OFFERING CIRCULAR

US$10,000,000,000

KAUPTHING BANK

KAUPTHING BANK HF.

Senior/Subordinated Medium-Term Note Program

Due Nine Months or More from Date of Issue

Under this program (the "Program"), we may issue at various times up to US$10,000,000,000 aggregate principal amount outstanding at any time of medium-term notes (the "Notes") denominated in U.S. dollars or in other currencies or composite currencies. The Notes are being offered on a continuous basis to or through the Dealers named below only to institutional accredited investors and qualified institutional buyers as described in this Offering Circular ("Offering Circular") under "Plan of Distribution". We will describe the final terms for each tranche of Notes in a Pricing Supplement (the "Pricing Supplement") which, with respect to Notes to be listed on the Euro MTF market of the Luxembourg Stock Exchange, will be delivered to the Luxembourg Stock Exchange. Unless otherwise provided in a Pricing Supplement, Notes may be issued with the following terms:

- **Maturity Date:** The Notes will mature in nine months or more from the date of issue.
- **Status:** Each tranche of Notes may be issued as Senior Notes, Subordinated Notes or Capital Notes.
- **Redemption or Repayment Option:** The Notes may be subject to redemption or repayment at our option or at the option of the Holder (defined below).
- **Interest Rate Basis:** The Notes will bear interest at either a fixed or a floating rate. The floating rate formula may be based on the CD Rate, CMT Rate, Commercial Paper Rate, Eleventh District Cost of Funds Rate, Federal Funds Rate, LIBOR, EURIBOR, Prime Rate, Treasury Rate, or such other basis as is described in the applicable Pricing Supplement. Each of those rates is described under "Description of the Notes" in this Offering Circular.
- **Other Features:** The Notes may also be issued as discount notes, indexed notes or amortizing notes.
- **Form:** The Notes will be issued as global notes ("Global Notes") in fully registered form without coupons or as fully registered Certificated Notes.
- **Denomination:** The Notes generally will have minimum denominations of US$100,000 and integral multiples of US$1,000 in excess of such minimum denomination (or the equivalent of such amount in other currencies).
- **Interest Payment Dates:** We will pay interest on the Notes on the dates specified in the applicable Pricing Supplement.

See "Risk Factors" commencing on page 12 for a discussion of certain risks that you should consider prior to making an investment in the Notes. The applicable Pricing Supplement may describe additional risks you should consider.

Application has been made for the Notes to be issued under this Program to be admitted to trading on the Euro MTF market of the Luxembourg Stock Exchange. In relation to Notes listed on the Luxembourg Stock Exchange, this Offering Circular is valid for a period of one year from the date hereof. However, unlisted Notes may be issued pursuant to the Program. The applicable Pricing Supplement for any issue of Notes will specify whether or not such Notes will be listed on the Luxembourg Stock Exchange (or any other stock exchange).

The Notes have not been, and will not be, registered under the U.S. Securities Act of 1933, as amended (the "Securities Act"), or any state securities laws, and are being offered only to qualified institutional buyers (within the meaning of Rule 144A under the Securities Act ("Rule 144A")) or in other transactions exempt from registration in accordance with Regulation S under the Securities Act or, if the applicable Pricing Supplement so specifies, to institutional investors that qualify as accredited investors (as defined in Rule 501(a) under the Securities Act) and, in each case, in compliance with applicable securities laws.

Each purchaser of a Note will be deemed, by its acceptance or purchase thereof, to have made certain acknowledgements, representations and agreements intended to restrict the resale or other transfer of such Note, as described in this Offering Circular, and, in connection therewith, may be required to provide confirmation of its compliance with such resale or other transfer restrictions in certain cases. See "Transfer Restrictions".

The Notes are offered on a continuing basis by us to or through the Dealers. One or more Dealers may purchase Notes, as principal, from us for resale to investors and other purchasers at varying prices relating to prevailing market prices as determined by any such Dealer at the time of resale or, if so agreed, at a fixed offering price. In addition, if agreed to by us and a Dealer, such Dealer may utilize its reasonable efforts on an agency basis specified in the applicable Pricing Supplement. We reserve the right to withdraw, cancel or modify the offering contemplated hereby without notice. We, or a Dealer if it solicits an offer on an agency basis, may reject any offer to purchase Notes in whole or in part. See "Plan of Distribution".

Citi

Banc of America Securities LLC

Credit Suisse

Deutsche Bank

Lehman Brothers

Merrill Lynch & Co.

Morgan Stanley

The date of this Offering Circular is July 19, 2007

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No dealer, salesman or other person has been authorized to give any information or make any representation other than those contained in this Offering Circular and any amendment or supplement to this Offering Circular and, if given or made, such information or representation must not be relied upon as having been so authorized. This Offering Circular and any amendment or supplement to this Offering Circular do not constitute an offer or solicitation by anyone in any jurisdiction in which such offer or solicitation is not authorized or in which the person making such offer or solicitation is not qualified to do so or to anyone to whom it is unlawful to make such offer or solicitation. Neither the delivery of this Offering Circular or any amendment or supplement to this Offering Circular nor any sale made under this Offering Circular shall, under any circumstances, create any implication that there has been no change in our affairs since the date of this Offering Circular or any such amendment or supplement or that the information contained in this Offering Circular or in any such amendment or supplement is correct as of any time subsequent to the date of such information.

The Issuer, having made all reasonable enquiries, confirms that, as of the date hereof, this Offering Circular contains or incorporates all information which is material in the context of the issuance and offering of Notes, that the information contained or incorporated in this Offering Circular is true and accurate in all material respects and is not misleading, that the opinions and intentions expressed in this Offering Circular are honestly held and that there are no other facts the omission of which would make this Offering Circular or any of such information or the expression of any such opinions or intentions misleading. The Issuer accepts responsibility accordingly.

IMPORTANT INFORMATION

This Offering Circular may only be used for the purposes for which it has been published.

This Offering Circular constitutes a Base Prospectus, and all references to a Pricing Supplement shall constitute a reference to Final Terms, for purposes of listing the Notes on the Euro MTF market of the Luxembourg Stock Exchange.

This Offering Circular does not constitute an offer of, or an invitation by or on behalf of the Issuer or by or on behalf of any Dealer to subscribe for or purchase, any of the Notes in any jurisdiction to any person to whom it is unlawful to make such an offer or solicitation in such jurisdiction. The distribution of this Offering Circular and the offering of the Notes in certain jurisdictions may be restricted by law. Persons into whose possession this Offering Circular comes are required by the Dealers and the Issuer to inform themselves about and to observe any such restrictions. For a further description of certain restrictions on the offering, sale and resale of the Notes, see "Plan of Distribution".

Each purchaser of a Note will be deemed, by its acceptance or purchase of a Note, to have made certain acknowledgements, representations and agreements to and with the Issuer and any applicable Dealer intended to restrict the resale or other transfer of such Note, as described in this Offering Circular, and, in connection therewith, may be required to provide confirmation of its compliance with such resale or other transfer restrictions in certain cases. See "Transfer Restrictions".

The information contained in this Offering Circular relating to the Issuer was obtained from the Issuer, and no assurance can be given by the Dealers as to the accuracy or completeness of such information. The Dealers make no representation or warranty, express or implied, as to the accuracy or completeness of the information contained in this Offering Circular. None of the information contained in this Offering Circular is, or should be relied upon as, a promise or representation by the Dealers. In making an investment decision, investors must rely on their own examinations of the Issuer and the terms of the offering, including the merits and risks involved.

All inquiries relating to the Issuer, this Offering Circular and the offering contemplated herein should be directed to the Dealers.

Any purchaser of Notes must be able to bear the economic risk of an investment in such Notes for an indefinite period of time because the Notes have not been registered under the Securities Act. There is no undertaking to register the Notes under the Securities Act and they cannot be resold unless they are subsequently registered thereunder or an exemption from registration is available (including the exemption provided for in Rule 144A).

The Notes have not been recommended by the U.S. Securities and Exchange Commission (the "SEC"), any state securities commission or any other regulatory authority. Furthermore, the foregoing authorities have not passed upon or endorsed the merits of this offering or the accuracy or adequacy of this Offering Circular. Any representation to the contrary is a criminal offense.

This Offering Circular is submitted to a limited number of investors for informational use solely in connection with the consideration of the purchase of the Notes. Its use for any other purpose is not authorized. This Offering Circular may not be copied or reproduced in whole or in part nor may it be distributed or any of its contents disclosed to anyone other than the prospective investors to whom it is submitted.

Neither the Dealers nor the Issuer are making any representation to any offeree or purchaser of the Notes described herein regarding (a) the legality of investment therein by such offeree or purchaser under applicable legal investment or similar laws or regulations, or (b) the consequences of investment therein under U.S. federal tax laws or other taxation statutes. Prospective purchasers should consult with their own advisers as to issues of legal investment or taxation.

No person is authorized to give any information or to make any representation not contained in this Offering Circular and any information or representation not contained herein must not be relied upon as having been authorized by or on behalf of the Issuer or the Dealers. The delivery of this Offering Circular at any time does not imply that the information herein is correct at any time subsequent to its date.

The Issuer will, at the specified offices of the Paying Agents (as defined under "Description of the Notes"), provide, free of charge, upon the written request therefor, a copy of this Offering Circular. Written requests for such documents should be directed to the specified office of any Paying Agent or the specified office of the Listing Agent in Luxembourg.

In connection with the issue and distribution of any tranche of Notes, the Dealer (if any) disclosed as the stabilizing manager in the applicable Pricing Supplement or any person acting for him may over-allot or effect transactions with a view to supporting the market price of the Series (as defined herein) of which such tranche forms part at a level higher than that which might otherwise prevail for a limited period in accordance with applicable laws and regulations. However, there may be no obligation on the stabilizing manager or any agent of his to do this. Such stabilizing, if commenced, may be discontinued at any time and must be brought to an end after a limited period.

CIRCULAR 230 NOTICE

TO ENSURE COMPLIANCE WITH U.S. TREASURY DEPARTMENT REGULATIONS, WE ADVISE YOU THAT ANY TAX DISCUSSION HEREIN WAS NOT WRITTEN AND IS NOT INTENDED TO BE USED AND CANNOT BE USED BY ANY TAXPAYER FOR PURPOSES OF AVOIDING U.S. FEDERAL INCOME TAX PENALTIES THAT MAY BE IMPOSED ON THE TAXPAYER. ANY SUCH TAX DISCUSSION WAS WRITTEN TO SUPPORT THE PROMOTION OR MARKETING OF THE NOTES TO BE ISSUED PURSUANT TO THIS INFORMATION MEMORANDUM. EACH TAXPAYER SHOULD SEEK ADVICE BASED ON THE TAXPAYER'S PARTICULAR CIRCUMSTANCES FROM AN INDEPENDENT TAX ADVISER.

NOTICE TO NEW HAMPSHIRE RESIDENTS

NEITHER THE FACT THAT A REGISTRATION STATEMENT OR AN APPLICATION FOR A LICENSE HAS BEEN FILED UNDER CHAPTER 421-B OF THE NEW HAMPSHIRE REVISED STATUTES WITH THE STATE OF NEW HAMPSHIRE NOR THE FACT THAT A SECURITY IS EFFECTIVELY REGISTERED OR A PERSON IS LICENSED IN THE STATE OF NEW HAMPSHIRE CONSTITUTES A FINDING BY THE SECRETARY OF STATE THAT ANY DOCUMENT FILED UNDER RSA 421-B IS TRUE, COMPLETE AND NOT MISLEADING. NEITHER ANY SUCH FACT NOR THE FACT THAT AN EXEMPTION OR EXCEPTION IS AVAILABLE FOR A SECURITY OR A TRANSACTION MEANS THAT THE SECRETARY OF STATE HAS PASSED IN ANY WAY UPON THE MERITS OR QUALIFICATIONS OF, OR RECOMMENDED OR GIVEN APPROVAL TO, ANY PERSON, SECURITY, OR TRANSACTION. IT IS UNLAWFUL TO MAKE, OR CAUSE TO BE MADE, TO ANY PROSPECTIVE PURCHASER, CUSTOMER, OR CLIENT, ANY REPRESENTATION INCONSISTENT WITH THE PROVISIONS OF THIS PARAGRAPH.

PRESENTATION OF CERTAIN FINANCIAL AND OTHER INFORMATION

In this Offering Circular, unless the context otherwise requires, references to:

- "Kaupthing" and "the Issuer" are to Kaupthing Bank hf.;
- "we", "our", "us" and "the group" are to Kaupthing together with its subsidiaries;
- the "OMXI" are to the OMX Nordic Exchange Iceland hf., which operates under the brand name Nordic Exchange in Iceland and which, up until June 30, 2007, was legally named the Iceland Stock Exchange (Kauphöll Íslands hf.) and referred to as the "ICEX". ;
- the "OMXS" are to the Nordic Exchange in Stockholm;
- the "ISD" are to the Icelandic Securities Depository (Verdbréfaskráning Íslands hf.); and
- the "VPC" are to the Swedish Securities Depository (VPC AB).

We present our financial statements in Icelandic króna and references in this Offering Circular to "Icelandic króna", "krona", "krónur" or "ISK" refer to the currency of Iceland. References to "U.S. dollars", "US$" or "$" are to the currency of the United States of America, references to "euro" or "€" are to the official currency of the European Union, references to "Swedish krona" or "SEK" are to the currency of Sweden, references to "Danish krone" or "DKK" are to the currency of Denmark, references to "GBP", "pounds sterling" or "£" are to the currency of the United Kingdom, references to "AUD$" or "Australian dollars" are to the currency of Australia, references to "¥" or "JPY" are to the currency of Japan and references to "Canadian dollars" or "CAD$" are to the currency of Canada.

For your convenience certain Icelandic króna amounts as at and for the year ended December 31, 2006 and as at and for the three months ended March 31, 2007 have been translated to dollar amounts. Certain balance sheet data as at December 31, 2006 have been translated at ISK 71.83 per $1.00, the mid rate quoted by the Central Bank of Iceland on December 31, 2006 and as at March 31, 2007 at ISK 65.78 per $1.00, the mid rate quoted by Reuters on March 31, 2007, and certain income statement data for the year ended December 31, 2006 have been translated at ISK 70.15 per $1.00, the average of the daily mid rates quoted by the Central Bank of Iceland for the year ended December 31, 2006 and at ISK 68.11 per $1.00, the average of the daily mid rates quoted by Reuters for the three-month period ended March 31, 2007.

Euro translations of the value of our acquisitions have been made using the mid rate prevailing on the date of acquisition. We have also translated other Icelandic króna amounts at other dates at the mid rate for the euro quoted by the Central Bank of Iceland on that date, unless otherwise indicated. No representation is made that the amounts in Icelandic króna have been, could have been or could be converted into U.S. dollars at the mid rate or at any other rate. For historical information regarding rates of exchange between the Icelandic króna and the U.S. dollar, see "Exchange Rates".

Certain numerical information and other amounts and percentages presented in this Offering Circular may not sum due to rounding. In addition, certain figures in this Offering Circular have been rounded to the nearest whole number.

As of January 1, 2005, we were required to prepare our financial statements in accordance with International Financial Reporting Standards ("IFRS"). Prior to this date, we had prepared our financial statements in accordance with generally accepted accounting principles in Iceland ("Icelandic GAAP"). We have, therefore, included in our audited consolidated financial statements as at and for the year ended December 31, 2005, prepared in accordance with IFRS, comparative information at January 1, 2005 and for the year ended December 31, 2004, restated in accordance with IFRS. Note 123 to our IFRS consolidated financial statements as at and for the years ended December 2005 contains an overview of the effect on our 2004 financial statements of the transition from Icelandic GAAP to IFRS.

For the convenience of the reader, we also have included in this Offering Circular certain summary consolidated financial information and certain selected consolidated financial information. See "Summary Consolidated Financial Information" and "Selected Consolidated Financial Information". This information is not complete and should be read together with the financial statements included elsewhere in this Offering Circular.

We accounted for our acquisitions of FIH Erhvervsbank A/S ("FIH") in July 2004 and Singer & Friedlander Group plc ("Singer & Friedlander", which we renamed Kaupthing Singer & Friedlander in 2006 "Kaupthing Singer & Friedlander") in July 2005 using the purchase method of accounting. The cost of each acquisition was measured at fair value at the date of exchange of the assets given, liabilities incurred or assumed and equity instruments issued, plus costs directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed were measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of the acquisition over the fair value of our share of the identifiable net assets acquired was recorded as goodwill. If the cost of the acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognized directly in the income statement.

The accounts of FIH and Singer & Friedlander have been fully consolidated into our accounts since July 2004 and July 2005, respectively.

References in this Offering Circular to:

- The "European Union" or "EU" are to Austria, Belgium, Cyprus, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Poland, Portugal, Slovakia, Slovenia, Spain, Sweden, The Netherlands and the United Kingdom.
- The "European Economic Area" or "EEA" are to the European Union and Iceland, Liechtenstein and Norway.
- The "Nordic countries" or the "Nordic region" are to Denmark, the Faroe Islands, Finland, Iceland, Norway and Sweden.
- "Northern Europe" are to the Nordic countries, the Baltic states (Lithuania, Latvia and Estonia), the United Kingdom, Ireland, Germany and the Benelux countries (Belgium, The Netherlands and Luxembourg).
- "Scandinavia", the "Scandinavian countries" and the "Scandinavian region" are to Denmark, the Faroe Islands, Finland, Norway and Sweden.

Due to the unavailability of certain data, the information we have presented in the section entitled "Selected Statistical Data" does not present all of the information required by Industry Guide 3 of the Securities Act. However, we believe we have disclosed the information required by Industry Guide 3 of the Securities Act to the extent we have available or are able to reasonably obtain the necessary source data.

MARKET AND INDUSTRY INFORMATION

Market data and certain industry forecasts used throughout this Offering Circular were obtained from internal surveys, reports and studies, where appropriate, as well as market research, publicly available information and industry publications. We believe that such market data and industry forecasts included in this Offering Circular are useful in helping you understand the markets in which we operate. However, unless indicated otherwise, these figures are based on our internal calculations and estimates of market data and have not been independently verified. Accordingly, no assurances can be given that such internal calculations and estimates of market data are accurate and you should not place undue reliance on such data included in this Offering Circular.

ENFORCEMENT OF CIVIL LIABILITIES

We are an Icelandic company, and a majority of our assets are located outside the United States. In addition, all of our directors and executive officers reside or are located in Northern Europe. As a result, investors may not be able to serve process outside Northern Europe upon these persons, or to enforce judgments obtained against us or these persons in foreign courts predicated solely upon the civil liability provisions of the securities laws of jurisdictions other than Iceland.

The United States and Iceland do not currently have a treaty providing for reciprocal recognition and enforcement of judgments, other than arbitration awards, in civil and commercial matters. Therefore, a final judgment for the payment of a fixed debt or a sum of money rendered by any U.S. court based on civil liability, whether or not predicated solely upon the U.S. federal securities laws, would not automatically be enforceable in Iceland. In addition, there is doubt that a foreign judgment based upon U.S. securities laws would be enforced in Iceland. There also is doubt as to the enforceability of judgments of this nature in several of the other jurisdictions in which we operate and where our assets are located.

FORWARD LOOKING STATEMENTS

This Offering Circular includes forward-looking statements. Examples of such forward-looking statements include, but are not limited to: (i) projections or expectations of net interest income, total income, profit, earnings per share, capital expenditures, dividends, capital structure or other financial items or ratios; (ii) statements of our plans, objectives or goals or those of our management for future operations, including those related to products or services; (iii) statements of future economic performance, including in particular any such statements included under the section entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations"; and (iv) statements of assumptions underlying such statements. Words such as "believes", "anticipates", "expects", "intends", "aims", "estimates", "continues", "will", "would be" and "plans" and similar expressions or the negatives thereof are intended to identify forward-looking statements but are not the exclusive means of identifying such statements.

We have based any forward-looking statements herein on current expectations and projections about uncertain future events. Forward-looking statements are subject to risks, uncertainties and assumptions about us. Although we believe that the plans, objectives, expectations, estimates and intentions expressed in such forward-looking statements are reasonable, we caution readers that a number of important factors could cause actual results to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward-looking statements. Such risks, uncertainties, assumptions and other important factors include those set forth in the section of this Offering Circular entitled "Risk Factors" beginning on page 12, as well as, among others:

- our ability to assess and manage credit risks;
- our continued ability to access wholesale and retail funding sources;
- inflation, interest rates, exchange rates, and market and monetary fluctuations;
- the prices and volumes in the debt and equity markets in the Northern European countries in which we operate, including Iceland;
- our ability to manage any mismatches between our interest-earning assets and our interest-bearing liabilities;
- the effects of competition in the geographic and business areas in which we operate;
- changes in consumer spending, saving and borrowing habits in Iceland, Denmark, the United Kingdom and in other regions in which we operate;
- changes in the banking and financial markets in Iceland, Denmark, the United Kingdom and in other regions in which we operate;
- our ability to increase or maintain market share;
- our ability to control expenses;
- the timely development of and acceptance of new products and services and the perceived overall value of these products and services by our clients;
- acquisitions, disposals and any other strategic transactions;
- liquidity risks and access to financial markets;
- the effects of changes in taxation or accounting standards or practices;
- the effects of, and changes in, laws, regulations and government policy;
- technological changes; and
- our success at managing the risks of the foregoing.

We caution that the foregoing list of important factors is not exhaustive. Should one or more of these risks or uncertainties materialize, or should any underlying assumptions prove to be incorrect, our actual financial condition or results of operations could differ materially from that described herein as anticipated, believed, estimated or expected. Investors and others should carefully consider the foregoing factors and other uncertainties and events when making an investment decision based on any forward-looking statement. In light of these risks, uncertainties and assumptions, the forward-looking events discussed in this Offering Circular may not occur. We do not intend, and do not assume any obligation, to update any industry information or forward-looking statements set out in this Offering Circular, except as required by law.

OFFERING OF MEDIUM-TERM NOTES

Citigroup Global Markets Inc., Banc of America Securities LLC, Credit Suisse Securities (USA) LLC, Deutsche Bank Securities Inc., Lehman Brothers Inc., Merrill Lynch, Pierce, Fenner & Smith Incorporated and Morgan Stanley & Co. Incorporated (collectively, the "Dealers") have been appointed by us as Dealers for the offering from time to time of the Notes. The Notes will be limited to US$10,000,000,000 aggregate principal amount (or the equivalent of that amount in one or more other currencies or composite currencies) outstanding at any time, subject to increase without the consent of the registered Holders (as defined in "Summary" below) of the Notes. The Notes have not been, and will not be, registered under the Securities Act, and are being offered pursuant to one or more exemptions from, or in transactions not subject to, the registration requirements of the Securities Act. Prospective investors are hereby notified that sellers of the Notes may be relying on the exemption from the registration requirements of Section 5 of the Securities Act provided by Rule 144A. Accordingly, the Notes are subject to restrictions on resale or other transfer. For a description of those restrictions, see "Transfer Restrictions".

This Offering Circular should be read and construed with any amendment or supplement hereto and, in relation to any Series (as defined in "Summary" below), should be read and construed together with the applicable Pricing Supplement.

Unless the context otherwise requires, references to the "Offering Circular" are intended to include this Offering Circular, together with any amendments and supplements applicable to a particular tranche of Notes.

SUMMARY

Prospective investors should read the Offering Circular in its entirety. Because this is a summary, it does not contain all the information that may be important to you. You should read this summary in conjunction with the more detailed information in the rest of this Offering Circular, including the "Risk Factors" section and the financial statements and the notes thereto.

Kaupthing Bank hf.

Overview

We are a Northern European bank with shares listed on the OMX Nordic Exchange Iceland hf. ("OMXI") and the Stockholm Stock Exchange ("OMXS"). We operate in ten countries, including all the Nordic countries, the United Kingdom, Luxembourg, Switzerland and the United States and two of the world's main business centers, London and New York. We hold banking licenses in eight countries: Iceland, the United Kingdom, Denmark, Sweden, Finland, the Faroe Islands, Norway and Luxembourg. In the United States, we operate through our subsidiary Kaupthing Securities Inc., a licensed broker-dealer. Iceland, Scandinavia and the United Kingdom currently are our most important markets, generating 47.0%, 24.8% and 19.6%, respectively, of our operating income in 2006.

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. In addition, we operate a retail banking franchise in Iceland, where we have our headquarters and, to a lesser extent, in Sweden.

We currently are one of the seven largest banks in the Nordic region in terms of market capitalization. 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 (DKK 7,292 million) and the more recent acquisition of UK-based bank Singer & Friedlander Group plc ("Singer & Friedlander") in July of 2005 for ISK 63,708 million. We believe that these acquisitions have improved the quality of our loan portfolio and increased the diversification of our operations. However, FIH, being a wholesale commercial bank, generates lower interest margins than other of our banking operations.

We believe that our results for 2006 reflect our focus on Northern Europe, which we consider to be our home market. Approximately 53.0% of our operating income in 2006 was generated outside Iceland. We expect this percentage to increase in 2007, as we seek to expand our activities in Finland, Luxembourg and the United Kingdom. We currently have senior long-term debt ratings of 'Aa3' from Moody's and 'A' from Fitch. As of December 31, 2006, our total assets were ISK 4,055,396 million, our Tier 1 ratio was 10.5% and our Capital Adequacy Directive ("CAD") ratio was 15.0%. Our net earnings for 2006 were ISK 86,447 million, an increase of 69.3% from 2005 primarily as a result of acquisitions.

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 Sales and Marketing.

Strategy and Strengths

Our goal is to become a leading provider of integrated financial services for small and medium-sized companies ("SMEs"), institutional investors and high net worth individuals in Northern Europe. We intend to achieve this goal by taking the following measures:

- ***Focus on defined clients, products and geographies***. We seek to exploit our market niche as an integrated financial services provider for SMEs, institutional investors and high net worth individuals, which we believe are not adequately served by larger financial institutions. We seek to provide these clients with the full range of products offered by larger financial institutions, with investment banking and corporate banking at the core of our strategy, complemented by capital markets, asset management and private banking, products and businesses which are provided in most of our geographic locations. As a result, we have a well diversified mix of income streams across all of our business areas and an asset base that is diversified across countries and industries. Geographically, our revenues are increasingly spread across jurisdictions. Our focus is on Northern Europe, with an emphasis on the Nordic region. However, we recognize the need to be present in key European financial centers such as the United Kingdom, Luxembourg and Switzerland.

- ***Leverage the diversification of our business through cross-selling***. A key advantage is our ability to provide a wide range of financial services to our clients, including co-investment, financing, advisory and capital markets services, as well as wealth management. We seek to capitalize on the diversification of our business across product lines and, as appropriate, across jurisdictions by cross-selling our full range of products to our existing client base. For our corporate clients, which are primarily SMEs, this includes acting as a partner to help them realize a sustainable growth platform. In addition to providing a full range of banking, investment banking, capital markets, asset management and treasury services, from time to time we also take equity stakes in our corporate clients to more fully align our economic interests with theirs. For our individual clients, this includes offering our full range of banking and brokerage services, as well as "wealth architecture" services to high net worth individuals for the management, protection and enhancement of their financial assets. We believe that these efforts leave us well positioned to continue our strong record of organic growth.

- ***Balance organic growth with well-executed acquisitions***. We believe that our strategic acquisitions of FIH in 2004 and Singer & Friedlander in 2005 have contributed to establishing a strong operating platform for organic growth. We intend to continue to expand our operations in our targeted geographic areas through a combination of organic growth, supported by strong cross-selling, and selected acquisitions that fit our strategic vision. With respect to our acquisitions, we seek to achieve a return on equity raised in connection with any acquisition of 15% and a return on equity of 15% for the acquired subsidiary within 18 months of the closing of the acquisition. Long term, we seek to achieve a 15% return on the aggregate purchase price. However, we do not view increased size as an objective in its own right, and we will evaluate both organic growth opportunities and potential acquisitions with a view to maximizing financial performance.

- ***Strong operational discipline.*** Risk management is at the heart of all our operations, as we continually seek to improve the asset quality of our loan portfolio and minimize trading losses. We control risk centrally, with local risk managers reporting from each market area, and maintain a robust credit approval process. This is manifested in strong credit quality and sustained cost discipline notwithstanding the rapid growth of our business. We have, in part due to more favorable conditions in the credit cycle in the countries in which we operate, been able to decrease the ratio of non-performing loans to loans to customers from 3.7% at December 31, 2003 to 1.0% at December 31, 2006.

Risk Factors

There are certain factors that may affect our ability to fulfill our obligations under the Notes. These are set out under “Risk Factors” beginning on page 12 below and include, among other things, the impact of changes in interest rates; our exposure to adverse changes in the economic conditions in Iceland and in the European Economic Area, Western Europe and the United States; the concentration of our loan portfolio; our ability to assess the credit risk of potential borrowers; fluctuations in the price of securities in our trading portfolio; the quality of the collateral securing loans in our portfolio; our ability to access funding sources on favorable terms; a reduction in our credit ratings; fluctuations in income from our investment banking activities and in the value of investments for our own account; our exposure to trading and investment positions in our treasury unit; mismatches of our positions in foreign currency; our exposure to the risks associated with cross-ownership of shares; our ability to grow through acquisitions; our ability to properly integrate our acquired operations; the future growth of our loan portfolio; our ability to comply with Basel II; our exposure to the risk of increased competition; our exposure to the residential mortgage market in Iceland; our ability to manage our risks, including our operational, legal and regulatory risks; our exposure to derivative transactions; our methods of risk management to reduce exposure to unidentified, unanticipated or incorrectly quantified risks; our ability to compete and keep up with new technologies; our ability to monitor and maintain our IT systems; our exposure to regulatory and legal risks; our exposure to catastrophic events, terrorist attacks and other acts of war; our ability to recruit and retain experienced and qualified personnel; and the adequacy of our insurance coverage.

In addition, there are certain factors that are material for the purpose of assessing the market risks associated with the Notes. These are set out under “Risk Factors” below and include the fact that the Notes may not be a suitable investment for all investors and the risks related to the structure of a particular issue of Notes. You should carefully consider these Risk Factors and all of the information in this Offering Circular before deciding to invest in the Notes.

The following is only a summary of the terms of the program and is qualified in its entirety by the section entitled "Description of the Notes" and the terms of the Indentures.

Summary of the Program

Arranger:..	Citigroup Global Markets Inc.
Dealers:..	Citigroup Global Markets Inc., Banc of America Securities LLC, Credit Suisse Securities (USA) LLC, Deutsche Bank Securities Inc., Lehman Brothers Inc., Merrill Lynch, Pierce, Fenner & Smith Incorporated and Morgan Stanley & Co. Incorporated.
Trustees:	Deutsche Bank Trust Company Americas (formerly, Bankers Trust Company), in its separate capacities as the Senior Trustee, the Subordinated Trustee and the Capital Trustee. We have entered into the Senior Indenture with the Senior Trustee relating to the Senior Notes, the Subordinated Indenture with the Subordinated Trustee relating to the Subordinated Notes and the Capital Indenture with the Capital Trustee relating to the Capital Notes. Each Trustee has also agreed under the applicable Indenture to act as the principal paying agent for Notes issued under such Indenture.
Luxembourg Listing Agent:	Fortis Banque Luxembourg S.A.
Paying Agents:...	Deutsche Bank Trust Company Americas, pursuant to the Indentures and Fortis Banque Luxembourg S.A. pursuant to the Luxembourg Paying Agency Agreement.
Program Size:	We may issue up to US$10,000,000,000 (or the equivalent of that amount in one or more other currencies or composite currencies) outstanding at any time. The program size may be increased from time to time without the consent of the holders of the Notes (the "Holders" or "Noteholders").
Currencies:...	Subject to any applicable legal or regulatory restrictions, such currencies as may be agreed between us and the relevant Dealer.
Issuance in Series:	The Senior Notes, the Subordinated Notes and the Capital Notes will be issued in separate series (each, a "Series") issued under the applicable Indentures. Notes will be issued in tranches. The Notes of each tranche that constitute the same Series will be subject to identical terms, except that the issue date, the issue price and the amount of the first payment of interest may be different in respect of different tranches.
Status of Senior Notes:	The Senior Notes will constitute direct, unconditional, unsecured and unsubordinated obligations of the Issuer without any preference among themselves and will rank equally with all other unsecured and unsubordinated obligations of the Issuer, subject in the event of insolvency, to laws of general applicability relating to or affecting creditors' rights.
Status of Subordinated Notes:	The Subordinated Notes will constitute direct, unconditional, unsecured and subordinated obligations of the Issuer without any preference among themselves. The rights of Holders of Subordinated Notes will be subordinated in right of payment to the Senior Notes and other senior indebtedness of the Issuer in the manner provided in the Subordinated Indenture and as described in "Description of the Notes" below.
Status of Capital Notes:	The Capital Notes will constitute direct, unconditional, unsecured and subordinated obligations of the Issuer without any preference among themselves. The rights of Holders of Capital Notes will be subordinated in right of payment to the Senior Notes, the Subordinated Notes and

	other senior and subordinated indebtedness of the Issuer in the manner provided in the Capital Indenture and as described in "Description of the Notes" below.
Issue Price:..	Notes may be offered at par or at a premium or discount to par as specified in the applicable Pricing Supplement.
Maturities:...	The Senior and Subordinated Notes will mature in nine months or longer as specified in the applicable Pricing Supplement. The Capital Notes will not have a stated maturity.
Redemption at Maturity:...........................	Senior Notes and Subordinated Notes may be redeemed by us at par on the maturity date or at such other amount as may be specified in the applicable Pricing Supplement. Capital Notes will have no final maturity date unless otherwise specified in the applicable Pricing Supplement.
Early Redemption:....................................	Early redemption will be permitted for tax reasons, but will otherwise be permitted only to the extent specified in the applicable Pricing Supplement. The early redemption of Capital Notes may occur under certain circumstances, subject to the prior written consent of the Iceland Financial Supervisory Authority (*Fjármálaeftirlitið*) (the "Financial Supervisory Authority") having been obtained.
Repayment:..	The Pricing Supplement may provide that the Notes of such tranche are repayable by us at the option of the Holder. The early repayment of Capital Notes will be subject to the prior written consent of the Financial Supervisory Authority having been obtained.
Interest:..	Interest may accrue at a fixed rate or a floating rate, which will be calculated by referring to an index and/or formula. The floating rate may be determined by reference to one or more base rates, such as LIBOR, and be adjusted by a spread or a spread multiplier or other interest rate formula, in each case as agreed by the Issuer and the purchaser and described in the applicable Pricing Supplement.
Interest Payments:.....................................	Interest may be paid monthly, quarterly, semi-annually, annually or at such other intervals as are described in the applicable Pricing Supplement.
Denominations:..	Notes will be issued in minimum denominations of US$100,000 and integral multiples of US$1,000 in excess thereof and in such other denominations as are specified in the applicable Pricing Supplement.
Form, Clearance and Settlement:...............	Notes offered in the United States to qualified institutional buyers in reliance on Rule 144A will be represented by one or more Global Notes (the "U.S. Global Notes") and Notes offered outside the United States in reliance on Regulation S will be represented by one or more Global Notes (the "International Global Notes"). If specified in the applicable Pricing Supplement, Notes may be offered to certain institutional accredited investors and initially will be represented by definitive notes in certificated form (the "Certificated Notes"). The Notes will be in fully registered form, unless otherwise specified in the applicable Pricing Supplement. Global Notes representing the Notes will be held by or on behalf of The Depository Trust Company ("DTC") for the benefit of participants in DTC. The Notes have not been registered under the Securities Act and may not be offered or sold within the United States or to or for the benefit of United States persons, except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act.

