Entities</b>	In respect of Credit Linked Interest Covered Bonds, entities as indicated in the applicable Final Terms
<b>Reference Price</b>	In respect of a Zero Coupon Covered Bond, the meaning given in the applicable Final Terms
<b>Reference Rate</b>	In respect of Floating Rate Covered Bonds to which Screen Rate Determination applies, the meaning given in the applicable Final Terms
<b>Regulation S</b>	Regulation S under the Securities Act
<b>Related Security</b>	In relation to a Loan, the security for the repayment of that Loan including the relevant Mortgage and all other matters applicable thereto acquired as part of the Portfolio
<b>Relevant Date</b>	The meaning given in Condition 9
<b>Relevant Implementation Date</b>	The meaning given on page 160
<b>Relevant Indebtedness</b>	The meaning given in Condition 3
<b>Relevant Member State</b>	The meaning given on page 3
<b>Relevant Screen Page</b>	In respect of Floating Rate Covered Bonds to which Screen Rate Determination applies, the meaning given in the Final Terms
<b>Representative</b>	Deutsche Trustee Company Limited, in its capacity as representative of the

	Covered Bondholders together with any successor appointed from time to time under the Representative and Agency Agreement
<b>Representative and Agency Agreement</b>	The amended and restated representative and agency agreement dated February 29, 2008 and made between the Issuer, the Fund, the Representative, the Principal Paying Agent and the other Paying Agents (as amended and/or supplemented and/or restated from time to time)
<b>Representations and Warranties</b>	The representations and warranties set out in the Mortgage Sale Agreement
<b>Required Amount</b>	<p>If the Issuer's short-term, unsecured, unsubordinated and unguaranteed debt obligations are rated at least P-1 by Moody's, nil or such other amount as Kaupthing Bank hf. shall direct the Fund from time to time and otherwise, an amount equal to the ISK Equivalent of the interest due on each Series of Covered Bonds for X months together with an amount equal to one-quarter of the anticipated aggregate annual amount payable in respect of the items specified in paragraphs (a) to (b) of the Pre-Acceleration Priority of Payments plus ISK 10,000,000 or such higher amount as Kaupthing Bank hf. shall direct the Fund from time to time</p> <p>where,</p> <p>X = the number of months between the Interest Payment Dates in relation to the Series of Covered Bonds</p>
<b>Required Outstanding Principal Balance Amount</b>	The meaning given on page 146
<b>Required Redemption Amount</b>	The meaning given on page 147
<b>Reserve Fund</b>	The reserve fund that the Fund will be required to establish on the GIC Account which will be credited with Available Receipts up to an amount equal to the Reserve Fund Required Amount and any Cash Equity Contributions made to the Fund by the Seller which the Seller directs the Fund to credit thereto
<b>Reserve Fund Required Amount</b>	The meaning given to it on page 151
<b>Reserve Ledger</b>	The ledger on the GIC Account of such name maintained by the Cash Manager pursuant to the Cash Management Agreement, to record the crediting of Revenue Receipts and (if so directed by the Seller) Cash Equity Contributions to the Reserve Fund and the debiting of such Reserve Fund in accordance with the terms of the Fund Deed
<b>Reserved Matter</b>	<p>In relation to Covered Bonds of a Series:</p> <ul style="list-style-type: none"> <li>(a) reduction or cancellation of the amount payable or, where applicable, modification of the method of calculating the amount payable or modification of the date of payment or, where applicable, modification of the method of calculating the date of payment in respect of any principal or interest in respect of the Covered Bonds other than in accordance with the terms thereof;</li> <li>(b) alteration of the currency in which payments under the Covered Bonds, Receipts and Coupons are to be made;</li> <li>(c) alteration of the majority required to pass an Extraordinary Resolution;</li> <li>(d) any amendment to the Covered Bond Guarantee (except in a manner determined by the Representative not to be materially prejudicial to</li> </ul>

the interests of the Covered Bondholders of any Series or an amendment which is in the sole opinion of the Representative of a formal, minor or technical nature or to correct a manifest error or an error which is, in the sole opinion of the Representative proven or is to comply with mandatory provisions of law);

- (e) the sanctioning of any such scheme or proposal for the exchange or sale of the Covered Bonds or the conversion of the Covered Bonds into, or the cancellation of the Covered Bonds in consideration of, shares, stock, covered bonds, bonds, debentures, debenture stock and/or other obligations and/or securities of the Issuer or any other company formed or to be formed, or for or into or in consideration of cash, or partly for or into or in consideration of such shares, stock, bonds, covered bonds, debentures, debenture stock and/or other obligations and/or securities as aforesaid and partly for or into or in consideration of cash; and
- (f) alteration of the proviso to paragraph 7 or paragraph 8 of Schedule 6 to the Representative and Agency Agreement