	Notes will bear a legend setting forth transfer restrictions and may not be transferred except in compliance with such transfer restrictions. Transfers of interests from a U.S. Global Note to an International Global Note, from an International Global Note to a U.S. Global Note and transfers of Certificated Notes held by institutional accredited investors are subject to certification requirements. If such Certificated Notes are transferred to qualified institutional buyers in reliance on Rule 144A or offered outside the United States in reliance on Regulation S, then these Certificated Notes will be represented by U.S. Global Notes or International Global Notes, as the case may be, and will be available for inspection at the specified office of the Paying Agent.
Governing Law:...	The Notes and all related contractual documentation will be governed by, and construed in accordance with, the laws of the State of New York, except that the subordination provisions of the Subordinated Notes and the Subordinated Indenture, and the Capital Notes and the Capital Indenture, will be governed by and construed in accordance with the laws of Iceland.
Ratings:..	The program has, unless otherwise described in the applicable Pricing Supplement, been issued the following indicative ratings:

Rating Agency	Senior Notes	Subordinated Notes	Capital Notes
Moody's Investors Service, Inc.	Aa3	A1	A2
Fitch Ratings	A	A-	A-

	The rating agencies have agreed to continue to monitor the credit of the Issuer. Accordingly, we cannot assure you that these ratings will not change in the future. The ratings set forth above are accurate only as of the date hereof, may not necessarily apply to any individual Series and are subject to change at any time. A rating reflects only the views of Moody's or Fitch, as the case may be, and is not a recommendation to buy, sell or hold the Notes.
Sales and Transfer Restrictions:	The Notes have not been registered under the Securities Act and may not be offered or sold within the United States or to or for the benefit of United States persons, except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act. In addition, there are certain restrictions on the offer, sale and transfer of the Notes in the European Economic Area (including the United Kingdom, Italy and Iceland) and Japan and such other restrictions as may be required in connection with the offer and sale of a particular Series of Notes. See "Plan of Distribution" and "Transfer Restrictions".
Listing:...	Each Series of Notes may be listed on the Luxembourg Stock Exchange and traded on the Euro MTF market. Each Series may also be listed, quoted and/or traded on or by any stock exchange, competent listing authority and/or quotation system as may be agreed between us and the Dealers. Notes which are neither listed nor admitted to trading on any market may also be issued.
	In March 2003, the European Commission published a proposal for a Directive of the European Parliament and of the Council on the harmonization of transparency requirements with regard to information about issuers whose securities are admitted to trading on a regulated market in the European Union (2003/0045(COD)), known as the "Transparency Directive". While the Euro MTF market of the Luxembourg Stock Exchange is not a regulated market, the Transparency Directive may become effective in a form such that it

becomes unduly burdensome for the Issuer to maintain a listing on the Euro MTF market of the Luxembourg Stock Exchange. In particular, the Issuer may be required to publish financial information either more regularly than it otherwise would be required to or according to accounting principles which are materially different from the accounting principles which the Issuer would otherwise use to prepare its published financial information. In such circumstances, the Issuer may seek an alternative admission to listing, trading and/or quotation for the Notes by another listing authority, stock exchange and/or quotation system outside the European Union, or, alternatively, the Issuer may opt not to have the Notes listed, traded and/or quoted by any listing authority, stock exchange and/or quotation system.

The applicable Pricing Supplement will state whether or not the relevant Notes are to be listed and/or admitted to trading and, if so, on which stock exchanges and/or markets.

SUMMARY CONSOLIDATED FINANCIAL INFORMATION

Set forth below is summary condensed consolidated financial information for the group as at, and for the years ended December 31, 2006 and 2005, prepared in accordance with IFRS, and comparison figures as at January 1, 2005 and for the year ended December 31, 2004, restated in accordance with IFRS. The summary condensed consolidated financial data as at December 31, 2006 and 2005 and as at January 1, 2005 and for the years ended December 31, 2006, 2005 and 2004 have been derived from our consolidated financial statements included elsewhere in this Offering Circular, which have been audited by our independent auditors, KPMG hf. The financial information set forth below should be read in connection with, and is qualified in its entirety by reference to, our consolidated financial statements and the accompanying notes included elsewhere in this Offering Circular.

Certain Icelandic króna amounts as at and for the year ended December 31, 2006 have been translated to dollar amounts, solely for your convenience. Certain income statement data for the year ended December 31, 2006 have been translated at ISK 70.15 per $1.00, the average of the daily mid rates quoted by the Central Bank of Iceland for the year ended December 31, 2006. Certain balance sheet data have been translated at ISK 71.83 per $1.00, the mid rate quoted by the Central Bank of Iceland on December 31, 2006.

	As at and for the year ended December 31,			
	2006 ($)	2006 (ISK)	2005 (ISK)	2004 (ISK)(1)
	(IFRS) (in millions, except percentages)			
Income Statement items				
Net interest income	746	52,362	32,710	18,259
Net fee and commission income	531	37,284	22,428	13,308
Net financial income	858	60,157	37,282	16,326
Other income	248	17,413	9,778	2,052
Operating income	2,383	167,216	102,198(2)	49,945(2)
Salaries and related expenses	(479)	(33,570)	(20,317)	(12,851)
Other operating expenses	(377)	(26,436)	(15,208)	(10,774)
Operating expenses	(856)	(60,006)	(35,525)	(23,625)
Impairment	(87)	(6,127)	(4,389)	(3,825)
Earnings before income tax	1,440	101,083	62,284	22,495
Income tax	(209)	(14,636)	(11,228)	(4,236)
Net earnings	1,231	86,447	51,056	18,259
Minority interest	(16)	(1,145)	(1,796)	(552)
Shareholders' net earnings	1,215	85,302	49,260	17,707
Balance Sheet items				
Loans and advances	42,099	3,023,943	1,739,294	1,154,416
Financial assets measured at fair value	9,259	665,129	612,534	305,961
Assets other than mentioned above	5,100	366,324	188,983	94,076
Total assets	56,458	4,055,396	2,540,811	1,554,453
Deposits from credit institutions and central banks	1,538	110,456	69,643	32,488
Other deposits	10,450	750,658	486,175	202,193
Borrowings	33,411	2,399,939	1,556,567	968,512
Subordinated loans	3,008	216,030	102,688	57,623
Liabilities other than mentioned above	3,389	243,421	123,226	134,728
Total liabilities	51,796	3,720,504	2,338,299	1,395,544
Minority interest	158	11,382	8,329	9,539
Shareholders' equity	4,504	323,510	194,183	149,370
Total liabilities and equity	56,458	4,055,396	2,540,811	1,554,453
Financial ratios				
Return on average assets (3)	2.53%	2.53%	2.34%	—
Return on average equity(4)	42.39%	42.39%	33.96%	—
Net interest margin	1.77%	1.77%	1.86%	—
Net interest spread	1.73%	1.73%	1.43%	—
Cost to income ratio (5)	35.89%	35.89%	34.76%	—

	As at and for the year ended December 31,			
	2006 ($)	2006 (ISK)	2005 (ISK)	2004 (ISK)[1]
	(IFRS)			
Asset quality ratios				
Non-performing loans as a percentage of loans to customers....	1.00%	1.00%	0.98%	—
Non-performing assets as a percentage of loans to customers...	1.10%	1.10%	1.12%	—
Provision for loans as a percentage of loans to customers.........	0.65%	0.65%	0.83%	—
Net write-offs as a percentage of average loans to customers outstanding	0.15%	0.15%	0.24%	—
Capital ratios				
CAD ratio	15.0%	15.0%	12.2%	—
Tier 1 capital ratio...	10.5%	10.5%	9.4%	—

(1) Balance sheet data is as at January 1, 2005.
(2) Operating income includes net (loss) gain on non-current assets held for sale.
(3) Average on quarter-end balances.
(4) Represents the annualized geometric mean of the return on shareholders' equity for each quarter during the period. The return on shareholders' equity for each quarter is calculated as (i) shareholders' net earnings for the quarter, divided by (ii) shareholders' equity at the beginning of the quarter, adjusted for changes in shareholders' equity (other than those resulting from shareholders' net earnings for that quarter) during the quarter.
(5) Operating expenses divided by operating income.

Set forth below is summary unaudited consolidated financial information for the group as at, and for the three months ended March 31, 2007 and 2006, prepared in accordance with IFRS. The financial information set forth below should be read in connection with, and is qualified in its entirety by reference to, our consolidated financial statements and the accompanying notes included elsewhere in this Offering Circular.

Icelandic króna amounts as at and for the three-month period ended March 31, 2007 have been translated to dollar amounts, solely for your convenience. Certain income statement data for the three-month period ended March 31, 3007 have been translated at ISK 68.11 per $1.00, the average of the daily mid rates quoted by Reuters for the three-month period ended March 31, 2007. Certain balance sheet data have been translated at ISK 65.78 per $1.00, the mid rate quoted by Reuters on March 31, 2007.

	As at and for the three months ended March 31,		
	2007 ($)	2007 (ISK)	2006 (ISK)
		(IFRS)	
	(in millions, except percentages)		
Income Statement items			
Net interest income	239	16,265	10,484
Net fee and commission income	181	12,337	8,602
Net financial income	198	13,456	13,505
Other income	29	2,002	2,860
Operating income(1)	647	44,060	35,451
Salaries and related expenses	(155)	(10,534)	(7,420)
Other operating expenses	(105)	(7,173)	(5,132)
Operating expenses	(260)	(17,707)	(12,552)
Impairment	(21)	(1,423)	(710)
Earnings before income tax	366	24,930	22,189
Income tax	(62)	(4,236)	(2,595)
Net earnings	304	20,694	19,594
Minority interest	(6)	(413)	(796)
Shareholders' net earnings	298	20,281	18,798
Balance Sheet items			
Loans	45,781	3,011,480	2,199,906
Financial assets measured at fair value	12,718	836,603	665,846
Assets other than mentioned above	5,326	350,302	205,492
Total assets	63,825	4,198,385	3,071,244
Deposits from credit institutions and central banks	1,822	119,871	97,625
Other deposits	13,563	892,170	548,281
Borrowings	37,019	2,435,101	1,921,899
Subordinated loans	3,327	218,856	113,596
Liabilities other than mentioned above	3,166	208,247	165,955
Total liabilities	58,897	3,874,245	2,847,356
Minority interest	156	10,240	9,881
Shareholders' equity	4,772	313,900	214,007
Total liabilities and equity	63,825	4,198,385	3,071,244
Financial ratios			
Return on average assets(2)	1.97%	1.97%	2.68%
Return on average equity(3)	27.6%	27.6%	44.7%
Net interest margin	1.82%	1.82%	1.66%
Net interest spread	2.08%	2.08%	1.72%

	As at and for the three months ended March 31,		
	2007 ($)	2007 (ISK)	2006 (ISK)
		(IFRS)	
		(in millions, except percentages)	
Cost to income ratio[4]	40.19%	40.19%	35.41%
Asset quality ratios			
Non-performing loans as a percentage of loans to customers	1.03%	1.03%	0.91%
Non-performing assets as a percentage of loans to customers	1.12%	1.12%	1.03%
Provision for loans as a percentage of loans to customers	0.64%	0.64%	0.72%
Net write-offs as a percentage of average loans to customers outstanding	0.12%	0.12%	0.23%
Capital ratios			
CAD ratio	13.8%	13.8%	11.4%
Tier 1 capital ratio	9.6%	9.6%	8.5%

(1) Operating income includes net (loss) gain on non-current assets held for sale.
(2) Average on quarter-end balances.
(3) Represents the annualized geometric mean of the return on shareholders' equity for each quarter during the period. The return on shareholders' equity for each quarter is calculated as (i) shareholders' net earnings for the quarter, divided by (ii) shareholders' equity at the beginning of the quarter, adjusted for changes in shareholders' equity (other than those resulting from shareholders' net earnings for that quarter) during the quarter.
(4) Operating expenses divided by operating income.

RISK FACTORS

We believe that the following factors may affect our ability to fulfill our obligations under Notes issued under the Program. Most of these factors are contingencies which may or may not occur and we are not in a position to express a view on the likelihood of any such contingency occurring. In addition, factors which are material for the purpose of assessing the market risks associated with Notes issued under the Program are also described below. Potential investors should also review the Pricing Supplement for any additional risk factors related to us or to a particular issue of Notes.

We believe that the factors described below represent the principal risks inherent in investing in the Notes, but our inability to pay interest, principal or other amounts on or in connection with any Notes may occur for other reasons which may not be considered significant risks by us based upon information currently available to us or which we may not currently be able to anticipate.

Prior to making any investment decision, prospective investors and their financial and legal advisers should carefully consider all of the information in this document and, in particular, the risks and uncertainties described below should be considered carefully. In particular, Notes denominated or payable in or determined by reference to a foreign or composite currency or to one or more interest rates, currencies or other indices or formulas are not an appropriate investment for investors who are unsophisticated with respect to foreign currency transactions or transactions involving the applicable interest rate or currency index or other indices or formulas. The matters described below, among other factors, should be carefully considered by any prospective investor.

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

Risks Related to our 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 significant for us and are 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 31% of our operating income for 2006, approximately 32% in 2005 and approximately 37% 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.

Our net interest margin has declined and we expect it will continue to decline as a result of, among other factors, rising interest rates, a flattening yield curve, and exposure to increased competition. 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 increasing interest rate environment. 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". At December 31, 2006, ISK 1,166,214 million or 32.9% 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. The European Central Bank raised interest rates once between December 31, 2004 and December 31, 2005, from 3.00% to 3.25%, five times in 2006, on March 8 to 3.50%, on June 15 to 3.75%, on August 9 to 4.00%, on October 11 to 4.25% and on December 13 to 4.50%, and once to date in 2007, to 4.75% on March 14. The Central Bank of Iceland raised interest rates five times between December 31, 2004 and December 31, 2005 from 8.25% to 10.50%, and seven times in 2006, on January 31 to 10.75%, on April,4 to 11.50%, on May 23 to 12.25%, on July 11 to 13.00%, on August 22 to 13.50%, on September 19 to 14.00% and on December 27 to 14.25%.

Our business, results of operations and financial condition are affected by conditions in Iceland

Our business, results of operations and financial condition are affected directly by economic and political conditions in Iceland. Although the Icelandic economy has experienced high growth rates in recent years, there can be no assurance that these growth rates will continue or that there will not be a downturn in the Icelandic economy. 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% at December 31, 2004 to 10.50% at December 31, 2005, to 14.3% at December 31, 2006. The twelve month inflation was 6.8% in 2006 an increase from 4.0% for 2005, 3.2% in 2004 and 2.1% in 2003. The consumer price index rose 2.3% from January 1, 2007 to July 1, 2007. In addition, Iceland's current account deficit at December 31, 2006 was 27.3% of gross domestic product for 2006, impacting the value of the Icelandic króna, which has fallen in value against the euro, the pound sterling and the U.S. dollar. As of July 16, 2007, the Icelandic króna had depreciated 12.2% against the euro to ISK 82.84 per €1.00 from its 2006 high of 73.83 per €1.00 at January 10, appreciated 1.3% against the U.S. dollar to ISK 60.12 per $1.00 from its 2006 high of 60.89 per $1.00 at January 12, depreciated 14.2% against the pound sterling to ISK 122.45 per £1.00 from its 2006 high of ISK 107.22 per £1.00 at January 6 and depreciated 12.5% against the Danish krone to ISK 11.13 per DKK 1.00 from its 2006 high of ISK 9.898 per DKK 1.00 at January 9 and 10. These developments and others may have a material adverse effect on our business, financial condition and results of operations. While we have diversified our business geographically in recent years, because of our position as a leading Icelandic bank, some of our business outside of Iceland is undertaken by us on behalf of our Icelandic clients, thereby increasing our exposure to the risks of the specific country where these business opportunities are present.

Our businesses are subject to the general economic conditions prevailing in the European Economic Area and elsewhere

The profitability of our businesses could be adversely affected by a decline in general economic conditions in the European Economic Area, Western Europe or the United States. These factors could also have a material adverse effect on our business, financial condition and results of operations. An economic downturn in the Nordic region could impact our results and financial position by affecting demand for our products and services. Such a downturn could also impact 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 conditions in Iceland".

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

Our loan portfolio is exposed to relatively high concentration in certain currencies and market sectors. As of December 31, 2006, 12.7% of our loans were denominated in Icelandic króna, 22.3% were denominated in Danish krone, 22.6% were denominated in pounds sterling and 19.1% in euro, compared to 17.1% in Icelandic króna, 25.8% in Danish krone, 18.3% in pounds sterling and 17.6% in euro as of December 31, 2005. At December 31, 2006, 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 19.9%, 24.3% and 16.6%, respectively, of our loan portfolio (excluding loans to banks and off-balance sheet credit related commitments). Furthermore, as of December 31, 2006, our ten largest borrowers represented 13.5% of our customer loans and our 20 largest borrowers represented 19.0% 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 2.4% of our customer loan portfolio. Following the acquisition of FIH, our exposure to the service sector as a percentage of total loans declined significantly due to the composition of FIH's loan portfolio, while our concentration in the manufacturing, real estate, food and beverage and banking and finance sectors increased. Although our loan portfolio has recently become more diversified, 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, 2006, 18.0% of our loans to customers, or ISK 458.3 billion, was 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.

After the merger with Búnadarbanki Íslands hf. ("Búnadarbanki") in 2003, we wrote off approximately ISK 1.4 billion in non-performing loans in 2003, and increased our provisions for loans to customers in certain sectors, particularly in the fishing, building and food and beverage industries. There can be no assurance that further unanticipated provisions for non-performing loans through loan losses or write-offs will not be required in the future, particularly with respect to banking operations that we may acquire in the future.

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

We are exposed to the risk that third parties who owe us money, securities or other assets will not meet, or 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 small- and medium-sized enterprises ("SMEs") than is the case for large corporate clients, and is even more limited for individuals. SMEs 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 51.3% and 16.6%, respectively, of our total loan portfolio as of December 31, 2006. Therefore, in spite of any credit risk determination procedures which we have in place, 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 particularly high 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, acquisition and leveraged finance transactions are becoming increasingly leveraged with looser covenant structures and pricing has been driven down. At December 31, 2006, our acquisition and leveraged finance portfolio amounted to approximately ISK 458.3 billion, or 18.0% 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 of the securities in our proprietary trading 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, 2006 our equity and debt investment portfolios totalled ISK 159,020 million and ISK 318,264 million, respectively, and accounted for 3.9% and 7.8%, respectively, of our total assets. A fall in the price of our Icelandic or other securities could substantially reduce the value of our securities portfolio and the amount of our other operating income attributable to trading gains.

Under IFRS, the securities in our trading portfolio are measured at their fair value at the end of each financial period, with changes in value during the period recognized in our income statement under "net gain on financial assets measured at fair value". As a result, declines in the market value of our trading portfolio could adversely affect our profitability, even if those declines have not been realized through a sale of the relevant securities. Under IFRS, 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, unrealized gains or losses of financial assets available-for-sale are recognized 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 1 capital ratios) that we are required to maintain under applicable law.

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 exposures) on one individual counterparty 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 condition 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 in Iceland, the United Kingdom, Denmark or Sweden generally, 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, often such securities are unlisted and illiquid and the value of such securities is closely linked to the business performance of the borrowers compared to such other types of collateral described above. A decline in the value of collateral securing these loans or the 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 rising interest rate environment compounds the risk that we will not be able to access funds at favorable rates. These and other factors also could lead creditors to form a negative view of our liquidity, which could result in less favorable 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 also are 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 prefund redemptions in 2007. As at December 31, 2006, we had ISK 936 billion of borrowings maturing in 2007 and ISK 2,041 billion of borrowings maturing in next five years. While we have issued ISK 859 billion of new long-term debt instruments during 2006, exceeding our total long term debt refinancing requirements through the end of 2007, there is no guarantee that we will be able to access further sources of funding to meet additional funding requirements in the future. Furthermore, approximately 20% of our total interest-bearing liabilities are deposits that are on demand or with a maturity of less than three months. These can be withdrawn quickly in the event of adverse economic developments in Iceland or in the other markets in which we operate, causing further strains on our liquidity. Further, many of our deposits are placed by deposit brokers and are dependent on both the rate paid and the risk of loss perceived of financial issuers. If our financial condition were to decline, we may not be able to replace these deposits when they mature, or may be required to pay higher interest rates to do so.

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 mechanisms, through our €12 billion European Medium-Term Note ("EMTN") program at Kaupthing and our €8 billion EMTN program at FIH Erhvervsbank. We have also raised funds in the Euromarkets through our €500 million and €2 billion European commercial paper program at Kaupthing and FIH Erhvervsbank, respectively. Given the size of our issuances in the Euromarkets to date, we have sought to diversify our sources of funding, including in the United States, Australia and Japan, where we raised funds for the first time in 2006. 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. 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.

While we monitor our liquidity position and funding strategies on an ongoing basis, unexpected events, unpredictable economic or market conditions, unforeseeable declines in our earnings or other situations beyond our control could cause either a short- or long-term liquidity crisis.

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 provision in some of our trading and collateralized 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 collateralized 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.

Our short-term debt ratings were last affirmed by Moody’s on April 11, 2007, when Moody's downgraded own long-term debt rating to Aa3 following an upgrading of four notches in February 2007. Our long and short-term debt ratings were last affirmed by Fitch on March 15, 2007. Fitch affirmed its outlook as stable, despite the downgrade of Iceland’s sovereign rating to A+ from AA- on March 15, 2007, citing our good performance in 2006, the geographical diversification of our funding, longer funding maturity profile, diversified profit streams and reduced equity exposure, notwithstanding that significant macro-imbalances remain. On September 12, 2006, Moody’s downgraded our bank financial strength rating from C+ to C, concluding its review for possible downgrade initiated in April, 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 1 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 February 26, 2007, Moody’s upgraded our long-term debt rating from A1 to Aaa, as a result of the application of its joint default analysis (JDA), which takes into account potential sources of external support for banks, and its updated bank financial strength rating (BFSR) methodology, but revised its rating to Aa3 on April 11, 2007 following a review of its JDA methodology. Moody’s outlook on all ratings is stable. On December 22, 2006, 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 ahead of the 2007 elections at a time when the macroeconomic imbalances in the economy due to excessive domestic demand are in urgent need of readjustment. We are not currently rated by Standard & Poor's.

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 impact our access to capital markets, if only temporarily, without impacting the rating agencies views on our credit rating.

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

For the year ended December 31, 2006, we derived approximately 29.5% of our operating income from our investment banking activities 16.4% (excluding capital gains from the disposal of a substantial portion of our stake in Exista), compared to 23.3% for the year ended December 31, 2005 and 20.9% for the year ended December 31, 2004. Our income from our investment banking activities is comprised 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 on 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 acquisition. As of December 31, 2006, these investments amounted to ISK 159,020 million, of which 72% was in listed shares and equity instruments and 28% was in unlisted shares and equity instruments, compared to ISK 114,355 million at December 31, 2005, of which 63% was in listed shares and equity instruments and 37% 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 of the securities in our proprietary trading 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 recognized in equity. Although we have not experienced significant volatility in the value of our private equity portfolio while we have been reporting under IFRS, significant declines in the fair value of this portfolio in the future could adversely affect our equity.

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 unfavorable 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.

At December 31, 2006, our Value-at-Risk (over 10 trading days with a 99% degree of certainty) was ISK 5.5 billion (€57.9 billion), or 1.7% of Tier I capital and 1.2% of CAD capital.

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

Our reporting currency is the Icelandic króna. As of December 31, 2006, approximately 87% of our loan portfolio was comprised of non-ISK-denominated loans and approximately 95% of our borrowings were in currencies other than the Icelandic króna, particularly the euro and the U.S. dollar. In addition, we trade currency on behalf of our clients and for our own account and maintain open currency positions in currencies other than Icelandic króna. We do not fully hedge our foreign currency exposure at all times. Although we have taken steps to limit this exposure, adhere to regulatory limits and establish strict limits aimed at reducing currency risk, there can be no assurance that future mismatches will not occur or that trading limits will not be breached. In addition, we present our financial statements in Icelandic króna. However, a significant portion of our revenues and expenses as well as dividend payments we receive from our subsidiaries originate in currencies other than króna, including pounds sterling, Danish krone, Swedish krona and the euro. Fluctuations in the exchange rate with these currencies will impact the translation of the results of these subsidiaries into Icelandic króna in our consolidated financial statements. As a result, fluctuations in exchange rates could have a material adverse effect on our business, financial condition and results of operations.

The cross-ownership of shares among many Icelandic companies and the higher levels of indebtedness of businesses and individuals in Iceland exposes us to greater systemic risk

Because Iceland is a relatively small, concentrated economy where company ownership is dominated by domestic investors, there is a higher degree of cross-ownership among companies than is found in other developed markets. In addition, a significant number of large borrowers in Iceland are investment companies whose principal assets are shares in other companies. Loans to these companies are typically secured by pledges of the shares in their portfolios and the value of this collateral is subject to declines in the values of such principal assets or in the Icelandic equity markets more generally. Further, our investment banking division may co-invest in companies to which we have extended loans, increasing our exposure to these companies. As a result of the foregoing factors, we have a greater exposure than certain other banks to general downturns in the economy in general and the equity markets in particular. Further, to the extent that other banks in Iceland have similar exposures in Iceland, the Icelandic banking system as a whole could be adversely affected by these risks. At December 31, 2006, loans to holding companies represented ISK 343 billion, or 11.4% of our total loan portfolio.

In addition, many businesses and individuals in Iceland may have higher levels of indebtedness than in other Nordic and Northern European countries, further increasing their exposure to economic downturns.

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 and we plan to leverage off our existing client base and banking operations to expand our business through cross-selling of our products, especially in the areas of investment banking and acquisition and leveraged finance. 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 impact the management of our current operations. Further, no assurance can be given that we will be successful in identifying and acquiring appropriate candidates 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 high 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 favorable terms in the future, or at all. Our failure to successfully realize our growth strategy could have a material adverse effect on our business, financial condition and results of operations.

We may fail to properly integrate our acquired operations

Since 2000, we have acquired ten financial institutions, primarily in Northern Europe. We intend to continue to grow our business through further expansion in Northern Europe as well as through further penetration of the banking markets in which we currently operate. Expansion of our operations will require significant investment, increased operating costs, greater allocation of management resources away from daily operations, continued development and integration of our financial and information management control systems across multiple banking platforms, including to ensure compliance with applicable laws and regulations, continued diversification of our funding sources, continued training of management and other personnel, adequate employee supervision and delivery of consistent client product and service messages. In addition, we continue to integrate some of our recent acquisitions, in particular Singer & Friedlander, into our business, which will involve further challenges and commitment of resources. Our failure to effectively manage these issues as well as our growth, while at the same time maintaining adequate focus on our current operations, 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 2002, our loan portfolio (excluding inter-bank loans and off-balance sheet credit-related commitments) grew by 32% to ISK 269,333 million and, in 2003, by 30% to ISK 350,995 million (in each case, giving pro forma effect to our acquisition of Búnadarbanki). Part of the growth in 2003 was attributable to the consolidation of the loan portfolio of JP Nordiska AB, following its acquisition in 2002. In 2004, our customer loan portfolio grew by 203% to ISK 992,400 million, mainly due to the acquisition of FIH. In 2005, our customer loan portfolio grew by 57% 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% 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% 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% in 2006, due to organic growth, most significantly at Kaupthing. It is unlikely that, absent other acquisitions in the future, we will 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 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 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 successfully compete in our primary markets.

Further, 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% share of the ISK 806 billion Icelandic mortgage market in 2006 compared to our 14.6% 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 (VaR) 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 which exists across the group. Some of our qualitative tools and metrics for managing risk are based upon use of observed historical market behavior. 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 modeling 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 modeling 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.

While we manage our operational risks, these 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. These events can potentially result in financial loss as well as harm to our reputation. 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 authorization 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.

We attempt to keep operational risks at appropriate levels by maintaining a sound and well controlled environment in light of the characteristics of our business, the markets and the regulatory environments in which we operate. While these control measures mitigate operational risks, they do not eliminate them and failures could subject us to regulatory scrutiny.

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 impact our business.

Unconfirmed derivative transactions and unauthorized 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 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. Unauthorized 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.

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 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 use of observed historical market behavior. 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, futures and operations 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 operation.

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.

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. We have not yet completed the installation of a group-wide IT system following our acquisition of Singer & Friedlander , nor can we offer our assurances that we will be able to do so on a timely basis or without undue disruption to our business.

The secure transmission of confidential information is a critical element of our operations. We cannot guarantee that existing security measures will prevent security breaches, including break-ins, viruses or 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. 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 licenses 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 licenses. 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 and a consultant to third party businesses. These risks include potential liability for our role in determining the price of a company, 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 authorized 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 or the European Union. This provides us with regulatory conditions similar to those of other European banks. However, it should be noted that 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.

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 our ability to continue to attract, retain and motivate qualified and experienced banking and management personnel, particularly those individuals who are experienced in investment banking and acquisition finance. Competition for personnel with relevant expertise is intense, due to the relatively small number of available qualified individuals. Competition for qualified personnel, including senior management, is particularly intense in Iceland, where the unemployment rate is currently below 2%. 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 employee 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.

Risks Related to the Notes

An active trading market for the Notes may not develop

Although we have applied to list the Notes on the Euro MTF market of the Luxembourg Stock Exchange, we cannot assure you that this application will be approved nor can we assure you that an active trading market for the Notes will ever develop or be maintained. Many factors independent of our creditworthiness affect the development and maintenance of a trading market. These factors include:

- the complexity and volatility of the index or formula applicable to the Notes;
- the method of calculating the principal, premium and interest in respect of the Notes;
- the time remaining to the maturity of the Notes;
- the outstanding amount of the Notes;
- the redemption features of the Notes;
- the amount of other debt securities linked to the index or formula applicable to the Notes; and
- the level, direction and volatility of market interest rates generally.

In addition, certain Notes have a more limited trading market and experience more price volatility because they are designed for specific investment objectives or strategies. In addition, unlisted Notes may be issued under the Program. There may be a limited number of buyers when an investor decides to sell such Notes. This may affect the price an investor receives for such Notes or the ability of an investor to sell such Notes at all. A prospective investor should not purchase Notes unless such an investor understands and knows it can bear these investment risks.

Furthermore, the Notes have not been, and will not be, registered under the Securities Act or any other applicable securities laws and are being offered pursuant to certain exemption from the registration requirements of the Securities Act. Accordingly, the Notes are subject to certain restrictions on the resale and other transfer thereof as set forth under "Transfer Restrictions". These restrictions may limit you ability to resell your Notes. Consequently, a Holder of Notes and owner of beneficial interests in such Notes must be able to bear the economic risk of an investment in such Notes for an indefinite period of time.

The Notes are subject to certain structural risks

General

With respect to an investment in Notes indexed to one or more interest rates, currencies or other indices or formulas, significant risks exist that are not associated with a conventional fixed rate or floating rate debt security. These risks include fluctuation of the particular indices or formulas and the possibility that an investor will receive a lower amount of principal, premium or interest and at different times than expected. We have no control over a number of matters, including economic, financial and political events, that are important in determining the existence, magnitude and longevity of these risks and their results. In addition, if an index or formula used to determine any amounts payable in respect of the Notes contains a multiplier or leverage factor, the effect of any change in such index or formula will be magnified. In recent years, values of certain indices and formulas have been volatile and volatility in those and other indices and formulas may be expected in the future. However, past experience is not necessarily indicative of what may occur in the future.

Certain of the Notes we may issue are complex financial instruments. Sophisticated investors generally do not purchase complex financial instruments as stand-alone investments. A potential investor should not invest in Notes which are complex financial instruments unless it has the expertise (either alone or with a financial adviser) to evaluate how the Notes will perform under changing conditions, the resulting effects on the value of the Notes and the impact this investment will have on the potential investor's overall investment portfolio.

The Notes may be subject to early redemption

If the applicable Pricing Supplement specifies that the Notes are redeemable at our option, or are otherwise subject to mandatory redemption, we may (in the case of optional redemption) or must (in the case of mandatory redemption) choose to redeem those Notes at times when prevailing interest rates may be relatively low. Accordingly, an investor generally will not be able to reinvest the redemption proceeds in a comparable security at an effective interest rate as high as that of the Notes.

The Notes are subject to certain exchange rate and exchange control risks

With respect to an investment in Notes that are denominated and/or payable in a currency other than U.S. dollars ("Specified Currency Notes"), there will be significant risks not associated with an investment in a debt security denominated and payable in U.S. dollars, including the possibility of material changes in the exchange rate between U.S. dollars and the payment currency and the imposition or modification of exchange controls by the applicable governments. We have no control over the factors that generally affect these risks, such as economic, financial and political events and the supply and demand for applicable currencies. Moreover, if payments on Specified Currency Notes are determined by reference to a formula containing a multiplier or leverage factor, the effect of any change in the exchange rates between the applicable currencies will be magnified. In recent years, exchange rates between certain currencies have been highly volatile and volatility between such currencies or with other currencies may be expected in the future. Fluctuations between currencies in the past are not necessarily indicative, however, of fluctuations that may occur in the future. Depreciation of the payment currency would result in a decrease in the U.S. dollar equivalent yield of the Specified Currency Notes, in the U.S. dollar equivalent value of the principal and any premium payable at maturity or earlier redemption of the Specified Currency Notes and generally, in the U.S. dollar equivalent market value of the Specified Currency Notes.

Governmental exchange controls could affect exchange rates and the availability of the payment currency on a required payment date. Even if there are no exchange controls, it is possible that the payment currency will not be available on a required payment date due to circumstances beyond our control. In such cases, we will be allowed to satisfy its obligations in respect of Specified Currency Notes in U.S. dollars.

Our credit ratings may not adequately reflect all of the risks related to the Notes

Real or anticipated changes in our credit ratings generally will affect the market value of the Notes. These credit ratings may not reflect the potential impact of all risks related to structure, market and other factors that may affect the value of the Notes. A credit rating is not a recommendation to buy, sell or hold securities and may be revised or withdrawn by the rating agency at any time.

There are no limitations on our incurrence of additional debt in the future

We are not prohibited from issuing, providing guarantees or otherwise incurring further debt ranking pari passu with, or senior to, our existing obligations and any future obligations arising under this Program.

The Subordinated Notes are subordinated obligations ranking junior to all of our senior and secured obligations

Any Subordinated Notes issued under the Program will be unsecured subordinated obligations ranking junior to all of our senior and secured obligations and junior to any other obligations preferred by law, including the claims of our depositors.

Remedies in case of a default on the Subordinated Notes are severely limited

In the event of a default under the Subordinated Notes, you may be able to accelerate payment of the Notes and institute legal proceedings against us to enforce such payment, as well as any other obligations we may have under the terms of the Notes. You may, however, claim payment for the full amount only if we become subject to a winding-up of our business, although at this time only the Financial Services Authority may institute a winding-up.

An investment in Subordinated Notes should only be undertaken by sophisticated investors

An investment in Subordinated Notes is suitable only for financially sophisticated investors who are capable of fully evaluating the risks involved in making such investment and who have an asset base sufficiently substantial as to enable them to sustain any loss that they might suffer as a result of making such investment.

The Capital Notes are deeply subordinated obligations

Any Capital Notes issued under the Program will be unsecured, deeply subordinated obligations and will rank among our most junior debt instruments, ranking behind the claims of our depositors and, our other senior and subordinated obligations, and ranking pari passu with our other outstanding capital securities and Tier I capital, and in priority only to all of our ordinary share capital. Consequently, if our financial condition were to deteriorate, Holders of the Capital Notes could suffer direct and materially adverse consequences, including reductions in interest payments due to conversion of the principal amount of any Capital Notes into conditional capital contributions. In addition, interest is not payable on the Capital Notes in certain cases and the Capital Notes are non-cumulative. If we were liquidated (whether voluntarily or involuntarily) or experienced certain other cases of financial difficulty, Holders of Capital Notes could lose their entire investment.

The Capital Notes have restrictions on interest payments

In certain circumstances, we are under no obligation to make interest payments on the Capital Notes. We may make only partial or no interest payments for any period for which interest is payable where there are not sufficient funds available with which to do so. The interest payment provisions of the Capital Notes are non-cumulative. As a result, any interest not paid because of these restrictions may be lost and we will have no obligation to make payment of such interest or to pay interest thereon.

The principal of the Capital Notes may be converted into conditional capital contributions or written-down

To the extent we may be required to meet requirements with respect to Minimum Own Funds as set out in the Act on Financial Undertaking (and as defined in the Notes), we may resolve that the principal amount (or part thereof, as the case may be) of each Capital Note should be made available to restore our regulatory capital through a write-down of all or part of the principal amount and a conversion of such amount into a conditional capital contribution. Interest will not, thereafter, accrue on the converted amount unless and until such amounts are reinstated. We are not required to reinstate such amounts and there may be significant impediments to our ability to do so.

The Capital Notes are perpetual in nature

The Capital Notes have no fixed final redemption date and Holders have no rights to call for the redemption of the Capital Notes. Although we may redeem the Capital Notes in certain circumstances, there are limitations on our ability to do so. Therefore, Holders should be aware that they will be required to bear the financial risks of an investment in the Capital Notes for an indefinite period of time.

The Capital Notes may be redeemed upon the occurrence of certain changes in tax laws or regulations

If we become obligated to pay additional amounts as a result of any change in, or amendment to, the laws or regulations of any relevant tax jurisdiction or upon the occurrence of a Capital Event (as defined in the Notes), we will have the right to redeem the Capital Notes at a redemption amount equal to 100% of the original principal amount, together with any accrued interest, to the date fixed for redemption. There can be no assurance that Holders of the Capital Notes will be able to reinvest the amounts received upon redemption at a rate that will provide the same rate of return as their investment in the Capital Notes.

Remedies in case of a default on the Capital Notes are severely limited

In the event that amounts owing under the Capital Notes are declared due and payable, in accordance with the terms of the Notes you can recover this payment only in the event of our insolvency or liquidation. In addition, you or the Trustee for the Capital Notes have only a limited ability to bring proceedings to enforce certain of our obligations under the Capital Notes. The availability of only limited remedies could adversely affect the value of your investment and your ability to recover your investment.

An investment in Capital Notes should only be undertaken by sophisticated investors

An investment in Capital Notes is suitable only for financially sophisticated investors who are capable of fully evaluating the risks involved in making such investment and who have an asset base sufficiently substantial as to enable them to sustain any loss that they might suffer as a result of making such investment.

USE OF PROCEEDS

The net proceeds from each issue of Notes will be used by us for our general corporate purposes, including the repayment of borrowings incurred in the ordinary course of business. See “Description of Business” for a detailed description of our operations. If, in respect of a particular Series of Notes, there is a particular identified use of proceeds, this will be stated in the applicable Pricing Supplement.

EXCHANGE RATES

The following table sets forth, for the periods indicated, certain information concerning the exchange rate for Icelandic króna based on the mid rate quoted by the Central Bank of Iceland from 2002 to 2006 and by Reuters for 2007 expressed in Icelandic króna per $1.00. No representation is made that amounts in Icelandic króna have been, could have been, or could be converted into U.S. dollars at the mid rate or at any other rate. At July 16, 2007, the mid rate was ISK 60.12 per $1.00.

	High	Low	Average(1)	Period End
		(króna per dollar)		
Recent Monthly Exchange Rate Data				
January, 2007	73.08	68.34	70.04	68.41
February, 2007	68.62	65.85	67.32	66.25
March, 2007	68.52	65.78	66.98	65.78
April, 2007	66.96	64.00	65.26	64.00
May, 2007	64.16	61.61	62.96	61.61
June, 2007	64.19	61.47	62.74	62.25
July, 2007 (through July 16)	62.14	60.01	60.98	60.12
Historical Annual Exchange Rate Data				
2006	77.92	60.89	70.15	71.83
2005	66.77	58.45	62.86	63.13
2004	74.51	61.19	70.12	61.19
2003	82.78	71.16	76.75	71.16
2002	103.71	80.77	91.46	80.77

(1) The average rate for each year from 2002 to 2006 is the average of the mid rates on the last business day of each month during the relevant period.

(2) The average rate for each month is the average of the mid rates of each business day during the month.

Sources: Central Bank of Iceland from 2002 to 2006; Reuters for 2007.

The exchange rate of the Icelandic króna is determined on the foreign exchange market, which is open between 9:15 Greenwich Mean Time ("GMT") and 16:00 GMT on business days. Once a day the Central Bank of Iceland quotes the official buying, selling and mid standard rate of the Icelandic króna against the U.S. dollar (and other currencies) and this is used as a standard for official agreements, court cases and other agreements between parties when an alternative standard for a rate of exchange is not specified. This is done between 10:45 GMT and 11:00 GMT every morning on days when organized foreign exchange markets are open for business. Under special circumstances, the Central Bank of Iceland may temporarily suspend the quotation of the exchange rate of the króna.

CAPITALIZATION

The following table sets forth our capitalization as at December 31, 2006. For further information on capitalization and indebtedness, see "Management's Discussion and Analysis of Financial Condition and Results of Operations – Liquidity, Capital and Funding" and "Selected Statistical Data – Indebtedness" below.

	At December 31, 2006	Percentage of total capitalization
	(ISK millions—IFRS)	(%)
Borrowings		
Issued bonds	1,762,483	46.4%
Loans	637,456	16.8%
Total borrowings	2,399,939	63.2%
Deposits		
Deposits from credit institutions and central banks	110,456	2.9%
Other deposits	750,658	19.8%
Total deposits	861,114	22.7%
Subordinated loans		
Tier I	51,817	1.3%
Tier II	164,213	4.3%
Total subordinated loans	216,030	5.6%
Equity		
Share capital	171,349	4.5%
Other equity	152,161	4.0%
Total shareholders' equity	323,510	8.5%
Total capitalization	3,800,593	100.0%

The following table sets forth our capitalization as at March 31, 2007

	At March 31, 2007	Percentage of total capitalization
	(ISK millions—IFRS)	(%)
Borrowings		
Issued bonds	1,735,629	43.6%
Loans	699,472	17.6%
Total borrowings	2,435,101	61.2%
Deposits		
Deposits from credit institutions and central banks	119,871	3.0%
Other deposits	892,170	22.4%
Total deposits	1,012,041	25.4%
Subordinated loans		
Tier I	48,727	1.2%
Tier II	170,129	4.3%
Total subordinated loans	218,856	5.5%
Equity		
Share capital	171,328	4.3%
Other equity	142,572	3.6%
Total shareholders' equity	313,900	7.9%
Total capitalization	3,979,898	100.00%

SELECTED CONSOLIDATED FINANCIAL INFORMATION

Set forth below is selected condensed consolidated financial information for the group as at, and for the years ended December 31, 2006 and 2005, prepared in accordance with IFRS, and comparison figures as at January 1, 2005 and for the year ended December 31, 2004, restated in accordance with IFRS. The selected condensed consolidated financial data as at December 31, 2006 and 2005 and as at January 1, 2005 and for the years ended December 31, 2006, 2005 and 2004 have been derived from our consolidated financial statements included elsewhere in this Offering Circular, which have been audited by our independent auditors, KPMG hf. The financial information set forth below should be read in connection with, and is qualified in its entirety by reference to, our consolidated financial statements and the accompanying notes included elsewhere in this Offering Circular.

Certain Icelandic króna amounts as at and for the year ended December 31, 2006 have been translated to dollar amounts, solely for your convenience. Certain income statement data for the year ended December 31, 2006 have been translated at ISK 70.15 per $1.00, the average of the daily mid rates quoted by the Central Bank of Iceland for the year ended December 31, 2006. Certain balance sheet data have been translated at ISK 71.83 per $1.00, the mid rate quoted by the Central Bank of Iceland on December 31, 2006.

	As at and for the year ended December 31,			
	2006 ($)	2006 (ISK)	2005 (ISK)	2004 (ISK)[1]
	(IFRS) (in millions, except percentages)			
Income Statement items				
Net interest income	746	52,362	32,710	18,259
Net fee and commission income	531	37,284	22,428	13,308
Net financial income	858	60,157	37,282	16,326
Other income	248	17,413	9,778	2,052
Operating income	2,383	167,216	102,198[2]	49,945[2]
Salaries and related expenses	(479)	(33,570)	(20,317)	(12,851)
Other operating expenses	(377)	(26,436)	(15,208)	(10,774)
Operating expenses	(856)	(60,006)	(35,525)	(23,625)
Impairment	(87)	(6,127)	(4,389)	(3,825)
Earnings before income tax	1,440	101,083	62,284	22,495
Income tax	(209)	(14,636)	(11,228)	(4,236)
Net earnings	1,231	86,447	51,056	18,259
Minority interest	(16)	(1,145)	(1,796)	(552)
Shareholders' net earnings	1,215	85,302	49,260	17,707
Balance Sheet items				
Loans and advances	42,099	3,023,943	1,739,294	1,154,416
Financial assets measured at fair value	9,259	665,129	612,534	305,961
Assets other than mentioned above	5,100	366,324	188,983	94,076
Total assets	56,458	4,055,396	2,540,811	1,554,453
Deposits from credit institutions and central banks	1,538	110,456	69,643	32,488
Other deposits	10,450	750,658	486,175	202,193
Borrowings	33,411	2,399,939	1,556,567	968,512
Subordinated loans	3,008	216,030	102,688	57,623
Liabilities other than mentioned above	3,389	243,421	123,226	134,728
Total liabilities	51,796	3,720,504	2,338,299	1,395,544
Minority interest	158	11,382	8,329	9,539
Shareholders' equity	4,504	323,510	194,183	149,370
Total liabilities and equity	56,458	4,055,396	2,540,811	1,554,453
Financial ratios				
Return on average assets [3]	2.53%	2.53%	2.34%	—
Return on average equity[4]	42.39%	42.39%	33.96%	—
Net interest margin	1.77%	1.77%	1.86%	—
Net interest spread	1.73%	1.73%	1.43%	—
Cost to income ratio [5]	35.89%	35.89%	34.76%	—

	As at and for the year ended December 31,			
	2006 ($)	2006 (ISK)	2005 (ISK)	2004 (ISK)[1]
		(IFRS)		
Asset quality ratios				
Non-performing loans as a percentage of loans to customers	1.00%	1.00%	0.98%	—
Non-performing assets as a percentage of loans to customers	1.10%	1.10%	1.12%	—
Provision for loans as a percentage of loans to customers	0.65%	0.65%	0.83%	—
Net write-offs as a percentage of average loans to customers outstanding	0.15%	0.15%	0.24%	—
Capital ratios				
CAD ratio	15.0%	15.0%	12.2%	—
Tier 1 capital ratio	10.5%	10.5%	9.4%	—

(1) Balance sheet data is as at January 1, 2005.
(2) Operating income includes net (loss) gain on non-current assets held for sale.
(3) Average on quarter-end balances.
(4) Represents the annualized geometric mean of the return on shareholders' equity for each quarter during the period. The return on shareholders' equity for each quarter is calculated as (i) shareholders' net earnings for the quarter, divided by (ii) shareholders' equity at the beginning of the quarter, adjusted for changes in shareholders' equity (other than those resulting from shareholders' net earnings for that quarter) during the quarter.
(5) Operating expenses divided by operating income.

Set forth below is selected unaudited consolidated financial information for the group as at, and for the three-month periods ended March 31, 2007 and 2006, prepared in accordance with IFRS. The financial information set forth below should be read in connection with, and is qualified in its entirety by reference to, our consolidated financial statements and the accompanying notes included elsewhere in this Offering Circular.

Icelandic króna amounts as at and for the three-month period ended March 31, 2007 have been translated to dollar amounts, solely for your convenience. Certain income statement data for the three-month period ended March 31, 3007 have been translated at ISK 68.11 per $1.00, the average of the daily mid rates quoted by Reuters for the three-month period ended March 31, 2007. Certain balance sheet data have been translated at ISK 65.78 per $1.00, the mid rate quoted by Reuters on March 31, 2007.

	As at and for the three months ended March 31,		
	2007 ($)	**2007 (ISK)**	**2006 (ISK)**
		(IFRS)	
		(in millions, except percentages)	
Income Statement items			
Net interest income	239	16,265	10,484
Net fee and commission income	181	12,337	8,602
Net financial income	198	13,456	13,505
Other income	29	2,002	2,860
Operating income[(1)]	647	44,060	35,451
Salaries and related expenses	(155)	(10,534)	(7,420)
Other operating expenses	(105)	(7,173)	(5,132)
Operating expenses	(260)	(17,707)	(12,552)
Impairment	(21)	(1,423)	(710)
Earnings before income tax	366	24,930	22,189
Income tax	(62)	(4,236)	(2,595)
Net earnings	304	20,694	19,594
Minority interest	(6)	(413)	(796)
Shareholders' net earnings	298	20,281	18,798
Balance Sheet items			
Loans	45,781	3,011,480	2,199,906
Financial assets measured at fair value	12,718	836,603	665,846
Assets other than mentioned above	5,326	350,302	205,492
Total assets	63,825	4,198,385	3,071,244

	As at and for the three months ended March 31,		
	2007 ($)	2007 (ISK)	2006 (ISK)
		(IFRS)	
		(in millions, except percentages)	
Deposits from credit institutions and central banks	1,822	119,871	97,625
Other deposits	13,563	892,170	548,281
Borrowings	37,019	2,435,101	1,921,899
Subordinated loans	3,327	218,856	113,596
Liabilities other than mentioned above	3,166	208,247	165,955
Total liabilities	58,897	3,874,245	2,847,356
Minority interest	156	10,240	9,881
Shareholders' equity	4,772	313,900	214,007
Total liabilities and equity	63,825	4,198,385	3,071,244
Financial ratios			
Return on average assets(2)	1.97%	1.97%	2.68%
Return on average equity(3)	27.6%	27.6%	44.7%
Net interest margin	1.82%	1.82%	1.66%
Net interest spread	2.08%	2.08%	1.72%
Cost to income ratio(4)	40.19%	40.19%	35.41%
Asset quality ratios			
Non-performing loans as a percentage of loans to customers	1.03%	1.03%	0.91%
Non-performing assets as a percentage of loans to customers	1.12%	1.12%	1.03%
Provision for loans as a percentage of loans to customers	0.64%	0.64%	0.72%
Net write-offs as a percentage of average loans to customers outstanding	0.12%	0.12%	0.23%
Capital ratios			
CAD ratio	13.8%	13.8%	11.4%
Tier 1 capital ratio	9.6%	9.6%	8.5%

(1) Operating income includes net (loss) gain on non-current assets held for sale.

(2) Average on quarter-end balances.

(3) Represents the annualized geometric mean of the return on shareholders' equity for each quarter during the period. The return on shareholders' equity for each quarter is calculated as (i) shareholders' net earnings for the quarter, divided by (ii) shareholders' equity at the beginning of the quarter, adjusted for changes in shareholders' equity (other than those resulting from shareholders' net earnings for that quarter) during the quarter.

(4) Operating expenses divided by operating income.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis should be read together with the financial statements, including the accompanying notes, included elsewhere in this Offering Circular. The financial statements and the accompanying notes for the years ended December 31, 2006, 2005 and 2004 have been prepared in accordance with IFRS. IFRS differ in certain respects from U.S. GAAP. The group has not prepared a summary of differences between IFRS and U.S. GAAP and has not prepared any financial information in accordance with U.S. GAAP or a reconciliation or quantification of differences between IFRS and U.S. GAAP. Investors are encouraged to consult their own financial advisers if they have any questions with respect to the differences between IFRS and U.S. GAAP. This discussion and analysis should also be read together with the information contained in "Selected Statistical Data".

Some of the information in the discussion and analysis set forth below and elsewhere in this Offering Circular includes forward-looking statements that involve risks and uncertainties. See "Forward Looking Statements" and "Risk Factors" for a discussion of important factors that could cause actual results to differ materially from the results described in the forward-looking statements contained in this Offering Circular.

Introduction

We are a Northern European bank with shares listed on the OMX Nordic Exchange Iceland hf. ("OMXI") and the Stockholm Stock Exchange ("OMXS"). We operate in ten countries, including all the Nordic countries, the United Kingdom, Luxembourg, Switzerland and the United States and two of the world's main business centers, London and New York. We hold banking licenses in eight countries: Iceland, the United Kingdom, Denmark, Sweden, Finland, the Faroe Islands, Norway and Luxembourg. In the United States, we operate through our subsidiary Kaupthing Securities Inc., a licensed broker-dealer. Iceland and Scandinavia and the United Kingdom currently are our most important markets, generating 47.0% and 24.8% and 19.6%, respectively, of our operating income in 2006.

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. In addition, we operate a retail banking franchise in Iceland, where we have our headquarters and, to a lesser extent, in Sweden.

We currently are one of the seven largest banks in the Nordic region in terms of market capitalization. We have expanded through organic growth and strategic acquisitions, such as the acquisition of FIH in July of 2004 for ISK 85,868 million (DKK 7,292 million) and the more recent acquisition of UK-based Singer & Friedlander in July of 2005 for ISK 63,708 million. We believe that these acquisitions have improved the quality of our loan portfolio and increased the diversification of our operations. However, FIH, being a wholesale commercial bank, generates lower interest margins than other of our banking operations.

We believe that our results for 2006 reflect our focus on Northern Europe, which we consider to be our home market. Approximately 70% of our income in 2005 was generated outside Iceland and we expect this percentage to increase in 2007, as we seek to expand our activities in Finland, Luxembourg and the United Kingdom. We currently have senior long-term debt ratings of 'Aa3' from Moody's and 'A' from Fitch. As of December 31, 2006, our total assets were ISK 4,055,396 million, our Tier 1 ratio was 10.5% and our CAD ratio was 15.0%. Our net earnings for 2006 were ISK 86,447 million, an increase of 69.32% from 2005, primarily as a result of acquisitions.

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 Sales and Marketing.

Recent Aquisitions

During the period under review, the scope of our consolidation and our business was affected by two significant transactions.

In July 2004, we acquired FIH in Denmark and we consolidated its results as of July 1, 2004. As a result of the acquisition, under Icelandic GAAP, net operating income increased during 2004 by ISK 2,648 million, or 5.5% of operating income, principally impacting our Banking division's net operating income. In addition, as a result of the acquisition, our total assets grew by ISK 767,915 million under Icelandic GAAP. As at January 1, 2005, FIH constituted 48.5% of our total assets and as of December 31, 2005, FIH constituted 32%. The acquisition of FIH also impacts the comparability of 2005 against 2004 due to inclusion of twelve months of FIH in 2005 compared to only six months in 2004.

In July 2005, we acquired Singer & Friedlander in the United Kingdom and we consolidated its results as of July 1, 2005. As a result of the acquisition, operating income increased during 2005 by ISK 7,804 million, or 7.7%, principally impacting both our Banking and Asset Management and Private Banking divisions' operating income. In addition, as a result of the acquisition, our total assets grew by ISK 369,673 million under IFRS. As at December 31, 2005 Kaupthing Singer & Friedlander constituted 14.2% of our total assets. The year ended December 31, 2006 is the first financial year incorporating the results of Kaupthing Singer & Friedlander for the entire year.

As explained above, the acquisitions of FIH and Singer & Friedlander had a significant impact on our financial statements and results of operations in the years in which they took place. As a result, comparisons of our results between the years preceding, during and after each of these transactions are more difficult.

Overview

During the period under review, we have been affected by certain macro-economic conditions in Iceland.

General Market Conditions

Our results of operations are affected by general market conditions, including economic cycles, banking industry cycles, volatility in the financial markets, fluctuations in interest rates and exchange rates, monetary policy and competitive factors.

Revenues and net earnings from our banking activities may vary from period to period based on fluctuations in interest rates and exchange rates, changes in market conditions and business cycles. Operating results from our investment banking, capital markets, asset management and treasury activities may vary significantly from period to period depending on market conditions. We also invest a portion of our assets in equities, which are generally subject to greater risks and more volatility than fixed income securities. This stock market volatility can significantly affect our investment returns.

Since 2003, the Nordic debt and equity markets in general, and the Icelandic markets in particular, have experienced a period of growth, recovering from the adverse market conditions that prevailed in 2001 and 2002. The OMXI15 index (formerly the ICEX15 index) increased 374% from 1,352 on January 1, 2003 to 6,410 on December 31, 2006, with a high of 6,925 on February 15, 2006, which was a 412% increase since January 1, 2003.

In the first quarter of 2006, concerns were raised in the global financial community about the Icelandic economy, including the rate of growth of the economy, the value of the króna against other major currencies and the size of the current account deficit. As a result, the securities markets in Iceland have experienced significant volatility in prices and trading volumes in 2006. Between January 1, 2006 and February 15, 2006, the OMXI15 index rose by 25.2%, from 5,529 to 6,925 points. After peaking on February 15, 2006, the OMXI15 fell by 24.0% to a low of 5,260 points on August 1, 2006. As of the close of trading on December 29, 2006, the OMXI15 had risen to 6,410 points, a 22% rise since August 1, 2006 and a 16% increase since January 1, 2006. In addition, the króna also devalued in response to these concerns. At July 16, 2007 the OMXI15 stood at 8,764.

During periods of adverse market conditions, trading volumes will often decrease, reducing our ability to realize trading gains in the capital markets. In addition, in accordance with IFRS, our proprietary investment portfolio is marked to market with gains and losses in the value of the portfolio being recognized in the income statement. As a result, we may recognize gains or losses on our investments in our income statement from time to time even where we have not realized the underlying positions. While in certain cases we may hedge all or a portion of our exposure on the investments in our proprietary investment portfolio, to the extent that we are not fully hedged market fluctuations will impact the value of this portfolio.

For information on significant trends and uncertainties which may affect our prospects for the current financial year, please see "Risk Factors".

Interest Rate Fluctuations

Changes in interest rates, including changes in the yield curve, which shows the relationship between interest rate yields and maturity lengths of bonds, can affect our banking, investment banking, capital markets and treasury results of operations. Over the past several years, movements in both short and long-term interest rates have affected the level and timing of recognition of gains and losses on securities held in our investment and proprietary trading portfolios.

Generally, a sustained period of lower interest rates will reduce the investment yield of the interest-earning assets in our investment portfolios, as higher yielding investments are called or mature and the proceeds of these investments are reinvested at lower rates. However, declining interest rates will generally increase the market value of interest earning assets in our investment portfolio and can lead to higher returns from our banking operations if interest-earning assets reprice more slowly than interest-bearing liabilities or the volume of average interest-earning assets grows as a result of higher amounts of credit demand.

Conversely, rising interest rates should over time increase investment income but may reduce the market value of existing investments in our portfolios. This can lead to higher returns from our banking operations if the interest rate spread widens, provided this effect is not offset by lower volumes of average interest-earning assets as a result of lower levels of credit demand or a deterioration in the quality of our loan portfolio or an increase in provisions for possible credit risk or lower interest income due to slower repricing of interest-earning assets compared to the repricing of interest-bearing liabilities.

Besides absolute levels of interest rates, income in our banking activities can be influenced by the steepness of the yield curve. In the case that the duration of interest earning assets is longer than the duration of interest bearing liabilities, a steeper yield curve would normally generate higher income in our banking operations. However, the same does not apply to our Treasury division, as Treasury adjusts its pricing according to the interest rates on the market.

Since 2003, Iceland has experienced a general increase in interest rates, with the benchmark policy rate of the Central Bank of Iceland rising from 5.30% in 2003 to 8.25% in 2004 and 10.50% in 2005. The Central Bank of Iceland raised its benchmark policy interest rate seven times in 2006: by 0.25 percentage points on January 31, 2006 to 10.75%, by 0.75 percentage points on April 4, 2006 to 11.50%, by 0.75 percentage points on May 23, 2006 to 12.25%, by 0.75 percentage points on July 11, 2006 to 13.0%, by 0.5 percentage points on August 22, 2006 to 13.5%, by 0.5 percentage points on September 19, 2006 to 14.0% and by a further 0.25% on December 27, 2006 to 14.25%. Similarly, the Central Bank of Denmark has also raised interest rates during the period that we have owned FIH, with its lending rate rising six times in 2006, from 2.50% in February to 3.75% in December. The Central Bank of Denmark raised its interest rates again on March 13, 2007 to 4.00%. Although the Bank of England lowered interest rates to 4.50% in August 2005, shortly after our acquisition of Singer & Friedlander, it subsequently raised the Official Bank Rate to 4.75% in August 2006, 5.00% in November 2006, 5.25% in January 2007 and 5.50% in May 2007. The majority of our loan portfolio bears interest at floating rates, the most notable exception being mortgage loans in Iceland. Accordingly, the interest spread on most of our loans is independent of the level of interest rates. The Icelandic mortgage loans are indexed to the consumer price index and, as the principal purpose of an increase in interest rates by the Central Bank of Iceland is to curb inflation, this indexation is to a certain extent adjusted for increased interest rates.

Exchange Rate Fluctuations

We present our consolidated financial statements in Icelandic króna. A substantial portion of our operations are accounted for in currencies other than króna, in particular pounds sterling and Danish krone. Fluctuations in the exchange rate between the Icelandic króna and these other currencies can have significant translation effects on our results of operations as reported in Icelandic króna, and have had such an effect during the periods under review.

Our reported results of operations were adversely affected in 2004 and 2005 as the Icelandic króna strengthened against other principal currencies and have benefited in 2006 by a weaker Icelandic króna compared to 2004 and 2005, which has increased the results of our operations outside of Iceland beyond the increases due to underlying business performance.

Exchange rate fluctuations also impact our capital adequacy ratios, as our loan portfolio is denominated principally in currencies other than the Icelandic króna, while our shareholders' equity is denominated in Icelandic króna. Our management has taken measures to hedge our shareholders' equity in order to limit the effect that the depreciation of the króna would have on our CAD ratio but as is the case with any hedging arrangements, no assurance can be provided as to the effectiveness of those hedges.

In 2006, the Icelandic króna depreciated against the U.S. dollar, the euro, the pound sterling and the Danish krone. Measured by the annual averages for each year, the ISV, the Central Bank of Iceland's weighted currency basket, depreciated by 23.1% in 2006. The table below presents the movement of the average Icelandic króna exchange rate against the U.S. Dollar, euro, pound sterling and the Danish krone during 2006.

	Year ended December 31,	
	2006	**2005**
Average ISK per USD	69.78	62.86
Average ISK per EUR	87.72	78.14
Average ISK per GBP	128.68	114.26
Average ISK per DKK	11.76	10.49

As of July 16, 2007, the Icelandic króna had depreciated 12.2% against the euro to ISK 82.84 per €1.00 from its 2006 high of ISK 73.83 per €1.00 at January 10, 2006, appreciated 1.3% against the U.S. dollar to ISK 60.12 per $1.00 from its 2006 high of ISK 60.89 per $1.00 at January 12, 2006, depreciated 14.2% against the pound sterling to ISK 122.45 per £1.00 from its 2006 high of ISK107.22 per £1.00 at January 6, 2006 and depreciated 12.5% against the Danish krone to ISK 11.13 per DKK 1.00 from its 2006 high of ISK 9.898 per DKK 1.00 at January 9 and 10, 2006.

Inflation

The rate of inflation has increased in Iceland from the beginning of 2004 until August 2006 when the 12 month inflation rate peaked at 8.6%. Since then it has declined slightly, to 5.3% in April 2007. From March 2004 to March 2007, the Icelandic consumer price index rose from 230.7 to 267.1, or 15.8% over a period of three years. With respect to our mortgage portfolio in Iceland, the outstanding principal amounts under these mortgages are linked to the Icelandic consumer price index, and adjusted on a monthly basis for fluctuations in the consumer price index. As a result, the amount of the principal and interest payments under these mortgages and the size of our Icelandic inflation-linked mortgage loan portfolio may increase or decrease in conjunction with the change in the inflation rate in Iceland. We invest in inflation index-linked bonds to hedge our exposure to fluctuations in the Icelandic consumer price index but the total amount invested does not cover the principal amount outstanding under inflation-linked mortgages. At December 31, 2006, we had ISK 117,981 million outstanding under inflation-linked mortgages, representing about 4.6% of our loans to customers, and our investments in index-linked bonds totalled ISK 32.7 billion. As a result, our results of operations are still affected by fluctuations in the inflation rate in Iceland to a certain extent. On a segmental level, increases or decreases in our net interest income resulting from fluctuations in inflation are reflected in our Treasury division, as opposed to our Banking division, as the Treasury division has overall responsibility for monitoring and managing our exposure to inflation.