<b>Reset Date</b>	The meaning given in the ISDA Definitions
<b>Responsible Persons</b>	The meaning given on page 5
<b>Revenue Ledger</b>	The ledger on the GIC Account of such name maintained by the Cash Manager pursuant to the Cash Management Agreement, to record credits and debits of Revenue Receipts and certain other amounts in accordance with the terms of the Fund Deed
<b>Revenue Receipts</b>	Any payment received in respect of any Loan (otherwise than in respect of a Loan that has been repurchased by the Seller), whether as all or part of a Monthly Payment in respect of such Loan, on redemption (including partial redemption) of such Loan, on enforcement of such Loan (including the proceeds of sale of the relevant Property) or on the disposal of such Loan or otherwise
<b>Scheduled Interest</b>	In relation to a Series of Covered Bonds, an amount equal to the amount in respect of interest which is or would have been due and payable under such Covered Bonds on each Interest Payment Date as specified in Condition 5, together in the case of Inflation Linked Annuity Covered Bonds, any indexation amount payable in respect of such interest in accordance with the provisions of the applicable Final Terms (but excluding any additional amounts relating to premiums, default interest or interest upon interest ( <b>Excluded Scheduled Interest Amounts</b> ) payable by the Issuer following service of an Issuer Acceleration Notice, but including such amounts (whenever the same arose) following service of a Fund Acceleration Notice), as if such Covered Bonds had not become due and repayable prior to their Final Maturity Date or, where applicable, after the Final Maturity Date, such other amount of interest as may be specified in the applicable Final Terms
<b>Scheduled Payment Date</b>	In relation to payments under the Covered Bond Guarantee in respect of a Series of Covered Bonds, each Interest Payment Date or the Final Maturity Date as if such Covered Bonds had not become due and repayable prior to their Final Maturity Date
<b>Scheduled Principal</b>	In relation to a Series of Covered Bonds, an amount equal to the amount in respect of principal or other amount which is or would have been due and repayable under such Covered Bonds on each Interest Payment Date or the

	Final Maturity Date (as the case may be) as specified in Condition 7.1 or 7.2, as the case may be, and Condition 7.6 (but excluding any additional amounts relating to prepayments, early redemption, broken funding indemnities, penalties, premiums or default interest ( <b>Excluded Scheduled Principal Amounts</b> ) payable by the Issuer following service of an Issuer Acceleration Notice, but including such amounts (whenever the same arose) following service of a Fund Acceleration Notice), as if such Covered Bonds had not become due and repayable prior to their Final Maturity Date
<b>Screen Rate Determination</b>	If specified as applicable in the applicable Final Terms, the manner in which the Rate of Interest on Floating Rate Covered Bonds is to be determined in accordance with Condition 5.3(b)(ii)
<b>Securities Act</b>	U.S. Securities Act of 1933, as amended
<b>Securities and Exchange Law</b>	The Securities and Exchange Law of Japan
<b>Security Interest</b>	The meaning given in Condition 3
<b>Selected Loan Offer Notice</b>	A notice from the Fund served on the Seller offering to sell Selected Loans and their Related Security for an offer price equal to the greater of the then Outstanding Principal Balance of the Selected Loans and the Required Redemption Amount
<b>Selected Loan Repurchase Notice</b>	A notice from the Seller served on the Fund accepting an offer set out in a Selected Loan Offer Notice
<b>Selected Loans</b>	Loans and their Related Security to be sold by the Fund pursuant to the terms of the Fund Deed or the Mortgage Sale Agreement having in aggregate the Required Outstanding Principal Balance Amount
<b>Selection Date</b>	The meaning given in Condition 7.3
<b>Seller</b>	Kaupthing Bank hf.
<b>Seller's Policy</b>	means the originating, underwriting, administration, arrears and enforcement policy applied by the Seller from time to time to Loans and their Related Security for their repayment which are owned by the Seller
<b>Series</b>	A Tranche of Covered Bonds together with any further Tranche or Tranches of Covered Bonds which are (a) expressed to be consolidated and form a single series and (b) 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
<b>Servicer</b>	Kaupthing Bank hf. in its capacity as servicer under the Servicing Agreement (and any successor servicer)
<b>Servicer Event of Default</b>	The meaning given on page 142
<b>Servicer Termination Event</b>	The meaning given on page 142
<b>Servicing and Custody Agreement</b>	The servicing and custody agreement entered into on the Programme Date between the Fund, the Servicer and the Representative
<b>Singer &amp; Friedlander</b>	Singer & Friedlander Group plc
<b>SMEs</b>	Small and medium sized enterprises
<b>Specified Asset</b>	The meaning given in Condition 3
<b>Specified Currency</b>	Subject to any applicable legal or regulatory restrictions, euro, Sterling, U.S. Dollars and such other currency or currencies as may be agreed from time to