Recent Developments

Funding

We accessed two new capital markets in 2007 for our funding needs. In January 2007 we issued a CHF 200 million 3.0% Notes due in 2010 in the Swiss fixed income market. We reopened this issue in February 2007 by CHF 100 million. In February 2007, we issued CAD$500 million 4.7% Notes due 2010 in the Canadian fixed-income market. In total we have raised over €3.75 billion in wholesale funding this year, including through private placements in the EU and US markets. As a result of these and prior capital markets issuances, we believe we have sufficient funds to cover our current maturing financial liabilities through 2007. See "—Liquidity, Capital and Funding".

Ratings

Our short-term debt ratings were last affirmed by Moody's on April 11, 2007, when Moody's downgraded our long-term debt rating to Aa3 following an upgrading of four notches in February 2007. Our long and short-term debt ratings were last affirmed by Fitch on March 15, 2007. Fitch affirmed the outlook for our ratings as stable, despite the downgrade of Iceland's sovereign rating by Fitch on March 15, 2007, citing good performance in 2006, the geographical diversification of our funding, longer funding maturity profile, diversified profit streams and reduced equity exposure, notwithstanding that significant macro-imbalances remain. On September 12, 2006, Moody's downgraded our bank financial strength rating from C+ to C, concluding its review for possible downgrade initiated in April, 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 1 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 February 26, 2007, Moody's upgraded our long-term debt rating from A1 to Aaa, as a result of the application of its joint default analysis ("JDA"), which takes into account potential sources of external support for banks, and its updated bank financial strength rating methodology. However, on April 11, 2007, Moody's subsequently downgraded our long-term debt rating to Aa3 following a review of its JDA methodology. Moody's outlook on all ratings is stable.

Establishment of Kaupthing Capital Partners II Fund

We are in the process of establishing a fund, Kaupthing Capital Partners II which will make private equity investments. Once the fund is established, all private equity investments will be made available to the fund, which will have a right of first refusal over such investments. If the fund has no interest in acquiring any such investment, the investment will remain with Kaupthing. All private equity investments made by Kaupthing since the beginning of 2007 have been made available to this fund. The fund itself will be of approximately £540 million, to which Kaupthing will commit £200 million on establishment and expect third party investors, namely institutions, international high new worth individuals and employees to commit an additional £340 million approximately. Going forward, we plan to have Kaupthing Capital Partners II Fund hold our new private equity investments. We believe the establishment of the fund will increase transparency and provide clarity and discipline over our private equity investment strategy, and expect the fund to allow us to take part in larger and more numerous projects and increase activity within our other business segments.

Sale of Eik

We completed the sale of our wholly-owned subsidiary, Eik Fasteignafélag hf., in April 2007. 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 of approximately ISK 4,000 million before taxes, which will be booked in the second quarter of 2007.

Plans to Launch New Operations in the Middle East

We are in the process of commencing operations in the Middle East, with a focus on developing investment banking and wealth management businesses in the Gulf region. Our current plan is to employ approximately 10 to 15 people in the region in 2007. To date, however, we are still in the process of securing the necessary licenses to commence operations, and we have not entered into any binding commitments to invest in any new operation in the region.

Payment of Dividends

On March 28, 2007, we paid a dividend of ISK 10,366 million on a pro rata basis to our shareholders.

Election of New Board of Directors at the Annual General Meeting

At our Annual General Meeting of shareholders on March 16, 2007, our shareholders, among other actions:

- approved the aggregate dividend payment of ISK 10,366 million;
- amended our Articles of Association to authorize our Board of Directors to increase our share capital by up to ISK 1,500,000,000 nominal value through the subscription of up to 150,000,000 new shares and our shareholders waived their pre-emptive rights with respect thereto;
- elected a new board of directors, in accordance with our articles of association which resulted in the appointment of Antonios P. Yerolemou to our Board of Directors and the resignation of Finnur Ingólfsson from our Board of Directors. See “Management”; and
- approved a remuneration policy proposed by the Board of Directors.

Storebrand ASA

In May 2007, we increased our stake in the Norwegian insurance and financial services company Storebrand ASA to 20.00% of the company's outstanding share capital. As a result, we have decided to treat Storebrand ASA as an associated company in our accounts and accordingly to commence recording a proportionate share of Storebrand ASA's earnings using the equity method, effective as of May 14th 2007. Prior to that date, our stake in Storebrand ASA had been treated as investments in shares and equity instruments and recorded at fair value on our balance sheet.

Acquistion of a 20% stake in FiNoble Advisors Private Ltd.

We signed an agreement in June 2007 to acquire a 20% stake in the Indian investment services company FiNoble Advisors Private Ltd. ("FiNoble") with an option to acquire the remaining 80% 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. Once the acquisiton is completed, FiNoble will be treated as an associated company on our accounts.

Critical Accounting Policies

The preparation of our financial statements requires management to make a number of judgments, estimates and assumptions that affect the reported amount of assets, liabilities, income and expense in our consolidated financial statements. We believe that the judgments, estimates and assumptions used in the preparation of our consolidated financial statements are appropriate given the factual circumstances as of December 31, 2006.

Various elements of our accounting policies, by their nature, are subject to estimation techniques, valuation assumptions and other subjective assessments. In particular, we have identified several accounting policies which, due to the judgments, estimates and assumptions inherent in those policies, and to the sensitivity of our IFRS financial statements to those judgments, estimates and assumptions, are critical to an understanding of our financial statements.

We make estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Our critical accounting policies are determined by our management, in consultation with our internal auditor and our external auditors.

Allowance for loan losses and impairment on loans

For our financial information as at December 31, 2006, December 31, 2005 and January 1, 2005 prepared under IFRS, our allowance for loan losses is based on our review of our loan portfolios to assess impairment at least on a quarterly basis. In determining whether an impairment loss should be recorded in the income statement, we evaluate whether there are any indications that there are measurable decreases in the estimated future cash flows from a portfolio of loans before the decreases can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group. We use estimates based on historical loss experience for assets with certain credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

Goodwill and equity method investments

In accordance with IFRS, we review goodwill for possible indications of impairment. Goodwill is stated at cost less any accumulated impairment losses. Goodwill is tested at least annually, or more frequently if there are indicators of impairment for factors such as changes in the economic or financial environments in which we operate or in our competitive position that are likely to affect our future earnings. If we identify indications of impairment, we assess whether the carrying amount of those assets remains fully recoverable. To make this assessment, we compare the carrying value to market value, if available, or a fair value determined by a qualified evaluator or pricing model. The determination of a fair value by a qualified evaluator or pricing model requires management to make assumptions and to use estimates. We believe that the assumptions and estimates used are reasonable and supportable in the existing market environment and commensurate with the risk profile of the assets valued. However, different assumptions and estimates could be used which would lead to different results.

In assessing goodwill for impairment, we have recently defined five independent cash generating units ("CGUs") within our operations, each devising its own budget and responsible for its own results. The CGUs are as follows: (1) Capital Markets, (2) Investment Banking, (3) Asset Management & Private Banking, (4) Treasury and (5) Banking. The costs of the ancillary units (i.e., non-CGUs) are distributed proportionally among the CGUs. With respect to operational restructuring and planning within the group, goodwill in our accounts is distributed among the CGUs according to its origin. As part of the apportioning of our goodwill, the recoverable amount is measured by value in use.

We review the businesses within each CGU on a regular basis, including the expectations and assumptions that were used in preparing their respective business plans and forecasts. Where these expectations or assumptions could have changed or may appear to be incorrect or where there have been other changes to the businesses or the markets in which they operate which lead to a downward revision in our expectations of the future profitability of a business, this may lead to a determination of impairment of goodwill in that business.

Fair value of derivatives

The fair value of financial instruments that are not quoted in active markets are determined by using certain valuation techniques. Where valuation models are used to determine fair values, they are validated and periodically reviewed by qualified personnel independent of the area that created the model. All models are calibrated to ensure that outputs reflect actual data and comparative market prices. To the extent practical, models use only observable data; however, areas such as credit risk, volatilities and correlations require management to make assumptions, estimates and judgments. Changes in assumptions, estimates or judgments regarding any of these factors could affect the reported fair value of financial instruments.

Recognition and measurement of financial instruments at fair value

Assets and liabilities that are trading instruments are recorded at fair value on the balance sheet, with changes in fair value reflected in the profit and loss account. For exchange-traded financial instruments, fair value is based on quoted market prices for each instrument. For substantially all of our non-exchange traded contracts, fair value is primarily based on pricing models. As a general rule, all interest rate products are broken down into cash flows, which are then discounted using the appropriate market discount rate. For our derivative financial instruments which have features similar to options, the relevant option model is used. Changes in assumptions, models, market discount rates and cash flow increments could affect the reported fair value of derivative financial instruments.

Operating Income Recognition

The following is a brief description of the principal revenue captions in our income statement.

Net interest income. Our net interest income is affected by a number of factors. It is determined primarily by the volume of our interest-earning assets and interest-bearing liabilities, together with the difference between the rates earned on interest-earning assets and the rates paid on interest-bearing liabilities. Interest-earning assets consist principally of loans to corporate clients, SMEs and individuals, together with loans to banks, corporate debt securities and sovereign bonds. Interest-bearing liabilities consist principally of bonds issued by us, borrowings from financial institutions and deposits from customers and financial institutions.

Interest income and expense are recognized in the income statement as they accrue, taking into account the effective yield of the asset or liability or an applicable floating rate. Interest income and expense include the amortization of any discount or premium or other differences between the initial carrying amount of an interest bearing instrument and its amount at maturity calculated on an effective interest rate basis. Under IFRS, loan origination fees are recognized in interest income and amortized over the life of the loan, calculated on an effective interest rate basis. Interest income and expense are recognized in the income statement as they accrue, taking into account the effective yield of the asset or liability or an applicable floating rate. Interest income and expense include the amortization of any discount or premium or other differences between the initial carrying amount of an interest bearing instrument and its amount at maturity calculated on an effective interest rate basis. Under IFRS, loan origination fees are recognized in interest income and amortized over the life of the loan, calculated on an effective interest rate basis. Net interest expense in our Investment Banking, Capital Markets and Asset Management divisions also reflects financial expenses on internal loans from our Treasury division, the proceeds of which are used primarily to invest in non-interest bearing assets. These financial expenses are recorded as interest income in Treasury and eliminated upon consolidation. Interest income in our Treasury division also includes interest on inflation-linked mortgages in Iceland, which are booked in Treasury rather than Banking as the Treasury division has overall responsibility for monitoring and managing our exposure to inflation. The Banking division, however, receives certain origination and administration fees in respect of these loans.

Net fee and commission income. We provide various services to our clients from which we earn income. Fee and commission income depend in large part on the volume and value of services we provide to clients, which in turn is contingent on conditions in the markets in which we operate as well as other factors such as competition from other banks. Fees earned from services that are provided over a certain period of time are recognized as those services are provided. Fees earned from transactional services are recognized upon completion of the service. Fees that are performance-linked are recognized when the performance criteria are fulfilled. Net fee and commission income includes the Banking division origination and administration fees related to Icelandic inflation linked mortgages.

Net financial income. Net financial income consists of dividend income, net gain on financial assets and liabilities, net foreign exchange difference and our share of profits from associates. Dividend income from equity investments and other non-fixed income investments is recognized in the income statement on the date that the dividend is declared. Transactions in foreign currencies are translated into functional currencies at the foreign exchange rate on the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated into functional currencies at the foreign exchange rate prevailing at that date. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction.

Other operating income. Other operating income includes our share of the profit of associates, income from operating leases in Kaupthing Singer & Friedlander's asset finance business (including leases of vehicles, plant and machinery and healthcare equipment) gain on disposals of assets other than assets held for sale, fair value adjustments on investment properties and insurance premiums.

Off-Balance Sheet Transactions

During the year ended December 31, 2006, we participated in a financing in an aggregate amount of €450 million to a customer which purchased from us and in the market, shares in a company with a credit rating of Baa1 from Moody's using a structure which caused us to retain a degree of on and off balance sheet exposure to both increases and decreases in the market price of the shares. The shares we sold had a fair value of ISK 38,619 million (€450 million). The maximum exposure retained by us is €360 million (ISK 34,060 million), although we have the right to increase such exposure to €400 million (ISK 37,844 million). As the value of our exposure is marked to market at the end of each quarter, the impact on our profit and loss may fluctuate materially from quarter to quarter depending on the market price of the shares. As of December 31, 2006, we have provided €81 million of cash collateral against this exposure, which is subject to a requirement to provide additional collateral based on changes in the market value of the shares. As a result the level of cash collateral we are required to provide will fluctuate from month to month. Although the market value of our exposure has fluctuated from quarter to quarter, through December 31, 2006, its impact has not been material.

Years ended December 31, 2006 and 2005

Results of Operations

The table below sets out our results of operations for the years ended December 31, 2006 and 2005.

	Year ended December 31,		
	2006	**2005**	**Change**
	(ISK millions—IFRS)		**(%)**
Interest income	187,451	100,009	87.4
Interest expense	(135,089)	(67,299)	100.7
Net interest income	52,362	32,710	60.1
Fee and commission income	40,904	23,508	74.0
Fee and commission expense	(3,620)	(1,080)	235.2
Net fee and commission income	37,284	22,428	66.2
Dividend income	5,074	1,808	180.6
Net gain on financial assets and liabilities not at fair value	142	147	(3.4)
Net gain on financial assets and liabilities at fair value	52,023	33,920	53.4
Net foreign exchange difference	2,918	1,407	107.4
Net financial income	60,157	37,282	61.4
Share of profit of associates	1,194	1,396	(14.5)
Other operating income	16,219	8,382	93.5
Other income	17,413	9,778	78.1
Operating income	167,216	102,198	63.6
Salaries and related expenses	(33,570)	(20,317)	65.2
Administration expenses	(19,800)	(11,594)	70.8
Depreciation and amortization	(5,976)	(2,818)	112.1
Other operating expenses	(660)	(796)	(17.1)
Operating expenses	(60,006)	(35,525)	68.9
Impairment on loans	(4,857)	(2,450)	98.2
Impairment on other assets	(1,270)	(1,939)	(34.5)
Earnings before income tax	101,083	62,284	62.3
Income tax	(14,636)	(11,228)	30.4
Net earnings	86,447	51,056	69.3
Minority interest	(1,145)	(1,796)	(36.2)
Shareholders of Kaupthing Bank hf.	85,302	49,260	73.2

Our reporting currency is the Icelandic króna. The króna depreciated by 23.1% during 2006 against the basket of currencies used by the Central Bank of Iceland to calculate the króna exchange rate index. It had depreciated by 28.0% during the first half of the year, but recovered to some extent during the second half of the year. This depreciation increased the income and expenses, as well as assets and liabilities, of our businesses outside of Iceland when their results were translated into króna in our consolidated financial statements.

In 2006, operating income increased by ISK 65,018 million or 63.6% to ISK 167,216 million, compared to ISK 102,198 million for 2005, driven by a full year of additional operating income from the acquisition of Singer & Friedlander (compared to only a half year of operating income in 2005 due to its acquisition in July 2005), capital gains of ISK 23.8 billion from the sale of our interests in Exista and capital gains of ISK 7.4 billion from the sale of our entire interest in VÍS hf.

In 2006, 47.0% of operating income was derived from Iceland, 24.8% from Scandinavia, 19.6% from the United Kingdom and 6.6% from Luxembourg, compared to 30.7% from Iceland, 25.8% from Scandinavia, 33.3% from the United Kingdom and 8.3% from Luxembourg for 2005. The significant increase in Iceland was primarily due to the increase in net financial income attributable to the capital gain on the sale of our shares in Exista and revaluation following listing of the Company and to the increase in other income attributable to the capital gains on the sale of our shares in VÍS. The table below presents our results of operations for 2006 and 2005 by geographic region.

Year ended December 31, 2006	Iceland	Scandinavia	UK	Luxembourg	Other	Total
			(ISK millions—IFRS)			
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
Operating income	78,544	41,420	32,785	11,079	3,388	167,216

Year ended December 31, 2005	Iceland	Scandinavia	UK	Luxembourg	Other	Total
			(ISK millions—IFRS)			
Net interest income	10,224	10,642	7,698	3,715	431	32,710
Net fee and commission income	8,859	3,814	6,364	2,896	495	22,428
Net financial income	6,217	10,218	18,015	1,907	925	37,282
Other income	6,048	1,742	1,986	2	—	9,778
Operating income	31,348	26,416	34,063	8,520	1,851	102,198

Operating income from Iceland was ISK 78,544 million in 2006 compared to ISK 31,348 million in 2005, an ISK 47,196 million or 150.6% increase. This increase was mainly due to an ISK 26,084 million increase in net financial income related to the sale and listing of Exista and an ISK 7,421 million increase in other income related to the sale of VÍS. Excluding these transactions, operating income in Iceland was ISK 45,039 million in 2006, representing a 43.7% increase over 2005. Operating income from Scandinavia was ISK 41,420 million in 2006 compared to ISK 26,416 million in 2005, an ISK 15,004 million or 56.8% increase. This change was due to an increase in net interest income and net fee and commission income due to higher levels of operations in Scandinavia as well as the depreciation of the Icelandic króna. Operating income from the United Kingdom remained relatively stable at ISK 32,785 million for 2006 compared to ISK 34,063 million for 2005. Net interest income, net fee and commission income and other income in the United Kingdom increased as a result of the inclusion of Kaupthing Singer & Friedlander for the full year 2006 compared to only six months in the 2005 period, as well as the depreciation of the Icelandic króna against the pound sterling during 2006 compared with 2005. This increase was partially offset by a significant decrease in net financial income due to a reduction in the size of Kaupthing's fixed income trading portfolio in the United Kingdom, caused in part by the sale of Bakkavör extendible bonds in May 2005. Operating income from Luxembourg was ISK 11,079 million for 2006 compared to ISK 8,520 million for 2005, an ISK 2,559 million or 30.0% increase. This increase was largely attributable to higher net fee and commission income in Luxembourg.

Total net interest income in 2006 amounted to ISK 52,362 million, an ISK 19,652 million or 60.1% increase from ISK 32,710 million in 2005. This increase includes an ISK 13,827 million increase in net interest income from our Banking division, of which ISK 5,426 million was attributable to net interest income from Kaupthing Singer & Friedlander and ISK 6,759 million reflects an increase in net interest income from our Treasury division, mainly due to interest income from inflation-linked mortgages in Iceland. Inflation in Iceland was 6.8% during 2006 compared with 4.0% for 2005, resulting in increased book value on the underlying mortgages and therefore higher interest income. The net interest margin, or interest income less interest expense as a percentage of average total interest earning assets, was 1.77% in 2006, compared to 1.86% in 2005. Net interest margin decreased as a result of a number of factors, including our decision to increase our liquidity (with excess liquidity invested in lower interest bearing assets), inflation, the depreciation of the króna and less favorable conditions in the funding markets compared to 2005. In 2006, 31.7% of net interest income was derived from Iceland, 33.0% from Scandinavia, 23.1% from the United Kingdom and 9.3% from Luxembourg, compared to 2005 when 31.3% of net interest income was derived from Iceland, 32.5% from Scandinavia, 23.5% from the United Kingdom and 11.4% from Luxembourg. Our net interest spread (calculated as average rate on total interest bearing assets less average cost of total interest bearing liabilities) was 1.73% for 2006, compared to 1.43% for 2005.

Net fee and commission income totalled ISK 37,284 million in 2006, an ISK 14,856 million or 66.2% increase compared to ISK 22,428 million in 2005. The increase in net fee and commission income was due in part to an increase in fee and commission income in Iceland, the net fee and commission income generated by Kaupthing Singer & Friedlander as well as due to depreciation of the Icelandic króna against the pound sterling, euro and the Danish krone and increases in net fee and commission income across all our divisions, in particular in our Asset Management and Private Banking division. In 2006, 39.5% of net fee and commission income was derived from Iceland, 15.9% from Scandinavia, 28.3% from the United Kingdom and 11.7% from Luxembourg, compared to 39.5% from Iceland, 17.0% from Scandinavia, 28.4% from the United Kingdom and 12.9% from Luxembourg for 2005.

Total net financial income, which includes dividend income, net gain on financial asset/liabilities at fair value, net gain on financial assets/liabilities not at fair value and net foreign exchange difference, was ISK 60,157 million in 2006, an ISK 22,875 million or 61.4% increase compared to ISK 37,282 million in 2005. The net financial income in 2006 reflects significant financial gains on the sale of Exista of ISK 26,084 million. The sale of our remaining shareholdings in Baugur Group hf. in March 2006 resulted in a gain of ISK 3,348 million. The equity markets in Scandinavia and UK and the financial income from derivatives in Iceland were also favorable during the period. Net gain from the Nordic bond markets declined during 2006 compared to the corresponding period in 2005. Dividend income was mainly from Icelandic and Scandinavian companies in our trading and investment portfolio. The table below presents our net gain on financial assets/liabilities for 2006 broken down by geographic regions and sources.

Year ended December 31, 2006	Iceland	Scandinavia	UK	Luxembourg	Other	Total
Net loss from bonds and fixed income securities	(3,427)	(1,437)	(1,382)	(20)	—	(6,266)
Net gain from equity and variable income securities	29,871	15,558	5,861	1,222	147	52,659
Net gain from derivatives	6,275	49	1,422	586	—	8,332
Net gain from hedge accounting instruments	—	356	2	—	—	358
Total	32,719	14,526	5,903	1,788	147	55,083
Dividend income	2,276	2,655	71	54	18	5,074
Total net financial income	34,995	17,181	5,974	1,842	165	60,157

In 2006, 58.2% of net financial income was derived from Iceland, 28.6% from Scandinavia, 9.9% from the United Kingdom and 3.1% from Luxembourg, compared to 16.7% from Iceland, 27.4% from Scandinavia, 48.3% from the United Kingdom and 5.1% from Luxembourg in 2005. Excluding gains from the Exista sale, in 2006, 26.2% of net financial income was derived from Iceland, 50.4% from Scandinavia, 17.5% from the United Kingdom and 5.4% from Luxembourg.

Other income, which consists of our share of the profit of associates and other operating income, was ISK 17,413 million in 2006, an ISK 7,635 million or 78.1% increase compared to other operating income of ISK 9,778 million in 2005. This increase was driven principally by profits of ISK 7,421 million from the sale of our holding in VÍS to Exista, as well as by the inclusion of ISK 1,194 million of earnings from associates and ISK 4,128 million of lease income from Kaupthing Singer & Friedlander's asset finance business. Comparative figures for 2005 included profit from associates amounting to ISK 1,396 million, ISK 1,555 million of lease income from Kaupthing Singer & Friedlander's asset finance business and a profit of ISK 3,093 million from the sale of the Icelandic leasing company Lýsing hf to Exista. In 2006, 70.3% of other income was derived from Iceland, 5.7% from Scandinavia and 23.9% from the United Kingdom, compared to 61.9% from Iceland, 17.8% from Scandinavia and 20.3% from the United Kingdom for 2005. The increase in Iceland was primarily due to the sale of our 24.7% stake in VÍS in April 2006.

Operating expenses (which consist of salaries and related expenses, administration expenses, depreciation and amortization and other operating expenses) in 2006 were ISK 60,006 million, an ISK 24,481 million or 68.9% increase from ISK 35,525 million in 2005, due in large part to the inclusion of Kaupthing Singer & Friedlander's operating expenses of ISK 22,459 million for the full year of 2006 compared to ISK 7,226 million for only six months in 2005, an increase of ISK 15,232 million or 210.8%. Our operating expenses were also affected by the costs of integrating Kaupthing Singer & Friedlander's operations into the group and the addition of new employees and other costs of supporting increases in operations at more of our subsidiaries in general, including at Kaupthing Singer & Friedlander.

Salaries and related expenses were ISK 33,570 million in 2006, an ISK 13,253 million or 65.2% increase compared to ISK 20,317 million in 2005. This increase was attributable primarily to an increase in full-time equivalent employees to 2,719 at December 31, 2006, compared to 2,368 at December 31, 2005. 519 of the new employees resulted from the acquisition of Singer & Friedlander and the remaining new employees were hired to support higher levels of operations at our other subsidiaries. In addition, performance-based bonus payments and a one time expense in the second quarter of 2006 of ISK 590 million related to the establishment of Capital Markets divisions at FIH Erhvervsbank and Kaupthing Singer & Friedlander and an Investment Banking division at FIH Erhvervsbank also increased salaries and related expenses during 2006 compared to 2005, as well as the inclusion of Kaupthing Singer & Friedlander for the full year in 2006.

Administration expenses totalled ISK 19,800 million in 2006, increasing by ISK 8,206 million or 70.8% from ISK 11,594 million in 2005, primarily due to the inclusion of administration expenses from Kaupthing Singer & Friedlander, start-up costs in connection with the establishment of FIH Erhvervsbank's Capital Markets division and the expansion of FIH Erhvervsbank's Investment Banking division as well as to overall higher levels of operations as a result of organic growth.

Depreciation and amortization was ISK 5,976 million in 2006, an ISK 3,158 million or 112.1% increase compared to ISK 2,818 million in 2005. This increase is primarily attributable to an increase of approximately ISK 2,505 million of depreciation from Kaupthing Singer & Friedlander, principally related to the assets in its vehicle leasing business, which is included in 2006.

Our cost to income ratio in 2006 was 35.9%, compared to 34.8% in 2005, with the increase in the cost to income ratio in 2006 primarily due to higher operating expenses in all areas in 2006 compared to in 2005.

Impairment on loans totalled ISK 4,857 million in 2006 compared to ISK 2,450 million in 2005. The increase is mainly due to the impairment of loans at Kaupthing Singer & Friedlander during the second half of 2006. Notwithstanding this impairment, impairments have generally remained stable, reflecting the increased quality of our loan portfolio, notwithstanding a 64.4% increase in the size of the loan portfolio in 2006. Provisions for losses as a percentage of loans to customers was 0.7% at the end of December 2006, compared to 0.8% at December 31, 2005.

Impairment on other assets totalled ISK 1,270 million in 2006, compared to ISK 1,939 million in 2005. This decrease was mainly in Kaupthing Singer & Friedlander's asset management business in the UK and related to the departure of certain key employees, which resulted in a determination by us that it was prudent to write-off a portion of the goodwill associated with the acquisition. Impairment in 2005 was mainly related to the sale of Neomarkka by Norvestia in Finland, and to our operation in Norway, which was restructured during 2005.

Tax and Net Earnings

Earnings before income tax was ISK 101,083 million in 2006, an ISK 38,799 million or 62.3% increase over earnings before income tax of ISK 62,284 million in 2005. Excluding gains from the sale and listing of Exista, earnings before income tax increased ISK 12,715 million or 20.4% to ISK 74,999 million. Approximately ISK 2,235 million of the increase was attributable to the inclusion of Kaupthing Singer & Friedlander for the full year in 2006 compared to only six months in 2005. In addition, earnings before income tax benefited from the depreciation of the Icelandic króna against the currencies in the other countries in which we operate. This increase in pre-tax earnings was achieved despite a 68.9% increase in operating expenses compared to the corresponding period of 2005, driven by a number of non-recurring expenses, including impairments on loans and other assets at Kaupthing Singer & Friedlander and employment expenses related to the establishment of capital markets divisions at FIH Erhvervsbank and Kaupthing Singer & Friedlander.

Income tax for 2006 was ISK 14,636 million (with an effective tax rate of 14.5%) compared to ISK 11,228 million (with an effective tax rate of 18.0%) for 2005. The lower tax rate was a result of the increase in non-taxable dividend income and in permanently deferred taxes related to gains in shares. The statutory tax rate in Iceland is 18% and the statutory tax rate in the United Kingdom is 30% but is scheduled to be reduced to 28%, with effect from April 1, 2008. The statutory tax rate in Denmark is 25% following a reduction from 28% which came into effect on July 1, 2007. Our effective tax rate may increase in the future if our income increases from higher tax jurisdictions.

Net earnings amounted to ISK 86,447 million in 2006, compared with ISK 51,056 million in 2005, an increase of ISK 35,391 million or 69.3%. Net earnings attributable to shareholders amounted to ISK 85,302 million in 2006, compared to ISK 49,260 million in 2005, an ISK 36,042 million or 73.2% increase. Earnings per share in 2006 were ISK 127.1, compared to ISK 75.2 in 2005.

Balance Sheet

The table below sets out our balance sheet under IFRS at December 31, 2006 and 2005.

	Year ended December 31,		
	2006	2005	Change
	(ISK millions—IFRS)		(%)
Assets:			
Cash and cash balances with central banks	106,961	34,877	206.7
Loans	3,023,943	1,739,294	73.9
Financial assets measured at fair value			
Trading assets	297,908	337,157	(11.6)
Financial assets designated at fair value	360,604	270,751	33.2
Financial assets available for sale	164	167	(1.8)
Derivatives used for hedging	6,453	4,459	44.7
Investments in associates	5,304	13,888	(61.8)
Intangible assets	68,301	54,943	24.3
Investment property	31,584	24,156	30.8
Property and equipment	30,466	22,433	35.8
Tax assets	5,834	5,004	16.6
Non-current assets and disposal groups classified as held-for-sale	2,334	2,302	1.4
Other assets	115,540	31,380	268.2
Total assets	4,055,396	2,540,811	59.6
Liabilities			
Due to credit institutions and central banks	110,456	69,643	58.6
Deposits	750,658	486,175	54.4
Borrowings	2,399,939	1,556,567	54.2
Subordinated loans	216,030	102,688	110.4
Financial liabilities measured at fair value	71,264	60,273	18.2
Tax liabilities	23,209	18,458	25.7
Other liabilities	148,948	44,495	234.8
Total liabilities	3,720,504	2,338,299	59.1
Equity:			
Share capital	7,321	6,638	10.3
Share premium	164,028	114,606	43.1
Reserves	17,220	(1,540)	–
Retained earnings	134,941	74,479	81.2
Total shareholders' equity	323,510	194,183	66.6
Minority interest	11,382	8,329	36.7
Total equity	334,892	202,512	65.4
Total liabilities and equity	4,055,396	2,540,811	59.6

Assets

Our total assets as of December 31, 2006 were ISK 4,055,396 million, an increase of ISK 1,514,585 million or 59.6% from ISK 2,540,811 million at December 31, 2005. This increase was driven primarily by organic growth, and in part by the depreciation of the Icelandic króna. The Icelandic króna's depreciation of 23.1% during 2006 increased the assets and liabilities of our businesses outside of Iceland when they were translated into króna in our consolidated financial statements. Excluding the effects of this depreciation, our total assets would have been ISK 3,482,558 million at December 31, 2006, which represents a 37.1% increase over our total assets at December 31, 2005, if only organic growth had been taken into account.

Loans increased from ISK 1,739,294 million as of December 31, 2005 to ISK 3,023,943 million as of December 31, 2006, reflecting an increase of ISK 1,284,649 million or 73.9%. Loans to customers increased ISK 994,909 million or 64.4% from ISK 1,543,700 million in 2005 to ISK 2,538,609 million in 2006. Excluding the effects of the Icelandic króna's depreciation, loans to customers in 2006 increased by 39.1% compared to 2005. Loans to credit institutions increased from ISK 195,594 million in 2005 to ISK 485,334 million in 2006, reflecting an increase of ISK 289,740 million or 148.1%.

Financial assets measured at fair value (which consists of trading assets, financial assets designated at fair value, financial assets available for sale and derivatives used for hedging) were ISK 665,129 million as of December 31, 2006, reflecting an increase of 8.6% or ISK 52,595 million, from ISK 612,534 million at the beginning of the year. Trading assets amounted to ISK 297,908 million as of December 31, 2006, decreasing by 11.6% or ISK 39,249 million, from ISK 337,157 million at December 31, 2005. Financial assets designated at fair value through profit or loss were ISK 360,604 million as of December 31, 2006, increasing by 33.2% or ISK 89,853 million, from ISK 270,751 million at December 31, 2005. Derivatives used for hedging amounted to ISK 6,453 million as of December 31, 2006 compared with ISK 4,459 million at the beginning of the year, reflecting an increase of 44.7% or ISK 1,994 million.

At December 31, 2006, we held ISK 384,996 million in bonds and debt instruments (including a total of ISK 10,508 million in mortgage loans measured at fair value) and ISK 280,133 million in shares and equity instruments, derivatives used for hedging, futures, over-the-counter derivatives and other trading derivatives. In total, we held ISK 665,129 million of financial assets measured at fair value and financial assets available-for-sale. We have entered into derivatives contracts amounting to ISK 49,206 million against our investment in shares and other equity instruments. Our net exposure to price fluctuations amounted to ISK 230,927 million at December 31, 2006. Similarly, at December 31, 2006 we had entered into derivatives contracts on debt instruments amounting to ISK 66,732 million, limiting our risk from our holdings in bonds and other debt instruments to ISK 318,264 million. We are not exposed to market risk of ISK 5.5 billion due to minority interests in our subsidiary Norvestia Oyj (“Norvestia”) in Finland, which we recognize using the equity method.

Non-current assets and disposal groups classified as held for sale, which includes properties from foreclosed mortgages and entities which we are seeking to sell, amounted to ISK 2,334 million on December 31, 2006, an increase of 1.4% or ISK 32 million from ISK 2,302 million at the beginning of the year.

As of December 31, 2006 our other assets amounted to ISK 115,540 million, an increase of ISK 84,160 million or 268.2% from ISK 31,380 million at December 31, 2005. This increase is primarily due to unsettled transactions.

Liabilities and Equity

Credit institutions and central banks totalled ISK 110,456 million as of December 31, 2006, an increase of ISK 40,813 million or 58.6% over ISK 69,643 million as of December 31, 2005. Deposits were ISK 750,658 million as of December 31, 2006, an increase of 54.4% over ISK 486,175 million as of December 31, 2005. Deposits represented 23.1% of our total funding as of December 31, 2006, compared with 23.8% as of December 31, 2005. ISK 97.872 million of the increase in deposits was attributable to Kaupthing Singer & Friedlander, ISK 49,901 million was attributable to FIH, ISK 24,320 million was attributable to Kaupthing and, ISK 58,506 million was attributable to Luxembourg, which began offering deposit products to its customers in late 2005. Other deposits represented 20.2% of our total funding as of December 31, 2006, compared with 20.8% at the beginning of the year. Excluding the effect of the depreciation of the Icelandic króna, deposits increased by 30.2% as of December 31, 2006 compared to deposits as of December 31, 2005.

Borrowings increased ISK 843,372 million or 54.2% from ISK 1,556,567 million as of December 31, 2005 to ISK 2,399,939 million as of December 31, 2006, reflecting increasing funding needs due to the growth of our balance sheet subordinated loans by 110.4%, from ISK 102,688 million in 2005 to ISK 216,030 million in 2006.

Our total shareholders’ equity was ISK 323,510 million as of December 31, 2006, an ISK 129,327 million or 66.6% increase over total shareholder’s equity of ISK 194,183 million as of December 31, 2005. The increase in shareholders' equity takes into account the dividend paid in October 2006 to our shareholders in the form of shares in Exista hf., with a fair value of ISK 18.3 billion. Our Capital Adequacy Directive ratio was 15.0% as of December 31, 2006, compared to 12.2% as of December 31, 2005. Our Tier I capital ratio was 10.5% as of December 31, 2006, compared to 9.4% as of December 31, 2005.

Segment analysis

Banking

	Year ended December 31,	
	2006	**2005**
	(ISK millions—IFRS)	
Net interest income	45,903	32,076
Net fee and commission income	5,744	3,165
Net financial income	750	232
Other income	6,631	3,419

	Year ended December 31,	
	2006	2005
	(ISK millions—IFRS)	
Operating income	59,028	38,892
Operating expenses	(14,969)	(10,580)
Impairment	(4,851)	(2,395)
Total expenses	(19,820)	(12,975)
Earnings before cost allocation	39,208	25,917
Allocated cost[(1)]	(8,744)	(5,356)
Earnings before income tax	30,464	20,561
Net segment revenue from external customers	135,108	78,481
Net segment revenue from other segments	(76,080)	(39,589)
Operating income	59,028	38,892
Total assets	2,597,032	1,849,845
Depreciation and amortization	3,512	1,475

(1) Allocated cost represents central costs (such as information technology, back office, marketing, human resources and finance costs) allocated to the division.

Operating income in our Banking division was ISK 59,028 million for 2006, an ISK 20,136 million or 51.8% increase over operating income of ISK 38,892 million for 2005. This increase was driven by an ISK 13,827 million or 43.1% increase in net interest income mainly attributable to the acquisition of Singer & Friedlander, which increased net interest income by approximately ISK 5,780 million, as well as increased growth in lending both to retail clients in Iceland and to corporate clients across the group, an ISK 2,579 million or 81.5% increase in net fee and commission income, principally due to our acquisition of Singer & Friedlander, and an ISK 3,212 million or 93.9% increase in other income. The increase in other operating income was largely attributable to the sale of Kreditkort hf., an Icelandic payment services company holding the MasterCard franchise, and an ISK 1,796 million increase in other income generated by Kaupthing Singer & Friedlander's operating lease contracts.

Total expenses increased to ISK 19,820 million in 2006, an ISK 6,845 million or 52.8% increase over total expenses of ISK 12,975 million in 2005, reflecting increased salary expenses and overall higher levels of operations, in part due to our acquisition of Singer & Friedlander. Allocated cost, or central costs allocated to our Banking division, was ISK 8,744 million for 2006, an increase of ISK 3,388 or 63.3% over ISK 5,356 million for 2005, primarily due to the acquisition of Singer & Friedlander and overall higher level of operations. Earnings before income tax in our Banking division increased by ISK 9,903 million or 48.2% to ISK 30,464 million in 2006, compared to ISK 20,561 million for 2005, as the increase in operating income significantly exceeded the increase in operating expenses.

Investment Banking

	Year ended December 31,	
	2006	2005
	(ISK millions—IFRS)	
Net interest income	(3,349)	(2,322)
Net fee and commission income	9,577	7,592
Net financial income	42,984	18,416
Other income	44	163
Operating income	49,256	23,849
Operating expenses	(3,636)	(1,808)
Impairment	1	(22)
Total expenses	(3,635)	(1,830)
Earnings before cost allocation	45,621	22,019
Allocated cost[(1)]	(888)	(706)
Earnings before income tax	44,733	21,313
Net segment revenue from external customers	53,425	25,620

	Year ended December 31,	
	2006	2005
	(ISK millions—IFRS)	
Net segment revenue from other segments	(4,169)	(1,771)
Operating income	49,256	23,849
Total assets	108,946	80,433
Depreciation and amortization	8	22

(1) Allocated cost represents central costs (such as information technology, back office, marketing, human resources and finance costs) allocated to the division.

Operating income in Investment Banking was ISK 49,256 million for 2006, an ISK 25,407 million or 106.5% increase compared to ISK 23,849 million for 2005. This increase was driven principally by a ISK 24,568 million increase in net financial income, largely attributable to the sale of our holding in Exista and the listing of Exista on the OMXI, which drove the increase in net financial income from ISK 18,416 million in 2005 to ISK 42,984 million in 2006, with the sale and listing of Exista responsible for ISK 26,084 million of the increase, and an ISK 1,985 million increase in net fee and commission income, driven by increased M&A advisory and capital markets transactions. This increase was partially offset by an ISK 1,027 million increase in net interest expense due to higher funding costs related to our investment portfolio, holding a higher percentage of equities instead of bonds and to the sale of Bakkavör extendible bonds in May 2006.

Total expenses in the Investment Banking division increased by ISK 1,805 million or 98.6%, from ISK 1,830 million in 2005 to ISK 3,635 million in 2006, primarily due to certain one-time costs associated with the establishment of investment banking operations at FIH Erhvervsbank, as well as overall increased salary expenses related to the accrual of performance-based bonuses tied to commissions and overall higher levels of operations. Allocated cost was ISK 888 million for 2006, an increase of ISK 182 million or 25.8% over 2005, primarily due to overall higher levels of operations.

Earnings before income tax in 2006 increased by ISK 23,420 million or 109.9% from ISK 21,313 million in 2005 to ISK 44,733 million in 2006 mainly attributable to the sale of Exista. The acquisition of Singer & Friedlander did not have a material impact on the results of our Investment Banking division.

Capital Markets

	Year ended December 31,	
	2006	2005
	(ISK millions—IFRS)	
Net interest income	(1,513)	(1,120)
Net fee and commission income	7,396	4,730
Net financial income	7,913	16,008
Other income	(1)	35
Operating income	13,795	19,653
Operating expenses	(6,205)	(3,113)
Impairment	(123)	0
Total expenses	(6,328)	(3,113)
Earnings before cost allocation	7,467	16,540
Allocated cost(1)	(3,206)	(1,751)
Earnings before income tax	4,261	14,789
Net segment revenue from external customers	20,697	22,830
Net segment revenue from other segments	(6,902)	(3,177)
Operating income	13,795	19,653
Total assets	214,433	70,277
Depreciation and amortization	9	19

(1) Allocated cost represents central costs (such as information technology, back office, marketing, human resources and finance costs) allocated to the division.

Operating income in our Capital Markets division was ISK 13,795 million for 2006, an ISK 5,858 million or 29.8% decrease from operating income of ISK 19,653 million for 2005. This decrease was principally due to a decrease of ISK 8,095 million in net financial income, which declined from ISK 16,008 million in 2005 to ISK 7,913 million for 2006. Net financial income, which includes our proprietary trading activities, declined as trading gains (both realized and unrealized) fell due to the overall negative performance of the Nordic equity markets in 2006 compared to 2005. This decrease was partly offset by an ISK 2,666 million increase in net fee and commission income, which primarily consists of commission income from institutional sales. The increase in net fee and commission income was due to increased customer trading activity in the capital markets, particularly in Iceland, Luxembourg and Sweden.

Total expenses increased to ISK 6,328 million in 2006, an ISK 3,215 million or 103.3% increase over total expenses of ISK 3,113 million in 2005. This increase reflects increased salary expenses, the one-time costs of establishing the Capital Markets divisions at FIH Erhvervsbank and Kaupthing Singer & Friedlander and overall higher levels of operations. The number of employees in Capital Markets almost doubled in 2006.

Allocated cost increased to ISK 3,206 million for 2006, an increase of ISK 1,455 million or 83.1% over 2005. This increase reflects new divisions established at FIH Erhvervsbank and Kaupthing Singer & Friedlander, as well as higher levels of operations in other areas.

Earnings before income tax in our Capital Markets division decreased by ISK 10,528 million or 71.2% to ISK 4,261 million in 2006, compared to ISK 14,789 million for 2005, reflecting the significant decrease in operating income and higher levels of expenses. The acquisition of Singer & Friedlander did not have a material impact on the results of our Capital Markets division.

In order to further separate securities brokerage for clients and proprietary trading for our own account, we have made certain changes to the results of operations we record in our Capital Markets and Treasury business segments, which changes took effect January 1, 2007. Beginning January 1, 2007, the results of operations of our Proprietary Trading division, which was up until then included in the results of operations of Capital Markets, have been included with the results of operations of our Treasury division. In addition, the results of operations of our Foreign Exchange and Derivatives Trading divisions were transferred from Treasury to Capital Markets.

Treasury

	Year ended December 31,	
	2006	**2005**
	(ISK millions—IFRS)	
Net interest income	11,492	4,733
Net fee and commission income	2,927	1,364
Net financial income	8,411	2,637
Other income	26	0
Operating income	22,856	8,734
Operating expenses	(3,078)	(1,481)
Impairment	(5)	6
Total expenses	(3,083)	(1,475)
Earnings before cost allocation	19,773	7,259
Allocated cost(1)	(2,015)	(877)
Earnings before income tax	17,758	6,382
Net segment revenue from external customers	(52,166)	(33,915)
Net segment revenue from other segments	75,022	42,649
Operating income	22,856	8,734
Total assets	1,649,940	428,027
Depreciation and amortization	11	4

(1) Allocated cost represents central costs (such as information technology, back office, marketing, human resources and finance costs) allocated to the division.

Operating income in our Treasury division was ISK 22,856 million for 2006, an ISK 14,122 million or 161.7% increase over operating income of ISK 8,734 million for 2005. This increase was attributable to an increase of ISK 6,759 million or 142.8% in net interest income, mainly driven by increases in our inflation-linked mortgage portfolio in

Iceland and overall higher levels of operations within the group, particularly in Capital Markets and Banking, which were funded through the Treasury division. The increase also reflects an increase of ISK 1,563 million or 114.6% in net fee and commission income, principally due to commission income on proprietary positions in swaps, foreign exchange options and equity options used for hedging equity-linked products, and an increase of ISK 5,774 million or 219.0% in net financial income, principally due to an increase in gains (both realized and unrealized) on derivatives contracts and currency exchange mainly in Iceland.

Total expenses increased to ISK 3,083 million in 2006, an ISK 1,608 million or 109.0% increase over total expenses of ISK 1,475 million in 2005, reflecting increased salary expenses corresponding to higher commission and overall higher levels of operations as a result of organic growth. Allocated cost increased to ISK 2,015 million for 2006, an increase of ISK 1,138 million or 129.7% over 2005. This increase reflects higher levels of operations in the Treasury division as it funded higher levels of operations across the group. Earnings before income tax in our Treasury division increased by ISK 11,376 million or 178.3% to ISK 17,758 million in 2006, compared to ISK 6,382 million for 2005, as the increase in operating income significantly exceeded the increase in operating expenses. The acquisition of Singer & Friedlander did not have a material impact on the results of our Treasury division.

We made certain changes to the results of operations we record in our Capital Markets and Treasury business segments, which changes took effect January 1, 2007. See "—Segment Analysis—Capital Markets".

Asset Management and Private Banking

	Year ended December 31,	
	2006	**2005**
	(ISK millions—IFRS)	
Net interest income	817	632
Net fee and commission income	11,231	5,256
Net financial income	531	100
Other income	962	0
Operating income	13,541	5,988
Operating expenses	(7,380)	(4,186)
Impairment	(1,138)	0
Total expenses	(8,518)	(4,186)
Earnings before cost allocation	5,023	1,802
Allocated cost(1)	(3,426)	(1,758)
Earnings before income tax	1,597	44
Net segment revenue from external customers	9,516	4,482
Net segment revenue from other segments	4,025	1,506
Operating income	13,541	5,988
Total assets	12,386	1,823
Depreciation and amortization	21	15

(1) Allocated cost represents central costs (such as information technology, back office, marketing, human resources and finance costs) allocated to the division.

Operating income in our Asset Management and Private Banking division was ISK 13,541 million for 2006, an ISK 7,553 million or 126.1% increase over operating income of ISK 5,988 million for 2005. This increase was driven principally by an increase of ISK 5,975 million or 113.7% in net fee and commission income attributable to fund management. Of this increase, ISK 1,651 million was attributable to Kaupthing Singer & Friedlander, which only contributed half a year of results in 2005 compared to a full year in 2006, ISK 2,342 was attributable to Kaupthing Luxembourg and ISK 1,308 million was attributable to Kaupthing Asset Management Company. The increase also reflects an increase of ISK 431 million in net financial income and an increase of ISK 185 million or 29.3% in net interest income. The departure of key employees from the Asset Management division of Kaupthing Singer & Friedlander did not affect our results in 2005.

Total expenses increased ISK 4,332 million or 103.5% from ISK 4,186 million in 2005 to ISK 8,518 in 2006. Operating expenses increased to ISK 7,380 million in 2006, an ISK 3,194 million or 76.3% increase over operating expenses of ISK 4,186 million in 2005. This increase reflects increased salary expenses mainly due to our acquisition of Singer & Friedlander.

Allocated cost increased to ISK 3,426 million for 2006, an increase of ISK 1,668 million, or 94.9% over allocated cost of ISK 1,758 million in 2005. This increase is related to higher levels of operation in Asset Management at Kaupthing Singer & Friedlander compared to other operations within the group.

We also recognized an impairment charge of ISK 1,138 million in the third quarter of 2006 due to impairment of intangible assets connected with Kaupthing Singer & Friedlander's asset management business. This impairment is related to the departure of a number of employees within Asset Management and was taken in the expectation that assets under management will decline following the departure of these employees.

Earnings before income tax in our Asset Management and Private Banking division increased by ISK 1,553 million from ISK 44 million for 2005 to ISK 1,597 million in 2006, primarily due to the strong increase in commission income, which offset the increase in operating expenses and the impairment charge.

Assets under custody totalled ISK 1,953 billion as of December 31, 2006, an increase of ISK 526 billion or 36.9% from December 31, 2005. Assets under management increased by ISK 330 billion or 30.7%, to ISK 1,403 billion at December 31, 2006, of which ISK 422 billion was attributable to assets under management at Kaupthing Singer & Friedlander, ISK 198 billion was attributable to the depreciation of the Icelandic króna, ISK 2 billion was attributable to the net inflow of new money and ISK 130 billion was attributable to returns on assets.

The table below presents the contributions to the growth of our assets under management during 2006.

	(ISK millions— IFRS)
Market value at December 31, 2005	1,073,651
Net new money	1,919
Returns	129,656
Currency effects	198,150
Market value at December 31, 2006	1,403,376

Years Ended December 31, 2005 and 2004 (IFRS)

Results of Operations

The table below sets out our results of operations under IFRS for 2005 and 2004.

	Year ended December 31,		
	2005	2004	Change
	(ISK millions—IFRS)		(%)
Interest income	100,009	40,074	149.6
Interest expense	(67,299)	(21,815)	208.5
Net interest income	32,710	18,259	79.1
Fee and commission income	23,508	15,481	51.8
Fee and commission expense	(1,080)	(2,173)	(50.3)
Net fee and commission income	22,428	13,308	68.5
Dividend income	1,808	3,972	(54.5)
Net gain on financial assets/liabilities not at fair value	147	492	(70.2)
Net gain on financial assets/liabilities at fair value	33,920	12,755	165.9
Net foreign exchange difference	1,407	(892)	—
Net financial income	37,282	16,327	128.3
Share of profit of associates	1,396	240	481.7
Other operating income	8,069	1,834	340.1
Net loss on non-current assets held for sale	(481)	(23)	—
Operating income(1)	101,404	49,945	103.0
Salaries and related expenses	(20,317)	(12,851)	58.1
Administrative expenses	(11,596)	(9,427)	23.0
Depreciation and amortization	(2,818)	(1,347)	109.2
Operating expenses(2)	(34,731)	(23,625)	47.0
Impairment on loans	(2,450)	(3,825)	(36.0)
Impairment on other assets	(1,939)	—	—

	Year ended December 31, 2005	Year ended December 31, 2004	Change
	(ISK millions—IFRS)		(%)
Earnings before income tax	62,284	22,495	176.9
Income tax	(11,228)	(4,236)	165.1
Net earnings	51,056	18,259	179.6
Minority interest	(1,796)	(552)	225.5
Shareholders' net earnings	49,260	17,707	178.2

(1) In 2006, we changed our classification of operating income. Up until 2006, we reported other operating income, which includes insurance claims, profit and loss for discontinued operations and other operating expenses, as net operating income. We did not include other operating income in our operating income for the year ended December 31, 2006 or for the comparative figures for the year ended December 31, 2005.

(2) Operating expenses for the year ended December 31, 2006 and for the comparative figures for the year ended December 31, 2005 includes other operating expenses, which includes other operating income and net loss on non-current assets held for sale.

Operating Income

Operating income in 2005 amounted to ISK 101,404 million, an increase of ISK 51,459 million or 103.0% compared to ISK 49,945 million in 2004.

In 2005, 30.1% of operating income was derived from Iceland, 26.1% from Scandinavia, 33.6% from the United Kingdom and 8.4% from Luxembourg, compared to 42.6% from Iceland, 27.5% from Scandinavia, 17.9% from the United Kingdom and 10.7% from Luxembourg in 2004. The table below presents a breakdown of our operating income for the years ended December 31, 2005 and 2004 by geographic region.

Year ended December 31, 2005	Iceland	Scandinavia	UK	Luxembourg	Other	Total
			(ISK millions—IFRS)			
Net interest income	10,224	10,642	7,698	3,715	431	32,710
Net fee and commission income	8,859	3,815	6,364	2,896	495	22,428
Net financial income	6,218	10,218	18,015	1,907	925	37,282
Other income	5,253	1,743	1,986	2	—	8,984
Operating income	30,554	26,418	34,063	8,520	1,851	101,404

Year ended December 31, 2004	Iceland	Scandinavia	UK	Luxembourg	Other	Total
			(ISK millions—IFRS)			
Net interest income	7,667	7,368	1,103	1,679	442	18,259
Net fee and commission income	7,184	3,344	1,197	1,411	172	13,308
Net financial income	5,486	2,381	6,214	2,243	2	16,326
Other income	929	646	473	3	1	2,052
Operating income	21,266	13,739	8,987	5,336	617	49,945

Operating income from Iceland was ISK 30,554 million for 2005 compared to ISK 21,266 million for 2004, an ISK 9,288 million or 43.7% increase. This increase was primarily due to an increase in other income led by profits from the sale of our leasing subsidiary Lýsing hf. and an increase in net interest income largely attributable to the growth of our Icelandic inflation-linked mortgage portfolio and overall higher levels of operations in Iceland. Operating income from Scandinavia was ISK 26,418 million for 2005 compared to ISK 13,739 million for 2004, an ISK 12,679 million or 92.3% increase. This change was primarily due to increased net financial income due to gains from trading activities reflecting more favorable conditions in the Nordic financial markets and the inclusion of a full year of results of FIH in 2005 as opposed to only a half a year of FIH's results in 2004. Operating income from the United Kingdom was ISK 34,063 million for 2005 compared to ISK 8,987 million for 2004, an ISK 25,076 million or 279.0% increase. This increase was largely attributable to the acquisition of Singer & Friedlander, which increased net interest income, net fee and commission income and other operating income (attributable to its vehicle leasing business). Operating income from Luxembourg was ISK 8,520 million for 2005 compared to ISK 5,336 million for 2004, an ISK 3,184 million or 59.7% increase. This increase was largely attributable to higher net interest income and net fee and commission income due to higher levels of operations in Luxembourg.

Net interest income in 2005 amounted to ISK 32,710 million, compared with ISK 18,259 million in 2004, representing an increase of ISK 14,451 million or 79.1%. This increase reflects an ISK 14,180 million increase in net interest income from Banking, in part due to our acquisition of Singer & Friedlander, which contributed ISK 4,693 million of net interest income during the year. The remaining increase in net interest income is in part due to the inclusion of 12 months of FIH in 2005 compared with 6 months in 2004 and in part due to organic growth in our operations. The increase in net interest income also reflects an ISK 2,693 million increase from our Treasury division, ISK 469 million of which was due to our acquisition of Singer & Friedlander with the rest due to overall higher levels of operations as a result of organic growth. The net interest margin, or interest income less interest expense as a percentage of average total interest earning assets, was 1.86% in 2005, compared with 1.92% in 2004. This lower net interest margin reflects interest expense rising faster than interest income, primarily due to higher cash balances prior to our acquisition of Singer & Friedlander in July 2005. In 2005, 31.3% of net interest income was derived from Iceland, 32.5% from Scandinavia, 23.5% from the United Kingdom and 11.4% from Luxembourg, compared to 42.0% from Iceland, 40.4% from Scandinavia, 6.0% from the United Kingdom and 9.2% from Luxembourg in 2004. Our net interest spread (calculated as average rate on total interest earning assets less average cost of total interest bearing liabilities) was 1.43% for the year ended December 31, 2005, compared to 1.87% for the year ended December 31, 2004. The decrease was due to increased competition and an increase in mortgage lending in Iceland, which tends to generate lower margins.

Net fee and commission income totalled ISK 22,428 million in 2005, compared with ISK 13,308 million in 2004, an increase of ISK 9,120 million or 68.5%. This increase was driven principally by an ISK 4,849 million increase in fees and commissions generated by our Investment Banking division, reflecting the completion of a number of significant investment banking transactions in 2005 as a result of favorable market conditions and increased activity due to the larger scale of our investment banking operations, which has allowed us to take on larger projects with generally higher commissions. The acquisition of Singer & Friedlander contributed ISK 1,335 million of net fee and commission income during the year. The increase in net fee and commission income also reflects an ISK 2,302 million increase in Asset Management and Private Banking, ISK 1,614 million of which was attributable to the consolidation of Kaupthing Singer & Friedlander's results in 2005, and the rest of the increase was due primarily to organic growth in assets under management and assets under custody in 2005 compared to 2004. The increases are also attributable to a greater amount of assets under management and assets under custody in 2005 than in 2004. In 2005, 39.5% of net fee and commission income was derived from Iceland, 17.0% from Scandinavia, 28.4% from the United Kingdom and 12.9% from Luxembourg, compared to 54.0% from Iceland, 25.1% from Scandinavia, 9.0% from the United Kingdom and 10.6% from Luxembourg in 2004.

Net financial income includes dividend income, net gain on financial assets/liabilities at fair value, net gain on financial assets/liabilities not at fair value and net foreign exchange difference. In 2005 net financial income was ISK 37,282 million, compared with ISK 16,326 million in 2004, an increase of ISK 20,956 million or 128.4%. This increase was driven principally by an ISK 9,967 million increase in our Investment Banking division, primarily due to investment gains, of which ISK 891 million was attributable to FIH and an ISK 9,763 million increase in Capital Markets, mostly related to trading activities, reflecting more favorable conditions in the Nordic financial markets. In 2005, 16.7% of net financial income was derived from Iceland, 27.4% from Scandinavia, 48.3% from the United Kingdom and 5.1% from Luxembourg, compared to 33.6% from Iceland, 14.6% from Scandinavia, 38.1% from the United Kingdom and 13.7% from Luxembourg in 2004.

Other operating income totalled ISK 8,071 million in 2005, compared with ISK 1,836 million in 2004, an increase of ISK 6,235 million, of which ISK 1,689 million was due to our acquisition of Singer & Friedlander, primarily income from operating leases in its vehicle leasing business. The rest of this increase was due largely to a profit of ISK 3,093 million from the sale of our leasing subsidiary Lýsing hf. and ISK 774 million from the sale of Neomarkka plc, a subsidiary of Norvestia. In 2005, 58.5% of other operating income was derived from Iceland, 19.4% from Scandinavia, 22.1% from the United Kingdom and 0.02% from Luxembourg, compared to 45.3% from Iceland, 31.5% from Scandinavia, 23.1% from the United Kingdom and 0.1% from Luxembourg in 2004.

Expenses

Operating expenses consist of salaries and related expenses, administrative expenses and depreciation and amortization. Operating expenses totalled ISK 34,731 million in 2005, compared with ISK 23,625 million in 2004, an increase of ISK 11,106 million or 47.0%. This increase was driven principally by the acquisition of Singer & Friedlander, which contributed ISK 6,342 million to operating expenses in 2005; the remaining ISK 4,764 million increase was due to the inclusion of a full year of results from FIH in 2005 compared to the inclusion of only half a year of FIH's results in 2004, and also to increased levels of operations within the group as a result of organic growth.

Salaries and related expenses totalled ISK 20,317 million in 2005 and increased by ISK 7,466 million or 58.1% from ISK 12,851 million in 2004, driven principally by the acquisition of Singer & Friedlander, which employed 519 people at December 31, 2005 and contributed ISK 3,390 million in salaries and related expenses during the year, as well as an increase in performance-related bonuses due to overall increased profitability and the full year effect of FIH. At the end of 2005, the total number of full-time equivalent employees was 2,368, compared with 1,606 at the beginning of the year.

Administrative expenses totalled ISK 11,594 million in 2005, increasing by 23.0% from ISK 9,428 million in 2004. Of this ISK 2,166 million increase, ISK 1,277 million was attributable to Kaupthing Singer & Friedlander and the remainder was primarily attributable to the full year effect of the acquisition of FIH, and in generally higher levels of operations in 2005 as a result of organic growth.

Depreciation and amortization was ISK 2,818 million in 2005, an increase of 109.2% compared with ISK 1,347 million in 2004. This increase is attributable principally to depreciation of operating lease assets of Kaupthing Singer & Friedlander's asset finance business, which were added to our depreciable asset base upon the acquisition of Singer & Friedlander.

The cost to income ratio in 2005 was 34.1%, a decrease from 47.3% in 2004 due to the inclusion of a full year of results from FIH, which had a lower cost to income ratio compared to the rest of the group, in 2005 compared to the inclusion of only half a year of FIH's results in 2004, as well as to a reduction in expenses in proportion to income in general throughout the group.

Impairment on loans totalled ISK 2,450 million in 2005, compared with ISK 3,825 million in 2004, a decrease of ISK 1,375 million or 35.9%. This reflects the increased quality of our loan portfolio, notwithstanding an increase in the size of the portfolio. Impairment on other assets was ISK 1,939 million in 2005 compared with no impairment in 2004, driven by impairment related to the sale of Neomarkka Plc in Finland, and impairment related to our operations in Norway, where a restructuring took place.

Tax and Net Earnings

We posted a profit before income tax of ISK 62,284 million in 2005, an increase of 176.9% over ISK 22,495 million the previous year. This increase was attributable to the significant organic growth in revenues due to the favorable market conditions we operated in during 2005 plus the inclusion of a full year of FIH's profits compared to only six months in 2004. This increase in pre-tax profit was achieved despite a 47% increase in expenses compared to 2004, including a net loss of ISK 241 million attributable to Kaupthing Singer & Friedlander, largely due to non-recurring expenses, such as one-off employee payments of ISK 714 million at our Asset Management and Banking divisions and an ISK 380 million impairment on real estate for our own use.

Income tax in 2005 totalled ISK 11,228 million, compared with ISK 4,236 million the previous year, reflecting our higher profitability during the year. Of this ISK 6,992 million increase, ISK 144 million was attributable to Kaupthing Singer & Friedlander. Our effective tax rate in 2005 was 18.0%, compared with 18.8% in 2004.

Net earnings amounted to ISK 51,056 million in 2005, compared with ISK 18,259 million in 2004, an increase of ISK 32,797 million or 179.6%. Net earnings attributable to shareholders amounted to ISK 49,260 million in 2005, compared with ISK 17,707 million in 2004, an increase of ISK 31,553 million or 178.2%. Earnings per share were ISK 75.2 in 2005, compared with ISK 35.6 in 2004.

Balance Sheet

The table below sets out our balance sheet under IFRS at December 31, 2005 and January 1, 2005. The implementation of IFRS has had a significant effect on how we present our balance sheet. Accordingly, references to amounts in the balance sheet at the beginning of the year refer to the opening IFRS balance sheet on January 1, 2005 and not to the December 31, 2004 balance sheet under Icelandic GAAP as published in our 2004 annual accounts.

	At December 31, 2005	At January 1, 2005	Change
	(ISK millions—IFRS)		%
Assets:			
Cash and cash balances with central banks	34,877	6,290	454.5
Loans	1,739,294	1,154,416	50.7
Financial assets measured at fair value:			
Trading assets	337,157	205,185	64.3
Financial assets designated at fair value	270,751	95,449	183.7
Financial assets available-for-sale	167	1,507	(88.9)
Derivatives used for hedging	4,459	3,820	16.7
Investments in associates	13,888	3,649	280.6
Intangible assets	54,943	35,098	56.5
Investment property	24,156	19,155	26.1
Property and equipment	22,433	6,092	268.2
Tax assets	5,004	1,092	358.2
Non-current assets and disposal groups classified as held-for-sale	2,302	3,631	(36.6)
Other assets	31,380	19,069	64.6
Total assets	2,540,811	1,554,453	63.5
Liabilities:			
Credit institutions and central banks	69,643	32,488	114.4
Deposits	486,176	202,193	140.5
Borrowings	1,556,567	968,512	60.7
Subordinated loans	102,688	57,623	78.2
Financial liabilities measured at fair value	60,273	68,011	(11.4)
Provisions	3,271	0	—
Tax liabilities	18,458	4,408	318.7
Liabilities included in disposal groups classified as held-for-sale	1,161	1,402	(17.2)
Other liabilities	40,062	60,907	(34.2)
Total liabilities	2,338,299	1,395,544	67.6
Equity:			
Share capital	6,638	6,521	1.8
Share premium	114,606	110,559	3.7
Reserves	(1,540)	(670)	129.9
Retained earnings	74,479	32,960	126.0
Total shareholders' equity	194,183	149,370	30.0
Minority interest	8,329	9,539	(12.7)
Total equity	202,512	158,909	27.4
Total liabilities and equity	2,540,811	1,554,453	63.5

	At December 31, 2005	At January 1, 2005	Change
	(ISK millions—IFRS)		(%)
Trading assets	337,157	205,185	64.3
Financial assets designated at fair value	258,717	63,695	306.2
Mortgage loans measured at fair value	12,033	31,754	(62.1)
Derivatives used for hedging	4,459	3,820	16.7
	612,366	304,454	

Assets

Our total assets as of December 31, 2005 were ISK 2,541 billion, an increase of ISK 987 billion or 63.5% over ISK 1,554 billion at the beginning of the year. The increase was driven by organic growth, as well as by the acquisition of Singer & Friedlander, whose assets at December 31, 2005 amounted to ISK 361 billion.

Mortgage loans in other countries are categorized under "loans". Loans as of December 31, 2005 were ISK 1,739,294 million, an increase of ISK 584,878 million, or 50.7%, from ISK 1,154,416 million at the beginning of the year, driven mainly by increases in loans at Kaupthing, Luxembourg and Kaupthing Singer & Friedlander. Loans to customers increased 56.9% from ISK 992,400 million at the beginning of 2005 to ISK 1,556,653 million as of December 31, 2005, due to the acquisition of Singer & Friedlander as well as increased loans to corporate customers and increased Icelandic mortgage loans. Loans to credit institutions increased 12.2% from ISK 174,310 million to ISK 195,594 million.