	time by the Issuer, the relevant Dealer, the Principal Paying Agent and the Representative and specified in the applicable Final Terms Document
<b>Specified Denomination</b>	In respect of a Series of Covered Bonds, the denomination or denominations of such Covered Bonds specified in the applicable Final Terms
<b>Specified Interest Payment Date</b>	In respect of Floating Rate Covered Bonds or Variable Interest Covered Bonds, the meaning (if any) given in the applicable Final Terms
<b>Specified Period</b>	In respect of Floating Rate Covered Bonds or Variable Interest Covered Bonds, the meaning (if any) given in the applicable Final Terms
<b>Stabilising Manager</b>	Kaupthing Bank hf.
<b>Standard Documentation</b>	The standard documentation, annexed as an exhibit of the Mortgage Sale Agreement or any update or replacement therefor as the Seller may from time to time introduce acting in accordance with the standards of a Reasonable, Prudent Mortgage Lender
<b>Subsidiary</b>	The meaning given in Condition 3
<b>Substitution Assets</b>	Each of: <ul style="list-style-type: none"> <li>(a) ISK deposits, certificates of deposit, long-term debt obligations and short-term debt obligations (including commercial paper) provided that in all cases such investments have a remaining period to maturity of less than one month and the short-term, unsecured, unguaranteed and unsubordinated debt obligations or, as applicable, the long-term, unsecured, unguaranteed and unsubordinated debt obligations of the issuing or guaranteeing entity or the entity with which the deposits are made (being an authorised Financial Institution under Act. 161/2002) are rated P-1/A-1 by Moody's or its equivalent by one other internationally recognised rating agency;</li> <li>(b) ISK deposits, certificates of deposit, long-term debt obligations and short-term debt obligations (including commercial paper) provided that in all cases such investments have a remaining period to maturity of one to three months and the short-term, unsecured, unguaranteed and unsubordinated debt obligations or, as applicable, the long-term, unsecured, unguaranteed and unsubordinated debt obligations of the issuing or guaranteeing entity or the entity with which the deposits are made (being an authorised Financial Institution under Act. 161/2002) are rated A-1/P-1 by Moody's or its equivalent by one other internationally recognised rating agency;</li> <li>(c) ISK deposits, certificates of deposit, long-term debt obligations and short-term debt obligations (including commercial paper) provided that in all cases such investments have a remaining period to maturity of longer than six months and the short-term, unsecured, unguaranteed and unsubordinated debt obligations or, as applicable, the long-term, unsecured, unguaranteed and unsubordinated debt obligations of the issuing or guaranteeing entity or the entity with which the deposits are made (being an authorised Financial Institution under Act. 161/2002) are rated Aaa by Moody's or its equivalent by one other internationally recognised rating agency</li> </ul>
<b>sub-unit</b>	The meaning given in Condition 5.8(g)
<b>Talons</b>	Talons for further Coupons in respect of interest-bearing Definitive Covered Bonds