Our total assets in securities (which consists of trading assets, financial assets designated at fair value and derivatives used for hedging) as of December 31, 2005, which excludes mortgage loans measured at fair value, were ISK 600,333 million, increasing by 120.1% from ISK 272,700 million at the beginning of the year, principally due to an ISK 123,130 million increase of financial assets designated at fair value at Kaupthing Singer & Friedlander and an increase in our positions in bonds both in Iceland and at FIH. Trading assets amounted to ISK 337,157 million as of December 31, 2005 increasing by 64.3% from ISK 205,185 million at January 1, 2005, ISK 68,472 million of which was attributable to an increase in shares and ISK 55,559 million of which was attributable to an increase in bonds, ISK 29,966 million of which shares and bonds were hedged against market risk with derivative instruments. Financial assets designated at fair value through profit or loss were ISK 258,717 million as of December 31, 2005 increasing by 306.2% from ISK 63,695 million at January 1, 2005. ISK 120,261 million in bonds and debt instruments was attributable to the acquisition of Singer & Friedlander, ISK 39,153 million was attributable to investments in certain investment grade bonds in cooperation with New Bond Street Asset Management LLP (a limited liability partnership we formed with eight individual partners providing independent advice, asset management services and fund products) and the remaining increase was due to changes in the market and fair value of securities during the year and to additional investments in shares and bonds during the year. Derivatives used for hedging amounted to ISK 4,459 million as of December 31, 2005 compared with ISK 3,820 million at the beginning of the year, an increase of 16.7% mainly due to an increase in hedge accounting agreements to regulate our exposure to interest rate risk and, to a lesser extent, currency risk.

At December 31, 2005, we held ISK 407,230 million in bonds and other debt instruments, ISK 167,764 million in shares and other equity instruments and a total of ISK 37,539 million in mortgage loans measured at fair value, derivatives used for hedging, futures, over-the-counter derivatives and other trading derivatives. In total, we held ISK 612,533 million of financial assets measured at fair value and financial assets available-for-sale. We had entered into derivatives contracts amounting to ISK 53,388 million against our investment in shares and other equity instruments at the end of 2005. Our net exposure to price fluctuations therefore amounts to ISK 114,376 million. Similarly, we have entered into derivatives contracts on debt instruments, limiting our risk from our holdings in bonds and other debt instruments to ISK 187,410 million. We are not exposed to market risk of ISK 5.5 billion due to minority interests in our subsidiary Norvestia Oyj ("Norvestia") in Finland, which we recognize using the equity method and do not mark-to-market.

In accordance with IFRS, we discontinued amortizing goodwill at the beginning of 2004. Instead, the goodwill is now tested annually for impairment. During the fourth quarter of 2005, impairment of goodwill totalled ISK 1,521 million. This impairment mainly was related to the sale of Neomarkka by Norvestia in Finland, and to our operations in Norway, which have been restructured.

Non-current assets and disposal groups classified as held for sale, which includes properties from foreclosed mortgages and entities which we are seeking to sell amounted to ISK 2,302 million on December 31, 2005, a decrease of ISK 1,329 million or 36.6% from ISK 3,631 million at the beginning of the year.

Other assets totalled ISK 31,380 million as of December 31, 2005 and had increased by ISK 12,311 million or 64.6% from ISK 19,069 million at the beginning of 2005. This increase is mainly due to unsettled transactions.

Liabilities and Equity

Credit institutions and central banks totalled ISK 69,643 million as of December 31, 2005, an increase of ISK 37,155 million or 114.4% over ISK 32,488 million at the beginning of the year. Deposits amounted to ISK 486,176 million as of December 31, 2005, an increase of ISK 283,983 million or 140.5% over ISK 202,193 million at the beginning of the year. This increase principally reflects the consolidation of Kaupthing Singer & Friedlander into the group, which represented ISK 17 million of deposits from credit institutions and central banks and ISK 191,766 million of other deposits, and was also caused by an increase in deposits at Kaupthing, Kaupthing Bank Luxembourg and FIH. Other deposits represented 19.1% of our total funding as of December 31, 2005, compared with 13.0% at the beginning of the year.

Borrowings increased from ISK 968,512 million at January 1, 2005 to ISK 1,556,567 million at the end of the year, an increase of ISK 588,055 million or 60.7%, reflecting increasing funding needs due to the growth of our assets, as well as the acquisition of Singer & Friedlander. Subordinated loans, partially to fund the acquisition of Singer & Friedlander, increased by ISK 45,065 million or 78.2% from ISK 57,623 million to ISK 102,688 million.

Our total shareholders' equity was ISK 194,183 million at December 31, 2005, compared with ISK 149,370 million at the beginning of the year, which represents an increase of ISK 44,813 million or 30.0% during the year. Our CAD ratio was 12.2% at December 31, 2005, compared with 14.2% as at the beginning of the year. Our Tier I capital ratio was 9.4% as of December 31, 2005, compared with 11.5% at the beginning of the year.

Segment Analysis

Banking

	Year ended December 31,	
	2005	**2004**
	(ISK millions—IFRS)	
Net interest income	32,076	17,896
Net fee and commission income	3,165	2,883
Net financial income	232	76
Other income	3,419	61
Operating income	38,892	20,916
Operating expenses	(10,580)	(4,830)
Impairment	(2,395)	(3,795)
Total expenses	(12,975)	(8,625)
Earnings before cost allocation	25,917	12,291
Allocated cost	(5,356)	(3,974)
Earnings before income tax	20,561	8,317
Net segment revenue from external customers	78,481	29,499
Net segment revenue from other segments	(39,589)	(8,583)
Operating income	38,892	20,916
Total assets	1,849,845	1,151,079
Depreciation and amortization	1,475	223

Operating income in Banking was ISK 38,212 million in 2005, an ISK 17,296 million or 82.7% increase over ISK 20,916 million in 2004. This increase was driven principally by an ISK 14,180 million increase in net interest income, due to increased growth in lending both to retail clients in Iceland and to corporate clients across the group as well as the acquisition of Singer & Friedlander, which accounted for ISK 3,845 million of the increase. Other operating income increased by ISK 2,678 million, due to operating lease contracts generated by Kaupthing Singer & Friedlander in its vehicle leasing business and due to the inclusion of 12 months of results of FIH in 2005 compared to only six months of

FIH's results in 2004. Operating expenses in Banking increased ISK 5,181 million or 107.3%, from ISK 4,830 million to ISK 10,011 million, due to increased salary expenses and overall higher levels of operations, partly due to organic growth and partly reflecting both the acquisition of Singer & Friedlander, which constituted ISK 4,225 million during the year, and the full year effect of FIH. Earnings before income tax in Banking increased ISK 12,133 million or 145.9% to ISK 20,450 million, from ISK 8,317 million in 2004, as the increase in operating income significantly exceeded the increase in operating expenses.

Investment Banking

	Year ended December 31,	
	2005	**2004**
	(ISK millions—IFRS)	
Net interest income	(2,322)	(802)
Net fee and commission income	7,592	2,743
Net financial income	18,416	8,449
Other income	163	33
Operating income	23,849	10,423
Operating expenses	(1,808)	(1,150)
Impairment	(22)	—
Total expenses	(1,830)	(1,150)
Earnings before cost allocation	22,019	9,273
Allocated cost	(706)	(887)
Earnings before income tax	21,313	8,386
Net segment revenue from external customers	25,620	12,092
Net segment revenue from other segments	(1,771)	(1,669)
Operating income	23,849	10,423
Total assets	80,433	51,732
Depreciation and amortization	22	12

Operating income in Investment Banking was ISK 23,849 million in 2005, an ISK 13,426 million or 128.8% increase over ISK 10,423 million in 2004. This increase was driven principally by an ISK 9,967 million increase in net financial income, largely due to the increase in value of certain of our principal investments, both recognized and unrecognized, and an ISK 4,849 million increase in net fee and commission income, driven by increased M&A advisory and capital markets transactions, reflecting the completion of a number of significant investment banking transactions in 2005 as a result of favourable market conditions and increased activity due to the larger scale of our investment banking operations, which has allowed us to take on larger projects with generally higher commissions. The acquisition of Singer & Friedlander contributed ISK 1,335 million of net fee and commission income during the year. This increase was partially offset by an ISK 1,520 million decrease in net interest income, as interest expense grew more quickly than interest income because we took a larger position in non-interest bearing assets such as shares in 2005 compared to 2004. Operating expenses in Investment Banking increased ISK 658 million or 57.2%, from ISK 1,150 million to ISK 1,808 million, due to increased salary expenses resulting from bonuses tied to increased fee and commission income compared to 2004 and overall higher levels of operations, particularly due to our ability to take on larger projects as we grew in size. The increase in operating expenses was also in part due to the inclusion of a full year of results of FIH in 2005, compared to only half a year of FIH's results in 2004. Earnings before income tax in Investment Banking in 2005 increased ISK 12,927 million or 154.2% to ISK 21,313 million from ISK 8,386 million in 2004, as the increase in operating income significantly exceeded the increase in operating expenses.

Capital Markets

	Year ended December 31,	
	2005	**2004**
	(ISK millions—IFRS)	
Net interest income	(1,120)	(182)
Net fee and commission income	4,730	2,808
Net financial income	16,008	6,245
Other income	35	—
Operating income	19,653	8,871

	Year ended December 31,	
	2005	2004
	(ISK millions—IFRS)	
Operating expenses	(3,113)	(2,483)
Impairment	—	—
Total expenses	(3,113)	(2,483)
Earnings before cost allocation	16,540	6,388
Allocated cost	(1,751)	(1,399)
Earnings before income tax	14,789	4,989
Net segment revenue from external customers	22,830	11,481
Net segment revenue from other segments	(3,177)	(2,610)
Operating income	19,653	8,871
Total assets	70,277	64,667
Depreciation and amortization	19	29

Operating income in Capital Markets was ISK 19,653 million in 2005, an ISK 10,782 million or 121.5% increase over ISK 8,871 million in 2004. This increase was driven principally by an ISK 9,763 million increase in net financial income and an ISK 1,922 million increase in net fee and commission income, due to more favorable conditions in the Nordic debt and equity markets, partially offset by an ISK 938 million decrease in net interest income, reflecting a higher cost of financing of proprietary trading positions. Operating expenses increased ISK 630 million or 25.4%, from ISK 2,483 million to ISK 3,113 million, due to increased salary expenses (performance-related bonuses) and overall higher levels of operations as a result of organic growth. Earnings before income tax in Capital Markets increased ISK 9,800 million or 196.4%, from ISK 4,989 million to ISK 14,789 million, as the increase in operating income significantly exceeded the increase in operating expenses.

Treasury

	Year ended December 31,	
	2005	2004
	(ISK millions—IFRS)	
Net interest income	4,733	2,040
Net fee and commission income	1,364	1,353
Net financial income	2,637	651
Other income	—	—
Operating income	8,734	4,044
Operating expenses	(1,481)	(922)
Impairment	6	(24)
Total expenses	(1,475)	(946)
Earnings before cost allocation	7,259	3,098
Allocated cost	(877)	(678)
Earnings before income tax	6,382	2,420
Net segment revenue from external customers	(33,915)	(7,510)
Net segment revenue from other segments	42,649	11,554
Operating income	8,734	4,044
Total assets	428,027	223,310
Depreciation and amortization	4	3

Operating income in Treasury was ISK 8,734 million in 2005, an ISK 4,690 million or 116.0% increase over ISK 4,044 million in 2004. This increase was driven principally by an ISK 2,693 million increase in net interest income, reflecting income from funding higher levels of operations in Capital Markets and Banking and an ISK 1,986 million increase in net financial income, primarily due to gains on proprietary positions in swaps, foreign exchange options and equity options used for hedging equity-linked products. Operating expenses in Treasury increased ISK 559 million or 60.6%, from ISK 922 million to ISK 1,481 million, due to increased salary expenses and overall higher levels of operations, in part related to our acquisitions. Earnings before income tax in Treasury increased ISK 3,962 million or

163.7% to ISK 6,382 million in 2005 from ISK 2,420 million in 2004, as the increase in operating income significantly exceeded the increase in operating expenses.

Asset Management and Private Banking

	Year ended December 31,	
	2005	2004
	(ISK million—IFRS)	
Net interest income	632	(188)
Net fee and commission income	5,256	2,954
Net financial income	100	—
Other income	—	—
Operating income	5,988	2,766
Operating expenses	(4,186)	(1,527)
Impairment	—	—
Total expenses	(4,186)	(1,527)
Earnings before cost allocation	1,802	1,239
Allocated cost	(1,758)	(1,122)
Earnings before income tax	44	117
Net segment revenue from external customers	4,482	1,644
Net segment revenue from other segments	1,506	1,122
Operating income	5,988	2,766
Total assets	1,823	589
Depreciation and amortization	15	1

Operating income in Asset Management and Private Banking was ISK 5,988 million in 2005, an ISK 3,222 million or 116.5% increase over ISK 2,766 million in 2004. Net commission income was ISK 5,256 million in 2005, an increase of ISK 2,302 million or 78% over ISK 2,954 million in 2004, driven by the acquisition of Singer & Friedlander, growth in assets under management, increases in performance-based commissions and the launch of new products. Net interest income was ISK 632 million in 2005, compared with net interest expense of ISK 188 million in 2004, mainly due to addition of net interest income of Kaupthing Singer & Friedlander and net interest income from the addition of new Asset Management products (such as new investment funds and new agreements with pension funds) from our Luxembourg operations. Operating expenses in Asset Management and Private Banking increased ISK 2,659 million or 174.1%, from ISK 1,527 million (or 55% of revenues) to ISK 4,186 million (or 70% of revenues), due to the acquisition of Singer & Friedlander, including a one-time charge of ISK 336 million for settlement of pension liabilities. Earnings before income tax in Asset Management and Private Banking decreased ISK 73 million or 62.4% to ISK 44 million in 2005 from ISK 117 million in 2004, as the increase in operating expenses exceeded the increase in operating income.

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 Aa3 and A by Moody's and Fitch, respectively, FIH Erhvervsbank, which has been rated A1 by Moody's and Kaupthing Singer & Friedlander, which has been rated A by Fitch. In general, we seek to raise funds in each entity in the group (principally Kaupthing and FIH) to meet that entity's funding needs although funds raised by Kaupthing can be used to finance other operations of the group. Our funding strategy for 2007 and 2008 is to cover all redemptions that fall within those periods as well as to cover the planned growth of our loan portfolio during the period and to ensure ongoing liquidity. The table below sets out our funding sources, by amount and as a percentage of total funding, at December 31, 2006, 2005 and 2004.

	At December 31,					
	2006		2005		2004	
	(ISK millions)	(%)	(ISK millions)	(%)	(ISK millions)	(%)
Credit institutions and central banks	110,456	3.2	69,643	3.1	32,488	2.6
Deposits	750,658	21.6	486,175	21.9	202,193	16.0

	At December 31,					
	2006		2005		2004	
	(ISK millions)	(%)	(ISK millions)	(%)	(ISK millions)	(%)
Bonds issued	1,762,483	50.7	1,158,806	52.4	779,931	61.9
Bills issued	156,203	4.5	164,910	7.4	35,726	2.8
Money market	373,285	10.7	200,581	9.1	111,901	8.9
Other loans	107,968	3.1	32,270	1.5	40,954	3.2
Subordinated loans	216,030	6.2	102,688	4.6	57,623	4.6
Total	3,477,083	100.0	2,215,073	100.0	1,260,816	100.0

The table below shows the maturity profile of our long-term borrowing at December 31, 2006.

	2011 and beyond	2010	2009	2008	2007
Kaupthing Bank	287,698	126,837	210,467	76,690	337,091
FIH	102,555	88,244	45,493	181,792	151,244
Total	390,254	215,082	255,960	258,482	488,335

Kaupthing Singer & Friedlander primarily funds its operations through deposits and inter-group borrowings from Kaupthing.

At December 31, 2006, we had raised approximately ISK 2,086,481 million (€22,053 million) in the international bond and loan markets. Of this, Kaupthing raised ISK 1,432,998 million (€15,146 million) and FIH Erhvervsbank raised ISK 603,312 million (€6,377 million). As at December 31, 2006, we had ISK 935,759 million of borrowings maturing in 2007 and ISK 2,041,195 million of borrowings maturing in the next five years.

Historically, we have relied primarily on the European markets as our principal source of funding, through issuances under our €12 billion EMTN program, and more recently through FIH Erhvervsbank's €8 billion EMTN program.

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 and Japan, Canada and Switzerland as well as structured covered bonds in Europe. We have also sought to extend the maturity profile of our debt. At December 31, 2006 14.9% of Kaupthing's borrowings matured later than five years compared to 10.8% at December 31, 2005.

An important step in our funding diversification was the establishment of our U.S.$10 billion Senior/Subordinated Medium Term Note Program. In April 2006, we issued U.S.$500,000,000 of Senior Floating Rate Notes due 2011 under this program and in May 2006, we issued U.S.$1,250,000,000 of 7.125% Fixed Rate Subordinated Notes due 2016. On September 27, 2006, we launched a U.S.$3 billion of senior notes under the program, the largest debt financing by a Nordic bank in the United States at that time. The transaction consisted of three tranches: U.S.$1,000,000,000 Senior Floating Rate Notes due 2010, U.S.$1,500,000,000 5.750% Senior Notes due 2011 and U.S.$500,000,000 6.125 % Senior Notes due 2016. We established an AUD$3 billion debt issuance program and in September 2006, we issued AUD$290 million of Senior Floating Rate Notes due 2013. In October 2006, we issued ¥50 billion 1.8% Samurai bonds to Japanese institutional investors. The Samurai bonds are the first bonds to be sold in the Japanese market by an Icelandic company. In November 2006, we issued and sold 66,000,000 new shares, (the "Share Offering"). As a result of the 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. In January 2007 we issued a CHF 200 million 3.0% Notes due in 2010 in the Swiss fixed income market. We reopened this issue in February 2007 by CHF 100 million. In February 2007, we issued CAD$500 million 4.7% Notes due 2010 in the Canadian fixed-income market.

In 2006 the EMTN private placement market (non-syndicated reverse enquiries) continued to play a significant role in Kaupthing's long-term funding. In 2006 we issued approximately €900 million of notes in private placements. We continue to place a strong focus on increasing Kaupthing's presence in the structured private placement market by establishing Kaupthing 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. In 2007 we completed our first reverse-inquiry trade under our U.S.$10 billion Senior/Subordinated Medium Term Note Program and we expect the EMTN private placement market to play a significant role in Kaupthing's long-term funding. We intend to continue to issue in the EMTN market, as well as further develop our presence in the US MTN market.

We are also exploring other types of funding sources, with particular emphasis on securitizations and other asset-backed issuances in order to increase the diversification of our sources of funding. To this end, we have identified up to

€10 billion of assets within the group that are eligible for securitization or similar transactions. We have in place an ISK 200 billion covered bond program, and we plan to become a regular issuer of covered bonds, subject to market conditions. In 2006 we issued two series of Inflation-Linked Annuity Covered Bonds under this program: Series 1 ISK 19 billion Inflation-Linked Annuity Covered Bonds due 2033 and Series 2 ISK 29.1 billion Inflation-Linked Annuity Covered Bonds due 2048. These covered bonds have been assigned an Aaa credit rating by Moody's. We are also considering issuing collateralized loan obligations ("CLOs") by using our loan portfolios in Iceland and Denmark and Commercial Mortgage-Backed Securities ("CMBSs") by using commercial mortgages in the United Kingdom, Iceland, Sweden and Denmark. In addition, we recently entered into several repurchase and warehousing transactions with international financial institutions totalling €1,160 million using our investment grade bonds and listed equities as the underlying assets. Other than as stated above, in connection with our issued bonds and borrowings, we have not pledged any of our assets or entered into arrangements involving securitizations, repurchase arrangements or other asset-backed issuances with respect to our assets.

However, our increased liquidity, as well as market turbulence and the costs of our increased funding diversification and extended debt maturity have led to increased funding costs in 2006. The average funding rate of our long-term borrowings, excluding subordinated issues, in the year ended December 31, 2006 was approximately 38 basis points higher than the average funding rate for our long term borrowings in 2005. The average rate for our short-term financing is approximately LIBOR, and we believe this rate should in general remain stable in the foreseeable future.

We believe that the diversification of our funding sources has not increased our currency exposure, as we actively hedge such exposure. We have currently hedged substantially all of our funding currency exposure, other than our 10 year US dollar denominated bonds.

Of borrowings that we have raised in the international bond and loan markets through December 31, 2006, 24% was in US dollars, 53% was in euro, 4% was in Icelandic króna, 1% was in Norwegian kroner, 1% was in Australian dollars and 17% was in other currencies. For a description of the currency distribution of our loan portfolio, see "Selected Statistical Data—Loan Portfolio".

We are also seeking to reduce our dependence on the capital markets as a source of funding by increasing our deposit base. During the year ended December 31, 2006, we have seen an increase in deposits to ISK 750,658 million at December 31, 2006, compared with ISK 486,175 million at December 31, 2005. Approximately ISK 117,655 of the increase was due to the depreciation of the Icelandic króna and ISK 146,828 million reflected deposit growth driven by strong organic growth, particularly in the United Kingdom, Luxembourg and Denmark. Deposits have grown from ISK 202,193 million at December 31, 2004 to ISK 750,658 million at December 31, 2006. 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. For example, we launched a CD program in Finland in May 2006. We had a deposit to loan ratio of 20.60% at December 31, 2004, 31.49% at December 31, 2005 and 31.83% at December 31, 2006 and have set a long-term target of 40%. For further information regarding our deposits, see "Selected Statistical Data—Liabilities—Deposits".

At Kaupthing, Kaupthing Singer & Friedlander and Kaupthing Luxembourg many of our wholesale deposits, which we define as corporate deposits from non-financial institutions, are placed by deposit brokers and are dependent on both the rate paid and the risk of loss perceived by financial issuers. If our financial condition or the Icelandic economy were to worsen, or the perception thereof, we may not be able to replace these deposits when they mature, or may be required to pay higher interest rates to do so. Our wholesale deposits have increased from ISK 395,515 million at December 31, 2005 to ISK 569,911 million at December 31, 2006, notwithstanding net outflows in the first quarter of 2006 due to adverse publicity about the Icelandic economy, reflecting our increased efforts to increase deposits as a source of funding.

The table below shows the maturity profile of our financial assets and liabilities at December 31, 2006.

	On demand	Up to 3 months	3 – 12 months	1 – 5 years	Over 5 years	Total
			(ISK millions)			
Assets:						
Cash and central bank balances	106,961					106,961
Loans to credit institutions	87,284	320,642	23,672	47,597	6,139	485,334
Loans to customers	202,564	437,861	326,551	796,445	775,188	2,538,609
Financial assets measured at fair value	205,983	142,166	17,197	183,867	115,752	664,965
Financial assets available-for-sale				164		164
Total financial assets	602,792	900,669	367,420	1,028,073	897,079	3,796,033

	On demand	Up to 3 months	3 – 12 months	1 – 5 years	Over 5 years	Total
			(ISK millions)			
Liabilities:						
Credit institutions and central banks	10,384	90,269	4,045	3,605	2,153	110,456
Deposits	226,966	409,317	86,755	21,459	6,161	750,658
Borrowings	3,569	489,330	442,860	1,105,436	358,744	2,399,939
Financial liabilities measured at fair value	3,503	15,658	7,684	35,714	224,735	287,294
Total financial liabilities	244,422	1,004,574	541,344	1,166,214	591,793	3,548,347
Net financial assets/(liabilities)	358,370	(103,905)	(173,924)	(138,141)	305,286	247,686
Cumulative net financial assets/(liabilities)	358,370	254,465	80,541	(57,600)	247,686	495,372

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, 2006, 2005 and 2004.

	At December 31,					
	2006		2005		2004	
	(ISK millions)	(%)	(ISK millions)	(%)	(ISK millions)	(%)
Cash and cash balances with central banks	106,961	10%	34,877	5%	4,101	1%
Loans to credit institutions	485,334	47%	195,594	28%	109,442	31%
Bonds and debt instruments	318,264	31%	390,575	56%	169,666	49%
Total liquid assets	910,559	89%	621,046	89%	283,209	81%
Listed equities	113,816	11%	72,596	11%	65,651	19%
Total liquid assets and listed equities	1,024,375	100%	693,642	100%	348,860	100%

In addition, at December 31, 2006, we had ISK 325,613 million of committed and undrawn revolving and backup credit facilities and ISK 25,300 million available under our commercial paper programs.

We have recently 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 support a moderate level of growth of the balance sheet without any access to the capital markets. To this end, we have established new committed bank facilities to strengthen our liquidity position. They include revolving credit facilities, repurchase agreements and a variety of backup facilities to give us continuous access to liquidity. They have strengthened our secured liquidity, and we (including FIH) now have secured liquidity in excess of 360 days, so that we can carry out our day-to-day business, including repaying all of our maturing obligations and supporting moderate growth of our balance sheet, for at least 360 days without having to access the capital markets.

We believe that our liquidity position has improved significantly over the past few months and that our exposure to the prevailing volatility in the markets where we operate, particularly in Iceland, has been significantly reduced. See "Risk Management—Liquidity Risk".

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 and ISK 3,068 billion at December 31, 2006. Against this increase, we have sought to increase our capital base, both through the issuance of additional equity and of subordinated debt that qualifies as Tier I and Tier II capital. To this end, we have completed a U.S.$165 million private placement of Tier I subordinated bonds in the United States in December 2005, a U.S.$1.25 billion issue of Tier II subordinated bonds under our US MTN program in May 2006 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,		
	2006	**2005**	**2004**
Total Risk Weighted assets	3,067,640	1,945,271	1,189,171
Equity			
Total Tier I capital	321,434	182,029	137,256
Total Tier II capital	139,392	54,834	31,510
Total capital	460,826	236,863	168,766
CAD ratio	15.0%	12.2%	14.2%
Tier I capital ratio	10.5%	9.4%	11.5%

We seek to maintain a CAD ratio of at least 11.0%. Under applicable Icelandic law, we are required to maintain a CAD ratio of at least 8.0%.

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 rising interest rate environment compounds the risk that we will not be able to access funds at favorable rates. These and other factors also could lead creditors 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 also are 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 over the next two years. As at December 31, 2006, we had ISK 2,615,969 million of borrowings and subordinated loans outstanding, of which ISK 571,337 million will mature later than five years, ISK 1,108,873 million will mature between 1 and 5 years and ISK 935,759 million will mature within 1 year. The ISK 935,759 million that mature within one year principally includes ISK 529,488 million of bills and money market loans, which are short term loans which we expect, but have no guarantee, to be rolled forward by investors. The remaining ISK 406,271 million maturing within one year is long term debt including issued bonds and loans other than money market or bills issued. While we have increased our borrowings by ISK 834,270 million during 2006, there is no guarantee that we will be able to access further sources of funding to meet additional funding requirements in the future. Furthermore, approximately 14% of our total interest-bearing liabilities are deposits that are on demand or with a maturity of less than three months. These can be withdrawn quickly in the event of adverse economic developments in Iceland or in the other markets in which we operate, causing further strains on our liquidity. Further, many of our deposits are placed by deposit brokers and are dependent on both the rate paid and the risk of loss perceived of financial issuers. Were our financial condition to worsen, we may not be able to replace these deposits when they mature, or may be required to pay higher interest rates to do so. Our funding requirements have in the past proven to be volatile. For example, in connection with the adverse economic developments in Iceland at the end of 2005 and the first quarter of 2006, the group had a net outflow of deposits.

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 mechanisms, through our €12 billion European Medium-Term Note ("EMTN") program at Kaupthing and our €8 billion EMTN program at FIH Erhvervsbank. We have also raised funds in the Euromarkets through our €500 million and €2 billion European commercial paper program at Kaupthing and FIH, respectively. Given the size of our issuances in the Euromarkets to date, we have sought to diversify our sources of funding, including in the United States, Australia and Asia, where we raised funds for the first time in 2006. 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 capital 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. 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.

Our credit ratings are also important to our ability to access capital. 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 provision in some of our trading and collateralized 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 collateralized 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.

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.

Certain factors which could restrict our use of capital resources in the future are discussed in “Risk Factors” above.

SELECTED STATISTICAL DATA

The following information is included for analytical purposes and should be read in connection with the financial statements contained elsewhere in the Offering Circular, as well as "Management's Discussion and Analysis of Financial Condition and Results of Operations".

Due to the unavailability of certain data, the information we have presented in this section does not present all of the information required by U.S. SEC Industry Guide 3 of the Securities Act. However, we believe we have disclosed the information required by Industry Guide 3 of the Securities Act to the extent we have available or are able to reasonably obtain the necessary source data.

Average Balance Sheets and Interest Rate Data

The tables below set forth average quarter-end balances of interest bearing assets and liabilities of the group for the years ended December 31, 2006 and 2005 under IFRS, together with the amount of interest earned or paid and the average rate of interest for such asset or liability. Average balances presented in these tables have been calculated on a quarterly basis because we do not record balance sheet items on a more frequent basis.

	Year ended December 31, 2006		
	Average balance(1)	Interest	Average rate %
	(ISK millions, except percentages—IFRS)		
Assets:			
Cash and cash balances with central banks	34,854	911	2.61
Loans	2,474,430	155,764	6.29
Interest-earning assets measured at fair value	495,228	28,191	5.69
Other assets	68,339	2,585	3.78
Total interest earning assets	3,072,851	187,451	6.10
Provision for losses	(14,549)	—	—
Total non-interest earning assets	318,177	—	—
Total assets	3,376,479	—	—
Liabilities:			
Due to credit institutions and central banks and deposits	717,543	43,470	6.06
Borrowings	2,050,448	77,613	3.79
Subordinated loans	172,634	10,665	6.18
Financial liabilities measured at fair value	65,791	2,372	3.61
Other liabilities	84,523	969	1.15
Total interest bearing liabilities	3,090,939	135,089	4.37
Total non-interest bearing liabilities	27,477		
Total liabilities	3,118,416	—	—
Total shareholders' equity	247,623	—	—
Minority interest	10,440	—	—
Total liabilities and equity	3,376,479	—	—
Net interest spread(2)	—	—	1.73
Net interest income and net interest margin(3)	—	52,362	1.77

(1) Average of quarter-end balances.
(2) Average rate on total interest earning assets—average cost of total interest bearing liabilities.
(3) Net interest margin is net interest income divided by average total interest earning assets.

	Year ended December 31, 2005		
	Average balance[1]	Interest	Average rate %
	(ISK millions, except percentages—IFRS)		
Assets			
Cash and cash balances with central banks	38,840	367	0.94
Loans	1,501,870	82,672	5.50
Interest-earning assets measured at fair value	442,784	15,356	3.47
Other assets	38,625	1,614	4.18
Total interest earning assets	2,022,119	100,009	4.95
Provisions for losses	(12,389)	—	—
Total non-interest earning assets	96,643	—	—
Total assets	2,106,373	—	—
Liabilities			
Due to credit institutions and central banks and deposits	403,017	18,856	4.68
Borrowings	1,306,549	37,776	2.89
Subordinated loans	87,661	3,646	4.16
Financial liabilities measured at fair value	64,921	2,153	3.32
Other liabilities	47,495	4,868	10.25
Total interest bearing liabilities	1,909,643	67,299	3.52
Total non-interest bearing liabilities	13,167	—	—
Total liabilities	1,922,810	—	—
Total shareholders' equity	173,677	—	—
Minority interest	9,886		
Total liabilities and equity	2,106,373	—	—
Net interest spread[2]	—	—	1.43
Net interest income and net interest margin[3]	—	32,710	1.86

(1) Average of quarter-end balances.
(2) Average rate on total interest earning assets—average cost of total interest bearing liabilities.
(3) Net interest margin is net interest income divided by average total interest earning assets.

Analysis of Changes in Net Interest Income and Interest Expense—Volume and Rate Analysis

The following tables analyze changes in the group's net interest income attributable to changes in average volume of interest-earning assets and interest-bearing liabilities and changes in their respective interest rates for the periods presented. Changes to net interest income due to changes in volume have been calculated by multiplying the change in volume during the year times the average rate for the preceding year. Changes to net interest income due to changes in rates have been calculated by multiplying the change in the current year average rate times the volume of the current year. The net change attributable to changes in both volume and rate has been allocated proportionately to the change due to average volume and the change due to average rate. The changes are calculated on the basis of the quarterly average balance sheets set forth in the preceding tables. The average balance sheet under IFRS for the year ended December 31, 2004 is based on our estimates of the balance sheet items under IFRS as of the end of each quarter of 2004. We did not maintain our books and accounts for the period under IFRS and have derived these numbers based on an estimated reconciliation. We cannot assure you that had we kept our accounts under IFRS for 2004, these numbers would not differ substantially.

	Year ended December 31, 2006 v 2005		
	Total interest change	Due to change in volume(1)	Due to change in interest rate(1)
	(ISK millions—IFRS)		
Interest income			
Cash and cash balances with central banks	544	(104)	648
Loans and advances	73,092	61,222	11,870
Interest-earning assets designated at fair value	12,835	2,985	9,850
Other assets	971	1,124	(153)
Total interest income	87,442	65,227	22,215
Interest expense			
Deposits from credit institutions and central banks	(24,614)	(19,055)	(5,559)
Borrowings	(39,837)	(28,158)	(11,679)
Subordinated loans	(7,019)	(5,249)	(1,770)
Financial liabilities measured at fair value	(219)	(31)	(188)
Other liabilities	3,899	(425)	4,324
Total interest expense	(67,790)	(52,918)	(14,872)
Net interest income	19,652	12,309	7,343

	Year ended December 31, 2005 v 2004		
	Total interest change	Due to change in volume(1)	Due to change in interest rate(1)
	(ISK millions—IFRS)		
Interest income			
Cash and cash balances with central banks	366	304	62
Loans and advances	50,527	37,440	13,087
Interest-earning assets designated at fair value	8,900	7,584	1,316
Other assets	142	3,862	(3,720)
Total interest income	59,935	49,190	10,745
Interest expense			
Deposits from credit institutions and central banks	(10,482)	(7,014)	(3,468)
Borrowings	(26,789)	(20,135)	(6,654)
Subordinated loans	(1,404)	(2,092)	688
Financial liabilities measured at fair value	(825)	(423)	(402)
Other liabilities	(5,984)	(2,068)	(3,916)
Total interest expense	(45,484)	(31,732)	(13,752)
Net interest income	14,451	17,458	(3,007)

(1) Based on average balances for 2004 calculated by averaging management's estimates of quarterly balances for 2004 under IFRS.

The tables below set forth a geographical analysis of operating income for the years indicated:

	Year ended December 31, 2006					
	Iceland	Scandinavia	UK	Luxembourg	Other	Total
	(ISK millions—IFRS)					
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
Operating income	78,544	41,420	32,785	11,079	3,388	167,216

	Year ended December 31, 2006					
	Year ended December 31, 2005					
	Iceland	Scandinavia	UK	Luxembourg	Other	Total
	(ISK millions—IFRS)					
Net interest income	10,224	10,642	7,698	3,715	431	32,710
Net fee and commission income	8,859	3,814	6,364	2,896	495	22,428
Net financial income	6,217	10,218	18,015	1,907	925	37,282
Other income	6,048	1,742	1,986	2	—	9,778
Operating income	31,348	26,416	34,063	8,520	1,851	102,198

	Year ended December 31, 2004					
	Iceland	Scandinavia	UK	Luxembourg	Other	Total
	(ISK millions—IFRS)					
Net interest income	7,667	7,368	1,103	1,679	442	18,259
Net fee and commission income	7,184	3,344	1,197	1,411	172	13,308
Net financial income	5,486	2,381	6,214	2,243	2	16,326
Other income	929	646	473	3	1	2,052
Operating income	21,266	13,739	8,987	5,336	617	49,945

Investment Portfolio

The following tables set forth the financial assets measured at fair value for each type of the group's investments in bonds and other fixed income securities and shares and other variable yield securities under IFRS at December 31, 2006, 2005 and at Januray 1, 2005.

	At December 31, 2006	At December 31, 2005	At January 1, 2005
	(ISK millions—IFRS)		
Trading assets			
Bonds and debt instruments	29,767	169,714	102,364
Futures	15	18	84
OTC derivatives	50,011	12,644	11,070
Other trading derivatives	15,428	8,385	1,931
Shares and equity instruments	88,944	64,298	36,712
Securities used for hedging:			
Shares and equity instruments	47,011	28,710	12,525
Bonds and debt instruments	66,732	53,388	40,501
Total trading assets	297,908	337,157	205,187
Financial assets designated at fair value			
Bonds and debt instruments	288,497	220,861	60,070
Shares and equity instruments	69,912	49,890	35,379
Securities used for hedging:			
Shares and equity instruments	2,195		
Total financial assets designated at fair value	360,604	270,751	95,449
Financial assets available for sale			
Shares and equity instruments	164	167	1,507
Total financial assets available for sale	164	167	1,507
Derivatives used for hedging			
Fair value hedge	2,953	982	370
Portfolio hedge of interest rate risk	3,500	3,477	3,450
Total derivatives used for hedging	6,453	4,459	3,820
Financial assets measured at fair value	665,129	612,534	305,963

The following table sets forth the fair value of the group's financial assets by maturity at December 31, 2006 and 2005.

	At December 31, 2006					
	On demand	**Up to 3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**Total**
Trading assets	203,788	47,187	12,190	25,176	9,567	297,908
Financial assets designated at fair value	2,195	94,356	4,861	157,506	101,686	360,604
Financial assets available for sale				164		164
Derivatives used for hedging		623	146	1,185	4,499	6,453
Financial assets measured at fair value	205,983	142,166	17,197	184,031	115,752	665,129

	At December 31, 2005					
	On demand	**Up to 3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**Total**
Trading assets	337,157	—	—	—	—	337,157
Financial assets designated at fair value	—	55,022	121,135	63,514	31,080	270,751
Financial assets available for sale	167	—	—	—	—	167
Derivatives used for hedging	983	677	11	659	2,129	4,459
Financial assets measured at fair value	338,307	55,699	121,146	64,173	33,209	612,534

Loan Portfolio

The following tables provide details of loans by type of loan as well as the breakdown of domestic and foreign loans at the dates indicated.

	At December 31, 2006	At December 31, 2005	At January 1, 2005
		(ISK millions—IFRS)	
Iceland			
Loans to Icelandic credit institutions:			
Bank accounts	50,772	16,739	4,183
Overdraft	4,324	—	—
Money market loans	9,846	7,433	47,989
Other loans	38,444	29,064	10,289
Total loans to Icelandic credit institutions	103,386	53,236	62,461
Loans to Icelandic customers:			
Overdrafts	39,703	37,027	18,108
Subordinated loans	2,562	3,474	5,238
Other loans	563,995	444,784	276,274
Finance lease	—	—	25,840
Provisions for losses	(7,836)	(6,778)	(8,116)
Total loans to Icelandic customers	598,424	478,507	317,344
Total Icelandic loans	701,810	531,743	379,805
Foreign			
Loans to foreign credit institutions:			
Bank accounts	45,056	30,142	11,124
Overdraft	3,578	1,733	1,739
Money market loans	232,438	90,111	92,890
Other loans	100,876	20,372	6,096
Total loans to foreign credit institutions	381,948	142,358	111,849
Loans to foreign customers:			
Overdrafts	73,651	45,760	22,995
Subordinated loans	4,807	4,173	1,785
Other loans	1,777,467	951,557	586,170
Finance lease	93,006	69,878	55,990
Provisions for losses	(8,746)	(6,175)	(4,178)
Total loans to foreign customers	1,940,185	1,065,193	662,762
Total foreign loans	2,322,133	1,207,551	774,611
Total loans to credit institutions and customers	3,023,943	1,739,294	1,154,416

The following table provides details at December 31, 2006 and 2005 of the maturities of loans made by the group, classified by maturity and type of loan, as well as the breakdown of domestic and foreign loans.

	At December 31, 2006					
	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	Total
			(ISK millions—IFRS)			
Iceland						
Loans to Icelandic credit institutions						
Bank accounts	50,772	—	—	—	—	50,772
Overdraft	1,843	234	683	1,533	31	4,324
Money market loans	—	8,812	1,034	—	—	9,846

	At December 31, 2006					
	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	Total
			(ISK millions—IFRS)			
Other loans	169	478	15,193	22,604	—	38,444
Total loans to Icelandic credit institutions	52,784	9,524	16,910	24,137	31	103,386
Loans to Icelandic customers						
Overdrafts	2,883	24,831	11,918	71	—	39,703
Subordinated loans	—	—	2,464	98	—	2,562
Other loans	7,997	65,277	94,767	237,148	158,806	563,995
Provisions for losses	(7,037)	(799)	—	—	—	(7,836)
Total loans to Icelandic customers	3,843	89,310	109,149	237,317	158,806	598,424
Total Icelandic loans	56,627	98,834	126,059	261,453	158,837	701,810
Foreign						
Loans to foreign credit institutions						
Bank accounts	11,151	16,735	761	14,954	1,455	45,056
Overdraft	3,578	—	—	—	—	3,578
Money market loans	16,920	215,469	49	—	—	232,438
Other loans	2,851	78,914	5,952	8,506	4,653	100,876
Total loans to foreign credit institutions	34,500	311,118	6,762	23,460	6,108	381,948
Loans to foreign customers:						
Overdrafts	73,381	15	255	—	—	73,651
Subordinated loans	—	—	—	—	4,807	4,807
Other loans	125,501	348,240	208,040	533,596	562,091	1,777,468
Finance lease	270	4,849	9,533	26,889	51,465	93,006
Provisions for losses	(431)	(4,552)	(426)	(1,357)	(1,981)	(8,747)
Total loans to foreign customers	198,721	348,552	217,402	559,128	616,382	1,940,185
Total foreign loans	233,221	659,670	224,164	582,588	622,490	2,322,133
Total loans to credit institutions and customers	289,848	758,503	350,223	844,042	781,327	3,023,943

	At December 31, 2005					
	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	Total
			(ISK millions—IFRS)			
Iceland:						
Loans to Icelandic credit institutions						
Bank accounts	16,648	82	—	—	9	16,739
Money market loans	—	2,271	5,162	—	—	7,433
Other loans	40	6,065	2,633	20,278	48	29,064
Total loans to Icelandic credit institutions	16,688	8,418	7,795	20,278	57	53,236
Loans to Icelandic customers						
Overdrafts	1,257	28,100	7,670	—	—	37,027
Subordinated loans	—	—	1,824	1,650	—	3,474
Other loans	3,586	51,094	39,438	182,858	167,808	444,784
Provisions for losses	(571)	(1,053)	(783)	(2,746)	(1,625)	(6,778)
Total loans to Icelandic customers	4,272	78,141	48,149	181,762	166,183	478,507
Total Icelandic loans	20,960	86,559	55,944	202,040	166,240	531,743
Foreign:						
Loans to foreign credit institutions						
Bank accounts	21,843	1,954	—	4,229	2,116	30,142
Overdraft	—	1,733	—	—	—	1,733
Money market loans	—	88,666	1,445	—	—	90,111
Other loans	4,329	9,873	3,243	1,567	1,360	20,372
Total loans to foreign credit institutions	26,172	102,226	4,688	5,796	3,476	142,358

	At December 31, 2005					
	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	Total
	(ISK millions—IFRS)					
Loans to foreign customers						
Overdrafts	983	38,945	5,832	—	—	45,760
Subordinated loans	—	—	—	—	4,173	4,173
Other loans	63,717	160,117	73,181	311,850	342,692	951,557
Finance lease	—	18,012	33,124	18,742	—	69,878
Provisions for losses	(260)	(1,955)	(499)	(1,254)	(2,207)	(6,175)
Total loans to foreign customers	64,440	215,119	111,638	329,338	344,658	1,065,193
Total foreign loans	90,612	317,345	116,326	335,134	348,134	1,207,551
Total loans to credit institutions and customers	111,572	403,904	172,270	537,174	514,374	1,739,294

The following tables provide details of loans by sector at the dates indicated. As the classification for sectors changed from 2005 to 2006, loans to customers for 2006 is presented separately.

	At December 31, 2006
	(ISK millions—IFRS)
Iceland	
Loans to credit institutions	103,386
Loans to customers:	
Individuals	195,981
Holding companies	122,933
Industry	112,551
Real estate	68,925
Service	47,286
Trade	43,171
Transportation	7,577
Total Iceland loans	701,810
Foreign	
Loans to credit institutions	381,948
Loans to customers:	
Individuals	225,682
Holding companies	220,541
Industry	504,839
Real estate	325,067
Service	457,643
Trade	172,357
Transportation	34,056
Total foreign loans	2,322,133
Total loans	3,023,943

	At December 31, 2005	At January 1, 2005
	(ISK millions—IFRS)	
Iceland		
Loans to credit institutions	53,236	62,461
Municipalities	1,662	2,139
Loans to customers:		
Agriculture	3,403	4,105
Fishing industry	12,492	10,023
Industry	49,175	50,624
Commerce	22,759	36,407
Service(1)	206,243	144,943
Individuals	189,551	77,219
Total	538,521	387,921
Provisions for losses	(6,778)	(8,116)
Total Iceland loans	531,743	379,805
Foreign		
Loans to credit institutions	142,358	111,849
Municipalities	42,084	40,261
Loans to customers:		
Agriculture	6,207	1,543

	At December 31, 2005	At January 1, 2005
	(ISK millions—IFRS)	
Fishing industry	655	7
Industry	123,280	256,256
Commerce	345,360	37,921
Service	472,355	285,612
Individuals	81,427	43,340
Total	1,213,726	778,789
Provisions for losses	(6,175)	(4,178)
Total foreign loans	1,207,551	774,611
Total loans to credit institutions and customers	1,739,294	1,154,416

(1) Service includes holding companies (investment companies), real estate, transportation and service for the years 2005 and 2004.

The following table sets forth the geographic distribution of our loans to customers at December 31, 2006.

	At December 31, 2006	
	(ISK millions)	(%)
Iceland	573,238	22.6
Scandinavia	1,085,119	42.7
United Kingdom	506,626	20.0
Luxembourg	271,469	10.7
Others	102,157	4.0
Total	2,538,609	100.0%

The following tables set forth the currency distribution (expressed in Icelandic króna) of our loans to customers at December 31, 2006 and 2005.

	At December 31, 2006	
	(ISK millions)	(%)
Icelandic króna	351,196	13.8
Euro	451,171	17.8
Pound sterling	553,032	21.8
Danish krone	582,576	23.0
Swedish krona	236,699	9.3
U.S. dollars	176,401	6.9
Other	187,534	7.4
Total	2,538,609	100.0%

	At December 31, 2005	
	(ISK millions)	(%)
Icelandic króna	263,753	17.1
Euro	272,087	17.6
Pound sterling	283,240	18.3
Danish krone	398,781	25.8
Swedish krona	121,993	7.9
Other	203,845	13.3
Total	1,543,700	100.0%

Characteristics of our 20 Largest Borrowers

At December 31, 2006, loans to the 20 largest borrowers in our loan portfolio amounted to ISK 482,739 billion, or 19.0% of customer loans, our exposure to the 10 largest borrowers in our loan portfolio amounted to 13.5% of customer loans and our exposure to the largest borrower in our loan portfolio represented 2.4% of our customer loan portfolio (in each case excluding loans to banks and off-balance sheet credit-related commitments). Loans to British, Icelandic and Danish customers represented 50.8%, 23.4%, and 23.0%, respectively, of loans to our 20 largest borrowers. Our exposure to our 20 largest borrowers include loans across a range of industries, including Industry, Retail and Investments. Our largest exposure to a single sector at December 31, 2006 was ISK 138.9 billion, or approximately 28.8% of the total of our loans to these 20 borrowers.

Loan Loss Allowances

Under IFRS, we recognize losses in respect of impaired loans promptly where there is objective evidence that impairment of a loan or portfolio of loans has occurred. This is done on a consistent basis in accordance with our internal guidelines. There are two basic methods of calculating impairment losses: one for calculation of impairments on individual loans and another for calculation of losses assessed on a collective basis. Losses expected as a result of future events, no matter how likely, are not recognized.

The following table sets forth the impairments or loan loss allowances and changes in loans, write-offs and recoveries as at and for the periods and date indicated as well as change to income and period end allowances for loan losses.

	Year ended December 31, 2006	**Year ended December 31, 2005**
	(IFRS) **(ISK millions, except percentages)**	
Balance at the beginning of the year	12,953	12,294
Acquisition through business combination	—	1,765
Impairment on loans during the year	4,857	2,450
Exchange rate differences on translation	1,786	(518)
Write offs during the year	(3,203)	(3,212)
Payment of loans previously written off	189	174
Balance at end of year	16,582	12,953
Restatement according to IFRS	—	—
Average outstanding loans to customers for the period indicated	2,068,883	1,268,050
Outstanding loans to customers at end of the period indicated	2,538,609	1,543,700
Provisions/outstanding loans to customers at the end of the period indicated	0.65%	0.83%
Net write-offs/average outstanding loans to customers for the period indicated	0.15%	0.24%

The following tables set forth by sector write-offs of average outstanding loans to customers over the years indicated. As the classification for sectors changed from 2005 to 2006, loans to customers for 2006 is presented separately.

	Year ended December 31, 2006
	(ISK millions)
Write-offs during the year:	
Individuals	714
Holding companies	39
Industry	1,883
Real estate	102
Service	426
Trade	39
Transportation	—
Total	3,203

	Year ended December 31,	
	2005	2004
	(ISK millions)	
Write-offs during the year:		
Agriculture	133	113
Fishing industry	39	416
Industry	1,010	1,770
Commerce	413	397
Service[(1)]	562	1,684
Individuals	1,055	1,221
Total	3,212	5,601

(1) Service includes holding companies (investment companies), real estate, transportation and service for the years 2005 and 2004.

Allocation of Provisions for Losses on Loans and Advances

The table below details the allocation of provisions for losses on loans to customers by sector under IFRS at December 31, 2006 and 2005 and January 1, 2005. As the classification for sectors changed from 2005 to 2006, loans to customers for 2006 is presented separately.

	At December 31, 2006		
	Iceland	Foreign	Total
	(ISK millions—IFRS)		
Individuals	5,322	293	5,615
Holding companies	45	3,178	3,222
Industry	214	1,112	1,326
Real estate		770	770
Service	226	1,287	1,512
Trade	102	640	742
Transportation	11	204	215
Collective assessment	1,916	1,262	3,178
Total	7,836	8,746	16,582

	At December 31, 2005			At January 1, 2005		
	Iceland	Foreign	Total	Iceland	Foreign	Total
	(ISK millions—IFRS)					
Agriculture	196	—	196	70	—	70
Fishing industry	46	—	46	35	—	35
Industry	708	3,127	3,835	818	2,796	3,614
Commerce	771	688	1,459	683	214	897
Service[(1)]	518	1,727	2,245	873	1,086	1,960
Individuals	1,313	61	1,373	1,578	81	1,660
Collective assessment	3,227	572	3,798	4,059	—	4,059
Total	6,778	6,175	12,953	8,116	4,178	12,294

(1) Service includes holding companies (investment companies), real estate, transportation and service for the years 2005 and 2004.

Assets

The tables below shows assets at December 31, 2006 and 2005 specified by locations of its markets and customers.

	At December 31, 2006					
	Iceland	Scandinavia	UK	Luxembourg	Other	Total
	(ISK millions—IFRS)					
Cash and cash balances with central banks	964	40,616	65,007	42	332	106,961
Loans to credit institutions	88,421	126,909	139,308	50,414	80,282	485,334
Loans to customers	573,238	1,085,119	506,626	271,469	102,157	2,538,609
Financial assets measured at fair value	332,744	261,918	30,621	36,426	3,420	665,129
Other assets	76,149	111,685	66,316	4,899	314	259,363
Total	1,071,516	1,626,247	807.878	363,250	186,505	4,055,396

	At December 31, 2005					
	Iceland	Scandinavia	UK	Luxembourg	Other	Total
	(ISK millions—IFRS)					
Cash and cash balances with central banks	811	32,078	59	1,929	—	34,877
Loans to credit institutions and customers	531,743	776,470	297,642	70,693	62,746	1,739,294
Financial assets measured at fair value	247,761	185,399	160,956	5,492	12,926	612,534
Other assets	69,362	36,809	45,389	2,165	381	154,106
Total	849,677	1,030,756	504,046	80,279	76,053	2,540,811

Non-performing Assets

The following table sets forth our non-performing assets at December 31, 2006 and 2005 under IFRS and at December 31, 2004 under Icelandic GAAP.

	At December 31,	
	2006	2005
		(IFRS)
	(ISK millions, except percentages)	
Total non-performing loans	25,506	15,078
Non-current assets and disposal groups classified as held for sale:		
Tangible assets held for sale	389	572
Total assets of legal entities held for sale	1,945	1,730
Total non-current assets and disposal groups classified as held for sale	2,334	2,302
Total non-performing assets	27,840	17,380
Non-performing loans as a percentage of loans to customers	1.00%	0.98%
Non-performing assets as a percentage of loans to customers	1.10%	1.12%
Provision for loans as a percentage of loans to customers	0.65%	0.83%
Net write-offs as a percentage of average loans to customers outstanding	0.15%	0.24%

Liabilities

Deposits

The following table shows details of the group's deposits for its Icelandic and foreign operations and the interest expense thereon, for each of the years ended December 31, 2006, 2005 and 2004.

	At December 31, 2006	At December 31, 2005	At January 1, 2005
	(ISK millions—IFRS)		
Icelandic operations:			
Deposits from credit institutions and central banks	10,596	10,126	8,875
Other deposits	173,638	149,300	112,941

Total Iceland deposits	184,234	159,426	121,816
Deposits in foreign banking offices:			
Deposits from credit institutions and central banks	99,860	59,517	23,613
Other deposits	577,020	336,876	89,252
Total foreign deposits	676,880	396,393	112,865
Total deposits	861,114	555,819	234,681
Interest expense	43,470	18,856	8,374

The following tables show the maturity of the group's deposits from credit institutions and central banks and other deposits as at the dates indicated.

	At December 31, 2006					
	On demand	**Up to 3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**Total**
	(ISK millions—IFRS)					
Deposits from credit institutions and central banks	10,384	90,269	4,045	3,605	2,153	110,456
Other deposits	226,966	409,317	86,755	21,459	6,161	750,658
Total deposits	237,350	499,586	90,800	25,064	8,314	861,114

	At December 31, 2005					
	On demand	**Up to 3 months**	**3-12 months**	**1-5 years**	**Over 5years**	**Total**
	(ISK millions—IFRS)					
Deposits from credit institutions and central banks	11,176	52,820	3,890	—	1,757	69,643
Other deposits	163,426	253,963	18,156	39,834	10,797	486,176
Total deposits	174,602	306,783	22,046	39,834	12,554	555,819

	At January 1, 2005					
	On demand	**Up to 3 months**	**3-12 months**	**1-5 years**	**Over 5years**	**Total**
	(ISK millions—IFRS)					
Deposits from credit institutions and central banks	18,017	3,252	6,838	2,118	2,263	32,488
Other deposits	80,084	82,980	8,773	23,922	6,434	202,193
Total deposits	98,101	86,232	15,611	26,040	8,697	234,681

Characteristics of our 20 Largest Deposits

At December 31, 2006, our 20 largest deposits amounted to ISK 91 billion, or 12.1% of our total deposits. Our 10 largest deposits amounted to 8.1% of our total deposits and the largest deposit represented 1.5% of our total deposits. Deposits from our operations in the United Kingdom, Iceland, Luxembourg and Denmark represented 38.6%, 23.1%, 14.1%, and 11.2%, respectively, of our total deposits.

Borrowings

The following table shows details of the types and maturities of the group's borrowings at December 31, 2006 and 2005 and at January 1, 2005.

	At December 31, 2006		At December 31, 2005 (IFRS)		At January 1, 2005	
	(ISK millions)	(%)	(ISK millions)	(%)	(ISK millions)	(%)
Borrowings						
Bonds issued	1,762,483	73.4	1,158,806	74.4	779,931	80.5
Bills issued	156,203	6.5	164,910	10.6	35,726	3.7
Money market loans	373,285	15.6	200,581	12.9	111,901	11.6
Other loans	107,968	4.5	32,270	2.1	40,954	4.2
Total borrowings	2,399,939	100.0	1,556,567	100.0	968,512	100.0
Borrowings mature						
On demand	3,569	0.1	10,684	0.7	9,685	1.0
Up to 3 months	489,330	20.4	300,885	19.3	145,277	15.0
Over 3 months and up to a year	442,860	18.5	214,935	13.8	125,907	13.0
Total short-term borrowings	935,759	39.0	526,504	33.8	280,869	29.0
Over 1 year and up to 5 years	1,105,436	46.1	862,240	55.4	581,107	60.0
Over 5 years	358,744	14.9	167,823	10.8	106,536	11.0
Total borrowings	2,399,939	100.0	1,556,567	100.0	968,512	100.0

Short-term Borrowings

The table below shows details of outstanding amounts of short-term borrowings (having a maturity of less than a year) of the group for each of the three years ended December 31, 2006 and 2005 and 2004.

	Maximum outstanding at any month end	Average balance	Ending balance	Interest rate at year-end
	(ISK millions, except percentages)			
As at or for the year ended December 31, 2006	968,756	811,135	935,759	3.35%
As at or for the year ended December 31, 2005	604,310	403,687	526,504	2.53%
As at or for the year ended December 31, 2004	280,869	184,226	280,869	2.22%

The following table sets forth the currency distribution (expressed in Icelandic króna) of our borrowings at December 31, 2006.

	At December 31, 2006 (IFRS)	
	(ISK millions)	(%)
Icelandic króna	111,085	4.6%
Euro	1,238,924	51.6%
Pound sterling	279,304	11.7%
Danish krone	47,695	2.0%
Swedish krona	23,905	1.0%
U.S. dollars	530,630	22.1%
Other	168,396	7.0%
Total	2,399,939	100.0%

Capital

The following table sets forth the group's risk-weighted assets and capital ratios at the date indicated.

Equity as at December 31, 2006 was ISK 334,892 million. The CAD ratio, calculated in accordance with Article 84 of the Icelandic Act on Financial Undertakings, was 15.0% at December 31, 2006, compared to 12.2% at December 31, 2005. Under applicable Icelandic law, we are required to maintain a CAD ratio of at least 8.0%.

The ratio is calculated as follows.

	At December 31,					
	2006		2005		2004	
	Book value	Weighted value	Book value	Weighted value	Book value	Weighted value
	(IFRS)				(Icelandic GAAP)	
	(ISK millions, except percentages)					
Risk weighted assets:						
Assets recorded in the financial statements	4,055,396	2,875,539	2,540,811	1,841,833	1,534,020	1,166,377
Assets deducted from equity		(66,922)		(62,590)		(50,335)
Guarantees and other items not included in the balance sheet		259,023		166,028		73,129
Total Risk weighted assets		3,067,640		1,945,271		1,189,171
Equity						
Tier I capital:						
Equity		334,892		202,512		158,749
Intangible assets		(65,276)		(54,943)		(34,208)
Assets subtracted from equity		—		(6,742)		(1,232)
Subordinated loans		51,817		41,201		13,947
Total Tier I capital		321,433		182,028		137,256
Tier II capital:						
Subordinated loans		160,717		61,285		43,108
Investment in credit institutions		(21,324)		(6,451)		(11,598)
Total capital		460,826		236,862		168,766
CAD ratio		15.0%		12.2%		14.2%
Tier I capital ratio		10.5%		9.4%		11.5%

Return on Average Assets and Equity

The following table shows the group's return on average assets and return on equity for the periods presented.

	Year ended December 31,	
	2006 (ISK)	2005 (ISK)
	(IFRS)	
Financial ratios:		
Return on average assets(1)	2.53%	2.34%
Return on equity(2)	42.39%	33.96%

(1) Represents shareholders' net earnings divided by average on quarter-end balances.

(2) Represents the annualized geometric mean of the return on shareholders' equity for each quarter during the period. The return on shareholders' equity for each quarter is calculated as (i) shareholders' net earnings for the quarter, divided by (ii) shareholders' equity at the beginning of the quarter, adjusted for changes in shareholders' equity (other than those resulting from shareholders' net earnings for that quarter) during the quarter.

Financial Assets and Liabilities (book value)

The following table shows, by maturity, the group's financial assets and liabilities that are sensitive to changes in interest rates as well as the group's interest-sensitive gap as at December 31, 2006 and 2005.

	At December 31, 2006				
	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years
	(ISK millions—IFRS)				
Cash and central banks balances	106,961	—	—	—	—
Loans to credit institutions	87,284	320,642	23,672	47,597	6,139
Loans to customers	202,564	437,861	326,551	796,445	775,188

	At December 31, 2006				
	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years
	(ISK millions—IFRS)				
Financial assets measured at fair value	205,983	142,166	17,197	183,867	115,752
Financial assets available-for-sale	—	—	—	164	—
Total	602,792	900,669	367,420	1,028,073	897,079
Credit institutions and central banks	10,384	90,269	4,045	3,605	2,153
Deposits	226,966	409,317	86,755	21,459	6,161
Borrowings	3,569	489,330	442,860	1,105,436	358,744
Financial liabilities measured at fair value	3,503	15,658	7,684	35,714	224,735
Total	244,422	1,004,574	541,344	1,166,214	591,793
Periodic interest-sensitive gap	358,370	(103,905)	(173,924)	(138,141)	305,286
Cumulative interest-sensitive gap	358,370	254,465	80,541	(57,600)	247,686

Cash Flows

The following table shows our condensed cash flows for the years ended December 31, 2006, 2005 and 2004.

	Year ended December 31,		
	2006	2005	2004
	(ISK millions—IFRS)		
Net cash (used in) provided by operating activities	(49,940)	88,999	(2,342)
Net cash flow provided by (used in) investing activities	8,737	(71,831)	(93,035)
Net cash flow provided by financing activities	133,679	39,615	107,155
Net increase in cash and cash equivalents	92,476	56,783	11,778
Cash and cash equivalents at the beginning of the year	81,758	26,985	15,537
Effect of exchange rate changes on cash and cash equivalents	28,555	(2,010)	(330)
Cash and cash equivalents at the end of the year / period	202,789	81,758	26,985

For further information regarding our Cash Flows, see—“Liquidity, Capital and Funding”.

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 described below Management devotes a significant portion of its time to the management of these risks. The mainstays of effective risk management are identifying significant risks, quantifying our risk exposure, implementing actions to limit risk and continually monitoring risk.

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, analyzing 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 more detailed or provide a summary of the information collected and analyzed, depending on the purpose of the reports. In addition, 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 the Risk Management division of Kaupthing in Iceland, 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 the Risk Management division at Kaupthing in Iceland or our Chief Risk Officer.

The assessment of risk, in particular the determination of its true magnitude along with actions aimed at limiting the risk with sensible credit and investments in other assets, is one of the major tasks of banks and other financial institutions. Many risks can adversely affect our business. It is the policy of our board of directors that the various risks that we face in our business be constantly monitored and managed. For these purposes, we operate a centralized 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 first needs the approval of our chief executive officer 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. To do so, the risk management team constantly monitors 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.

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 enhanced if the assigned collateral only partly covers the claims made on 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 securitization and cross border (or transfer) risk.

Our main asset is our loan portfolio, and our increasing size means that managing and analyzing the loan portfolio becomes increasingly more important. We have increased our emphasis on improving the quality of our credit portfolio, not only by seeking business with more creditworthy borrowers, but also by making our credit processes stricter and by critically monitoring problem loans and taking provisions where appropriate. It is not our policy solely to lend to the highest quality borrowers, but we believe it is important that the price of our issued credit reflects both risk and costs incurred.

Credit Risk Management

Credit risk is monitored within the Risk Management division. The research and development group within the group's Risk Management division is responsible for developing and maintaining credit monitoring and reporting systems. This group also performs numerical analyses of the loan portfolio at least once a year, such as estimating expected loss and concentrations within the loan portfolio, and it records defaults in a systematic way. The proprietary rating models that we use have been developed by the research and development group and similar functions within our subsidiaries. Models for corporate, retail and private banking have been developed and currently more specific models, such as for specialized lending, are under development.

In addition, two groups within the Risk Management division concentrate on different aspects of the credit portfolio. The credit control group focuses on the distressed client process, monitoring defaults, following up on legal proceedings and overseeing specific provisions and write-offs. The credit risk analysis group is dedicated to, but financially independent from, the credit process in general and the loan application phase in particular. This group monitors the integrity of the credit process and rating systems, for example in regard to data collection, performance, limit compliance, application preparation, documentation and collateral registration and valuation.

We review our credit portfolio at least once a year, adjusting internal credit ratings as needed. For more doubtful exposures, we monitor our credit risk more frequently, often quarterly but on a daily basis if the situation requires heightened attention.

Our Corporate Banking and Risk Management divisions work together to analyze larger exposures and the manner in which different related entities are intertwined. This process provides us with a comprehensive overview of our outstanding exposure and the potential risks that can arise from interlinked ownership.

The structure of credit risk management is similar across our subsidiaries, but may differ in terms of location within the structure of the organization. However, it is the responsibility of the Risk Management division at Kaupthing in Iceland to monitor credit risk on a group-wide level. In particular, specific procedures are in place to monitor the aggregate exposure of a single counterparty across the group.

Credit Application Process

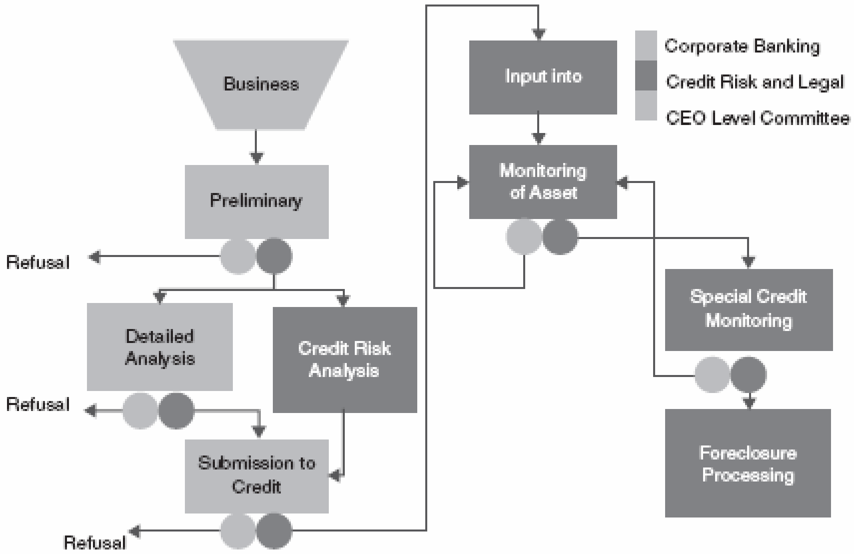
The highest credit authority within the group is the Group Board Credit Committee, whose members consist of three board members and our CEO. All exposures above €165 million are referred to the Group Board Credit Committee for approval.