<b>TARGET System</b>	The meaning given in Condition 5.8(a)(ii)
<b>Tax Jurisdiction</b>	The meaning given in Condition 8
<b>Temporary Global Covered Bond</b>	A temporary global covered bond without receipts and interest coupons attached initially representing each Tranche of Covered Bonds, unless otherwise specified in the applicable Final Terms
<b>Term Advance</b>	Each term advance made by the Issuer to the Fund from the proceeds of Covered Bonds pursuant to the Intercompany Loan Agreement
<b>Terms and Conditions or Conditions</b>	The terms and conditions of the Covered Bonds (as set out in Schedule 1 to the Representative and Agency Agreement)
<b>Third Party Amounts</b>	Amounts under a direct debit which are repaid to the bank making the payment if such a bank is unable to recoup that amount itself from the customer's account or payments by Borrowers of any fee due to the Seller which amounts shall be payable on receipt by the Fund to the Seller from moneys on deposit in the GIC Account
<b>Tranche</b>	An issue of Covered Bonds which are identical in all respects (including as to listing and admission to trading)
<b>Transaction Documents</b>	<p>The following documents (and each a <b>Transaction Document</b>):</p> <ul style="list-style-type: none"> <li>(a) Mortgage Sale Agreement;</li> <li>(b) Servicing Agreement;</li> <li>(c) Asset Monitor Agreement;</li> <li>(d) Intercompany Loan Agreement;</li> <li>(e) Fund Deed;</li> <li>(f) Cash Management Agreement;</li> <li>(g) Guaranteed Investment Contract;</li> <li>(h) Bank Account Agreement;</li> <li>(i) Representative and Agency Agreement;</li> <li>(j) Programme Agreement;</li> <li>(k) each Final Terms (as applicable in the case of each issue of listed Covered Bonds subscribed for pursuant to a subscription agreement);</li> <li>(l) each Subscription Agreement (as applicable in the case of each issue of listed Covered Bonds subscribed for pursuant to a subscription agreement);</li> <li>(m) Master Definitions and Construction Agreement; and</li> <li>(n) Issuer-ICSD Agreement</li> </ul>
<b>Treaty</b>	The meaning given in Condition 4
<b>UCITS</b>	Act No. 30/2003 on Undertaking for Collective Investment in Transferable Securities and Investment Funds
<b>Unit Account Ledger</b>	The ledger maintained by the Cash Manager on behalf of the Fund in respect of each Holder to record the balance of each Holder's Equity Contributions from time to time
<b>Unit Distribution</b>	Any return on a Holder's Equity Contribution in accordance with the terms of

	the Fund Deed
<b>Valuation Report</b>	The valuation report or reports for mortgage purposes, in the form of the pro-forma report contained in the Standard Documentation, obtained by the Seller from a Valuer in respect of each Property or a valuation report in respect of a valuation of a Property made using a methodology which would be acceptable to a Reasonable, Prudent Mortgage Lender
<b>Valuer</b>	An entity registered as a real estate broker in accordance with Icelandic laws and regulations and having the relevant insurance policy in place
<b>Variable Interest Covered Bonds</b>	Index Linked Interest Covered Bonds, Credit Linked Interest Covered Bonds, Equity Linked Interest Covered Bonds, Dual Currency Interest Covered Bonds and other Covered Bonds (excluding Floating Rate Covered Bonds and Inflation Linked Annuity Covered Bonds) where the rate of interest is variable
<b>Yen or JPY</b>	The lawful currency for the time being of Japan
<b>Zero Coupon Covered Bonds</b>	Covered Bonds which will be offered and sold at a discount to their nominal amount and which will not bear interest
<b>30/360, 360/360 or Bond Basis</b>	The meaning given in Condition 5.8(c)(vi)
<b>30E/360 or Eurobond Basis</b>	The meaning given in Condition 5.8(c)(vii)
<b>€, Euro or euro</b>	The currency introduced at the start of the third stage of European economic monetary union pursuant to the Treaty
<b>£ or Sterling</b>	The lawful currency for the time being of the United Kingdom of Great Britain and Northern Ireland
<b>\$, U.S.\$ or U.S. Dollars or US Dollars</b>	The lawful currency for the time being of the United States of America

**THE ISSUER**

**Kaupthing Bank hf.**

Borgartun 19  
105 Reykjavik  
Iceland

**THE FUND**

**Kaupthing Mortgages Institutional Investor Fund**

Borgartun 19  
105 Reykjavik  
Iceland

**PRINCIPAL PAYING AGENT**

**Deutsche Bank AG, London Branch**

Winchester House  
1 Great Winchester Street  
London EC2N 2DB  
United Kingdom

**PAYING AGENT**

**Kaupthing Bank hf.**

Borgartun 19  
105 Reykjavik  
Iceland

**REPRESENTATIVE**

**Deutsche Trustee Company Limited**

Winchester House  
1 Great Winchester Street  
London EC2N 2DB  
United Kingdom

**ARRANGER**

**Kaupthing Bank hf.**

Borgartun 19  
105 Reykjavik  
Iceland

**LEGAL ADVISERS**

*To the Issuer and the Fund as to Icelandic law*

**LM Attorneys**  
Skólavörðustígur 12  
101 Reykjavik  
Iceland

*To the Arranger and the Representative  
as to English law*

**Allen & Overy LLP**  
One Bishops Square  
London E1 6AO  
United Kingdom

**AUDITORS**

*To the Issuer*

**KPMG hf.**

Borgartun 27  
105 Reykjavik  
Iceland

*To the Fund*

**KPMG hf.**

Borgartun 27  
105 Reykjavik  
Iceland