At December 31, 2006 we had three large exposures exceeding 10% of our risk capital. The highest credit authority at Kaupthing Bank is the Management Credit Committee, which is overseen by the Group Board Credit Committee. There are also two lower levels of committees at Kaupthing Bank within corporate and retail banking that have the authority to approve exposures within certain 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. In each case, the management credit committee may only approve exposure 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. We have established our CEO as a member of all subsidiary board level credit committees and the Group Board Credit Committee, as well as our 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 10% of the group's risk capital, the exposure must be referred to the Group Board Credit Committee.

The chart below illustrates the principal parts of our credit process.



An effective and precise credit rating system is essential for analyzing and pricing risk accurately. Recently, we have emphasized improving our credit risk modeling on a group wide scale. Where applicable, and together with our internal credit rating system, we use the services of external credit rating agencies. Recently, we have developed and tested proprietary rating models. The credit evaluation process is, however, not only dependant upon these quantitative criteria but on a number of qualitative factors, such as its industry sector and our knowledge of the borrower. Furthermore, a facility rating of the collateral is performed to determine the potential loss in the case of default.

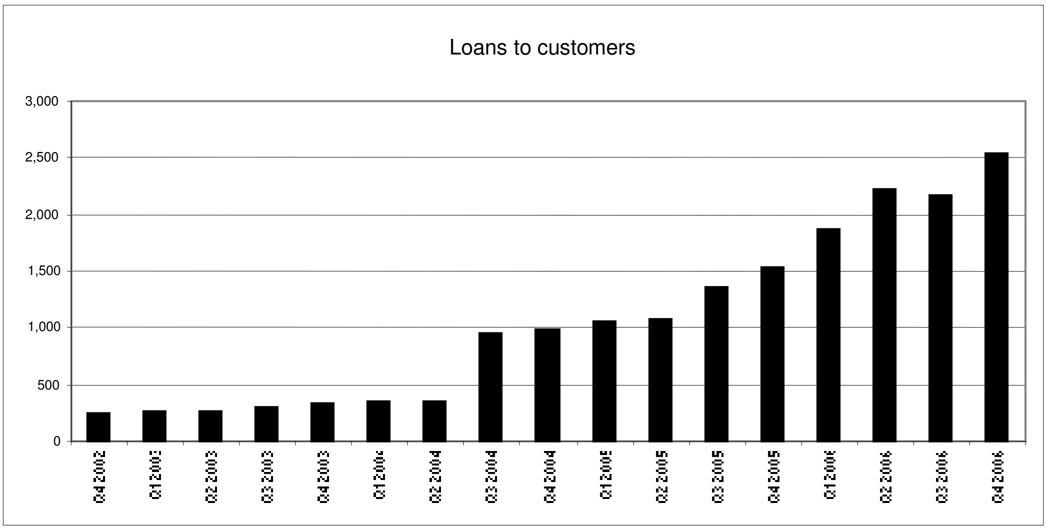
We review our credit portfolio at least once a year and rate credit exposures on a scale of one to twelve, based on quantitative and qualitative factors. The quantitative factors include the borrower's debt service history and various financial ratios. The qualitative factors include an assessment of the borrower's market position, the stability and outlook of its industry sector, its management and strategy and financial and risk control.

In general, the larger the exposure, the more detailed is the analysis that we perform. For smaller exposures, the process is fundamentally the same, but requires less scrutiny and data. Guarantors are analyzed in the same manner.

Credit Exposure

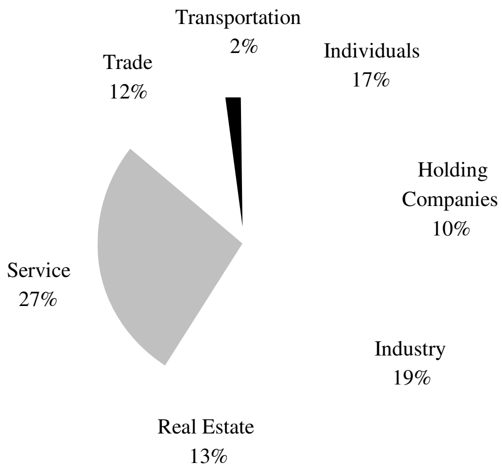
At December 31, 2006, total loans to customers net of provisions for losses amounted to ISK 2,539 billion. The loan portfolio increased by approximately 64.4% in 2006, 39.1% at a fixed exchange rate and the rest largely attributable to increases in loans outside Iceland. At the end of 2005, total loans to customers net of provisions for losses amounted to ISK 1,544 billion. The loan portfolio increased by approximately 57% in 2005, with the acquisition of Singer & Friedlander accounting for approximately one third of this growth. At December 31, 2006, corporate loans totalled ISK 2,116 billion, and loans to individuals totalled ISK 422 billion. We believe that our portfolio is well diversified. Our largest exposures are to companies within the industry sector, which constitute around 24.3% of our portfolio, followed by loans to the service sector at approximately 19.9%, individuals at approximately 16.6%, real estate at approximately 15.6%, holding companies (investment companies) at approximately 13.5%, trade at approximately 8.5% and transportation at approximately 1.6%. At the end of 2006, corporate loans totalled ISK 2,116 billion, up from ISK 1,275 billion in 2005, and loans to individuals totalled ISK 422 billion, up from ISK 268 billion in 2005, largely due to the addition of Kaupthing Singer & Friedlander and new mortgage loans introduced in Iceland during the latter half of 2004.

The chart below illustrates the growth of our loan portfolio on a quarterly basis since the end of 2002.

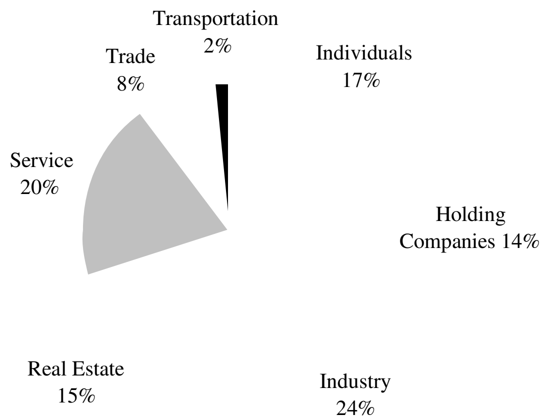


The chart below illustrates the distribution of our loan portfolio to customers, net of loan loss provisions, by sector at December 31, 2006, which totalled ISK 2,538 billion and at December 31, 2005, which totalled ISK 1,544 billion.

Loans to customers by sectors at December 31, 2005



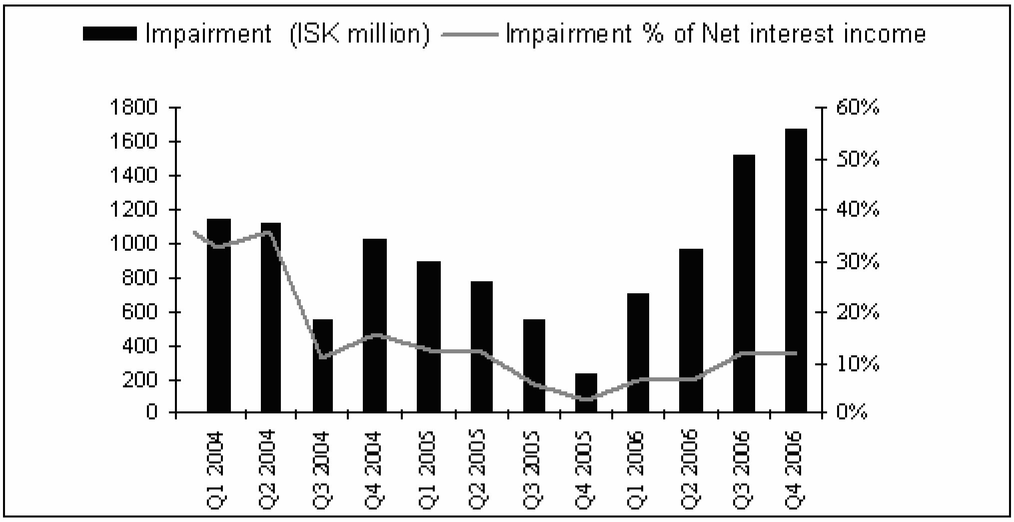
Loans to customers by sectors at December 31, 2006



Credit defaults

Since 2003, significant efforts have been made to improve the quality of the loan portfolio. Stricter rules and work procedures when issuing credit were introduced and certain loans that were considered doubtful were accelerated on default.

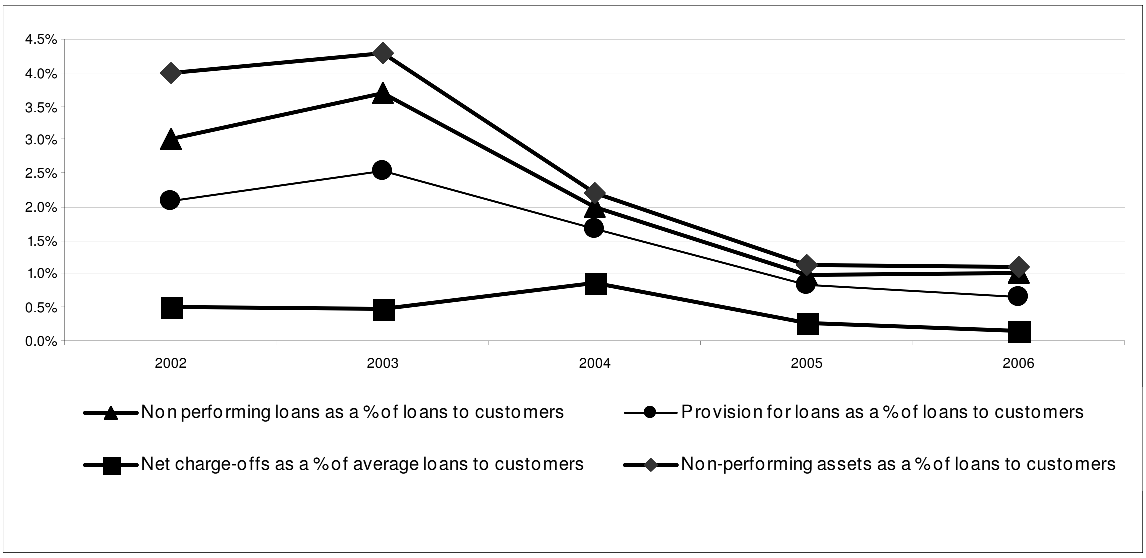
The chart below illustrates the development of our provisions on a quarterly basis since 2003, both in absolute amounts and as a percentage of net interest income.



We believe that our efforts have generally improved the quality of our loan portfolio. During 2006 and the second half of 2005, provisions were approximately 10% of net interest income, down from over 50% in the third quarter of 2003, 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 our portfolio. However, our provisions increased substantially in the third quarter of 2006 due to a £7 million provision related to a single exposure to a company which went bankrupt.

Asset Quality Ratios

Our main asset is our loan portfolio. 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 chart below shows non-performing assets as a percentage of loans to customers, non-performing loans as a percentage of loans to customers, provision for loans as a percentage of loans to customers and net write-offs as a percentage of average outstanding loans to customers.



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 locally and on a group 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 Managing Director of Trading 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 Risk Management and reviewed by our chief executive officer. 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% of our risk capital (which does not include off-balance sheet exposures) based on a decision by our board of directors. Transactions which meet certain criteria, are reviewed and approved by our board of directors. As at December 31, 2006, our total equity exposure (excluding off-balance sheet exposure) was ISK 159,020 million, representing 34.5% of our risk capital and 3.9% of our total assets.

Measurement Methods

Risk measures are generated by proprietary systems that utilize 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 head of the Risk Management division through a position monitoring system. The head of the Risk Management division appoints both 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 head 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 head of the Risk Management division, the head of the Trading division and our chief executive officer. The division also sends a weekly risk assessment report to the head of Trading, our chief executive officer 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% 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

In 2006, we made a trading profit in 54% of days, and our average daily profit on the days in which we recorded a profit was ISK 600 million per day and our overall average daily profit was ISK 85 million per day. We made a trading loss in 46% of days and our average daily loss on the days in which we recorded a loss was ISK 500 million per day. Our maximum daily trading loss in 2006 was ISK 3,000 million. In 2005, we made a trading profit in 60% of days, and our average daily profit on the days in which we recorded a profit was ISK 329.3 million per day and our overall average daily profit was ISK 102.9 million per day. We made a trading loss in 40% of days and our average daily loss on the days in which we recorded a loss was ISK 234.5 million per day. Our maximum daily trading loss in 2005 was ISK 1,008 million.

Other simulation-based models, such as Monte Carlo simulation (which use random numbers and probability statistics), are also used to measure the VaR of our security portfolio, which helps to identify all major contributing factors of market risk.

The table below sets out our VaR in absolute amounts and as a percentage of total risk capital at the dates shown:

	At December 31,		
	2006	2005	2004
In ISK millions	5,476	3,602	1,932
As a percentage of total risk capital	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, 2006 decreased from our VaR at December 31, 2005, however, due to higher risk capital.

Liquidity Risk

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. Access to liquid funds is essential to our business. 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 both 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 program 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).

We now have one fundamental liquidity measure focusing on secured liquidity, which 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 support a moderate level of growth of the balance sheet without any access to capital markets. Eligible secured assets under the new secured liquidity calculations consist of deposits, bonds eligible for repo transactions, unused committed revolving credit facilities with maturities over 1 year without material adverse change clauses and backup facilities with maturities over 1 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, 2006 and December 31, 2005.

	Up to 1 month	1-3 months	3-6 months	6-12 months	1-2 years
		(ISK billions—IFRS)			
Secured liquidity at December 31, 2006	856	573	360	121	(136)
Secured liquidity at December 31, 2005	247	18	(82)	(241)	(548)

We maintain a contingency funding plan which specifies an approach to analyze and respond to liquidity events and crises. The plan provides a framework to estimate the likelihood of a liquidity event at Kaupthing and to determine the severity of a liquidity event. 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 optimizing 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 December 31, 2006. Risk is measured by assuming a 1% 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 recognized immediately. Banking interest rate risk refers to exposure on the banking book where pre-tax profit or loss is realized over the lifetime of the exposure.

		At December 31, 2006					
		Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
		(ISK millions—IFRS)					
Currency:							
Icelandic króna	Trading	(712)	33	535	1,916	(254)	1,518
	Banking	(903)	(109)	(313)	(738)	(15,048)	(17,111)
Danish krone	Trading	106	1,120	134	103	(2,745)	(1,282)
	Banking	(10)	(37)	(30)	360	(3,673)	(3,390)
Euro	Trading	(40)	135	416	(529)	1,493	1,475
	Banking	55	50	(123)	518	(692)	(192)
Pounds Sterling	Trading	2	503	(126)	(151)	(2)	226
	Banking	(19)	(87)	(644)	(120)	(853)	(1,723)
United States Dollar	Trading	1	(302)	83	828	2	612
	Banking	(8)	(34)	(86)	(72)	(133)	(333)
Swiss Franc	Trading	51	89	(56)	3	0	87
	Banking	(2)	(40)	(92)	(21)	(37)	(192)
Other	Trading	(762)	196	(44)	735	(15)	110
	Banking	(9)	(68)	(113)	72	(332)	(450)
	Total	(2,250)	1,449	(459)	2,904	(22,289)	(20,645)

At the end of 2006, the total amount of our ISK-denominated inflation-linked assets was ISK 325,845 million and the total amount of our ISK-denominated inflation-linked liabilities was ISK 180,241 million.

In analyzing net interest income, we have calculated net interest income under several different rate scenarios over a twelve-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 January 1, 2007 using a static balance sheet, is estimated to be an ISK 2,746 million decrease in our operating income assuming an instantaneous shift in all yield curves and static foreign exchange rates.

In evaluating interest rate risk, we consider various rate scenarios which take into account changes in the shape of the yield curve, forecasts by groups of economists and projections based on movements in the futures markets, changes in our balance sheet and movements in foreign exchange rates. All of these scenarios indicate that the interest sensitivity to our net interest income is low, as most interest rate risk is in the banking book, where changes in interest rates are reflected proportionately in net interest income, as opposed to the trading book, where interest rate changes are marked-to-market and bear a higher degree of risk for fixed income products with long maturities.

Interest rate risk increased significantly at the end of 2004 following the introduction of fixed-interest mortgage products in the retail market in Iceland. However, our recent issue of covered bonds, rated Aaa by Moody's, is a direct and matching funding source for these loans.

Operational Risk

Operational risk is the risk of direct or indirect loss, or damage to our reputation, resulting from inadequate or failed internal processes or systems, or from human error or external events that affect our image or operations or that can have an adverse effect on our share price. Strategic risk, reputation risk, legal 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 a strong culture surrounding operational risk, based upon internal controls, quality management, leadership skills and 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 risk 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 the Bank's 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 Organization for Standardization. We maintain this security policy to 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.

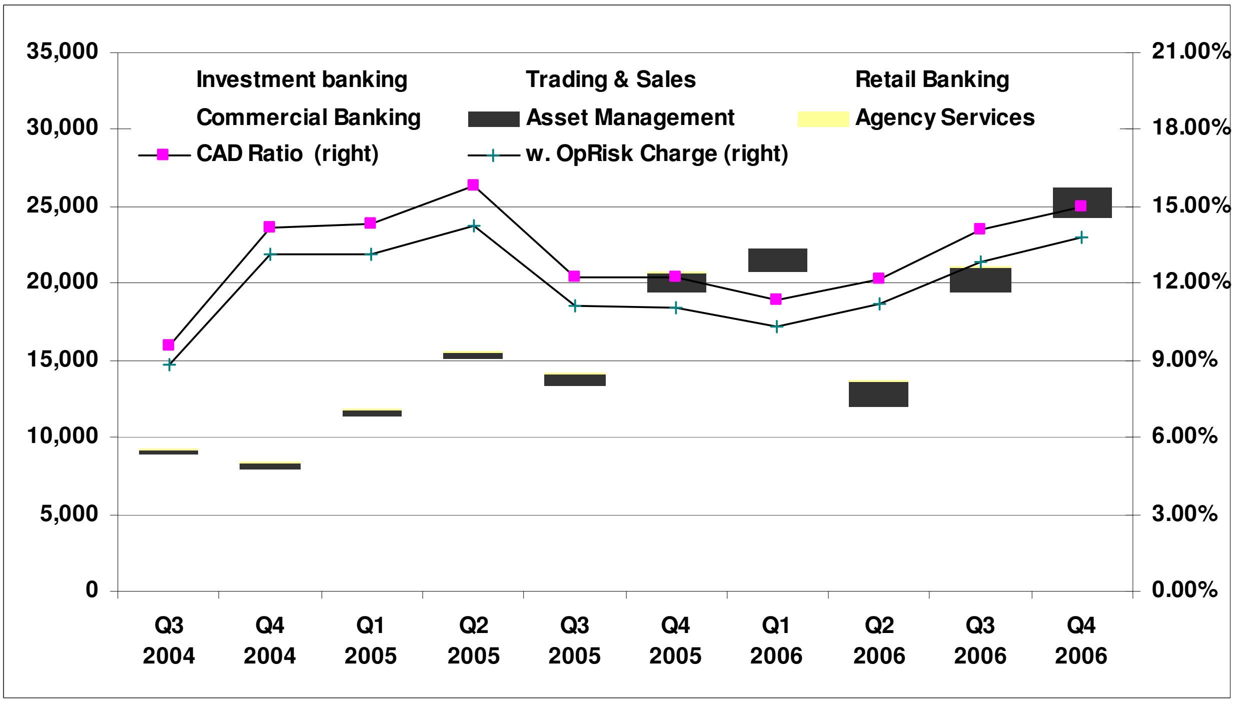
Operational Risk Analysis

We evaluate the capital charge due to operational risk applicable to us according to the Standardized 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 segments: Investment Banking, Trading and Sales, Retail Banking, Corporate Banking, Agency Services and Asset Management, According to the CRD the remaining two business lines; Payment & Settlement and Retail Brokerage, are included in the Trading & Sales business segment.

The total operational risk for all the business lines is currently measured at approximately ISK 26.3 billion using only gross income in the fourth quarter of 2006, and ISK 15.3 billion using a three-year average gross income. If the operational risk is accounted for in the equity ratio, without estimating changes to the credit risk charge due to the new

CRD, the equity ratio would be approximately 13.8% instead of its current value, 15.0% using only gross income in the fourth quarter of 2006, and 14.1% using a three-year average gross income.

The chart below shows operational risk for each business segment, according to the Basel II Standardized 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. Since then, the revised framework, the International Convergence of Capital Measurement and Capital Standards, was published in November 2005. 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 risk 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 Standardized method (which is similar to the Basel I rules), Foundation Internal Ratings-Based ("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 Standardized 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 should have minimal impact on our capital.

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 IRB approach for calculation of Risk Weighted Assets from 2007 by using our own estimation of Probability of Default (PD) 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.

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 quantity 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 the process of implementing of Basel II rules since late 2004. However, the first rating models were introduced into part of our portfolio in December 2003. The focus in 2006 has been on application to the FSA for the IRB method and fulfilment of Basel II requirements. A great deal of work has been expended on data preparation and collection of historical statistical analysis and model construction. We have also focused on aligning our control environment and risk management processes with Basel II requirements.

With regard to operational risk, we intend to initially implement the Standardized Approach, which has already been implemented in part within Kaupthing, and then move towards the AMA.

DESCRIPTION OF BUSINESS

Overview

We are a Northern European bank with shares listed on the OMX Nordic Exchange Iceland hf. ("OMXI") and the Stockholm Stock Exchange ("OMXS"). We operate in ten countries, including all the Nordic countries, the United Kingdom, Luxembourg, Switzerland and the United States and two of the world's main business centers, London and New York. We hold banking licenses in eight countries: Iceland, the United Kingdom, Denmark, Sweden, Finland, the Faroe Islands, Norway and Luxembourg. In the United States, we operate through our subsidiary Kaupthing Securities Inc., a licensed broker-dealer. Iceland, Scandinavia and the United Kingdom currently are our most important markets, generating 47.0%, 24.8% and 19.6%,, respectively, of our operating income in 2006.

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. In addition, we operate a retail banking franchise in Iceland, where we have our headquarters and, to a lesser extent, in Sweden.

We currently are one of the seven largest banks in the Nordic region in terms of market capitalization. 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 (DKK 7,292 million) and the more recent acquisition of UK-based bank Singer & Friedlander Group plc ("Singer & Friedlander") in July of 2005 for ISK 63,708 million. We believe that these acquisitions have improved the quality of our loan portfolio and increased the diversification of our operations. However, FIH, being a wholesale commercial bank, generates lower interest margins than other of our banking operations.

We believe that our results for 2006 reflect our focus on Northern Europe, which we consider to be our home market. Approximately 53.0% of our operating income in 2006 was generated outside Iceland. We expect this percentage to increase in 2007, as we seek to expand our activities in Finland, Luxembourg and the United Kingdom. We currently have senior long-term debt ratings of 'Aa3' from Moody's and 'A' from Fitch. As of December 31, 2006, our total assets were ISK 4,055,396 million, our Tier 1 ratio was 10.5% and our Capital Adequacy Directive ("CAD") ratio was 15.0%. Our net earnings for 2006 were ISK 86,447 million, an increase of 69.3% from 2005, primarily as a result of acquisitions.

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 Sales & Marketing, which support our core business segments.

The following chart illustrates our operations by business segment and location at December 31, 2006:

	Headcount	Banking	Investment Banking	Capital Markets	Treasury	Asset Management and Private Banking
Iceland	1,094					
UK	657					
Sweden	336					
Denmark	288					
Luxembourg	100					
Finland	154					
Norway	64					
Faroe Islands	17					
United States(1)	9					
Total	2,719					

Segments in which we operate under a banking license.
Segments in which we do not operate under a banking license.
Segments in which we do not offer products or services.

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

Our operating subsidiaries are Arion Custody Service, Rekstrarfelag Kaupthings banka hf., and Kaupthing Líftryggingar hf. (formerly Althjóda Iíftryggingarfélagid hf.) ("Kaupthing Líftryggingar hf." or "Kaupthing-Líf") in Iceland, Kaupthing Ltd. and Kaupthing Singer & Friedlander in the United Kingdom, 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. All of our subsidiaries are wholly owned by us except for Arion Custody Service (in which we hold a 99.98% interest) and Norvestia (in which we currently hold a 30.6% economic interest and have 54.6% of the voting rights). See "Listing and General Information— Subsidiaries" for a list of our principal consolidated subsidiaries.

The table below shows the geographical distribution of our operating income for the years ended December 31, 2006 and 2005.

Year ended December 31, 2006	Iceland	Scandinavia	UK	Luxembourg	Other	Total
			(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
Operating income	78,544	41,420	32,785	11,079	3,388	167,216

Year ended December 31, 2005	Iceland	Scandinavia	UK	Luxembourg	Other	Total
			(ISK millions)			
Net interest income	10,224	10,642	7,698	3,715	431	32,710
Net fee and commission income	8,859	3,814	6,364	2,896	495	22,428
Net financial income	6,217	10,218	18,015	1,907	925	37,282
Other income	6,048	1,742	1,986	2	—	9,778
Operating income	31,348	26,416	34,063	8,520	1,851	102,198

History

We were created in our present form by the merger of two of Iceland's foremost banks, Kaupthing Bank hf. and Búnadarbanki Íslands hf. in 2003, both of which enjoyed a strong market position in Iceland. Búnadarbanki dates back to 1929, when the Icelandic parliament passed a law on the founding of Búnadarbanki. At the beginning of 1998, Búnadarbanki became a limited liability company and the government began to sell its holdings in the bank. Búnadarbanki was listed on the Main List of the OMXI in December 1998. The bank was privatized in stages and this process was completed at the beginning of 2003.

Kaupthing hf. was established in Reykjavík in 1982, coinciding with the launch of the free capital markets in Iceland. Kaupthing 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 OMXI and in December 2002, it was listed on the O-list of the OMXS, which has now been replaced by the Nordic List.

Principal Acquisitions

In recent years, in addition to strengthening our position in Iceland through our merger with Búnadarbanki, consistent with our strategy to diversity geographically and expand our home market outside of Iceland, we have expanded organically through the establishment of subsidiaries but have grown more significantly 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% interest in November 2003 and an additional 10% interest in February 2004. The acquisition established a broad growth platform in the important UK SME market. A comprehensive integration and restructuring program is currently in progress, including the integration of Singer & Friedlander's operations with Kaupthing Ltd, through which we have previously conducted operations in the United Kingdom. As a step in this process the two businesses moved into new joint premises during the second half of 2006. We have installed a new chief executive and senior management team and integrated the risk management, reporting and credit assessment procedures of Kaupthing Singer & Friedlander into the group. Kaupthing Singer & Friedlander's target return on equity is 15% for 2007.

- ***FIH***. In September 2004, we acquired the entire share capital of FI-Holding A/S ("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 to the entire group. FIH is the third largest corporate bank in Denmark with 12% market share based on the Monetary Financial Institution statistics published by the Danish Central Bank at year-end 2006 (the "2006 MFI-statistics"). This transaction was an important step towards becoming a full service Nordic investment bank. FIH's return on equity has increased from approximately 10% at the time of acquisition to 13% in 2005 and 16% for 2006.

- ***Búnadarbanki***. 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% of the total share capital in Kaupthing Bank 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 capitalization and a leading provider of corporate banking, invest banking and capital markets services and products in Iceland. Búnadarbanki's return on equity was 18% at the time of merger, compared to the group's return on equity of 42.4% in 2006.

- ***JP Nordiska***. In November 2002 we acquired the remaining share capital of JP Nordiska AB in Sweden (now Kaupthing Bank Sverige AB). The implied value of the company was €80 million as of August 28, 2002, the announcement date of our public bid, at which date we had a 28% stake in the company, acquired in June 2002. This transaction gave us a significant entry into Northern Europe, particularly in Sweden. Following the acquisition we implemented a comprehensive restructuring program to improve productivity and have now fully integrated JP Nordiska AB's operations into the group. We have now transformed JP Nordiska from a loss-making business at the time of our acquisition into a growth business through extensive cross-selling and capitalizing on synergies. Kaupthing Bank Sverige AB is now profitable and was generating a 14% return on equity in 2006 compared to 17% in 2005.

Consistent with our strategy, we intend to continue to expand the Company's operations in our targeted geographic areas through a balanced combination of organic growth and selected acquisitions that fit our strategic vision. Being part of a consolidating industry, we are frequently presented with acquisition opportunities which we consider from time to time. Before we make any acquisition, we will take into account our financial targets as well as other factors, such as strategic fit, profitability, independent funding sources, level of goodwill and any conflicts of interest, and intend to pursue acquisitions that we believe will maximize our financial performance. Although we are not presently considering any material acquisitions, such opportunity could arise at any time. From 2000 to 2006, we experienced an organic operating income compound annual growth rate of approximately 55%. Organic growth has been calculated by taking into account the growth in both Kaupthing's and Búnadarbanki's operating income from the period from 2000 to the date of their merger in 2003 on a pro forma basis and the operating income growth of the combined entity going forward, as well as the growth in JP Nordiska's, Norvestia's and a small Norwegian entity's operating income from the beginning of 2005 when these entities became fully integrated into our operations, but excluding the growth from FIH and Kaupthing Singer & Friedlander for the entire period and from Lýsing hf. after its sale in February 2005.

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 table below shows the development of our ratings by both Moody's and Fitch:

Moody's	Long-term debt	Subordinated debt	Financial strength	Short-term debt
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

Fitch	Long-term debt	Subordinated Debt	Support	Short-term debt
February 2006	A	A-	2	F1
August 2006	A	A-	2	F1

Our short-term debt ratings were last affirmed by Moody's on April 11, 2007, when Moody's downgraded our long-term debt rating to Aa3 following an upgrading of four notches in February, 2007. Our long and short-term debt ratings were last affirmed by Fitch on March 15, 2007. Fitch affirmed the outlook for our ratings as stable, despite the downgrade of Iceland's sovereign rating by Fitch on March 15, 2007, citing good performance in 2006, the geographical diversification of our funding, longer funding maturity profile, diversified profit streams and reduced equity exposure, notwithstanding that significant macro-imbalances remain. On September 12, 2006, Moody's downgraded our bank financial strength rating from C+ to C, concluding its review for possible downgrade initiated in April, 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 1 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 February 26, 2007, Moody's upgraded our long-term debt rating from A1 to Aaa, as a result of the application of its joint default analysis ("JDA"), which takes into account potential sources of external support for banks, and its updated bank financial strength rating methodology. However, on April 4, 2007, Moody's put our rating on review for a possible downgrade after it decided to refine the JDA upon which the February 2007 credit rating upgrade was made. On April 10, 2007, Moody's revised our rating to Aa3 following a review of its JDA methodology. Moody's outlook on all ratings is stable.

Strategy and Strengths

Our goal is to become a leading provider of integrated financial services for SMEs, institutional investors and high net worth individuals in Northern Europe. We intend to achieve this goal by taking the following measures:

- ***Focus on defined clients, products and geographies***. We seek to exploit our market niche as an integrated financial services provider for SMEs, institutional investors and high net worth individuals, which we believe are not adequately served by larger financial institutions. We seek to provide these clients with the full range of products offered by larger financial institutions, with investment banking and corporate banking at the core of our strategy, complemented by capital markets, asset management and private banking, products and businesses which are provided in most of our geographic locations. As a result, we have a well diversified mix of income streams across all of our business areas and an asset base that is diversified across countries and industries. Geographically, our revenues are increasingly spread across jurisdictions. Our focus is on Northern Europe, with an emphasis on the Nordic region. However, we recognize the need to be present in key European financial centers such as the United Kingdom, Luxembourg and Switzerland.

- ***Leverage the diversification of our business through cross-selling***. A key advantage is our ability to provide a wide range of financial services to our clients, including co-investment, financing, advisory and capital markets services, as well as wealth management. We seek to capitalize on the diversification of our business across product lines and, as appropriate, across jurisdictions by cross-selling our full range of products to our existing client base. For our corporate clients, which are primarily SMEs, this includes acting as a partner to help them realize a sustainable growth platform. In addition to providing a full range of banking, investment banking, capital markets, asset management and treasury services, from time to time we also take equity stakes in our corporate clients to more fully align our economic interests with theirs. For our individual clients, this includes offering our full range of banking and brokerage services, as well as "wealth architecture" services to high net worth individuals for the management, protection and enhancement of their financial assets. We believe that these efforts leave us well positioned to continue our strong record of organic growth.

- ***Balance organic growth with well-executed acquisitions***. We believe that our strategic acquisitions of FIH (in 2004) and Singer & Friedlander (in 2005) have contributed to establishing a strong operating platform for organic growth. We intend to continue to expand our operations in our targeted geographic areas through a combination of organic growth, supported by strong cross-selling, and selected acquisitions that fit our strategic vision. With respect to our acquisitions, we seek to achieve a return on equity raised in connection with any acquisition of 15% and a return on equity of 15% for the acquired subsidiary within 18 months of the closing of the acquisition. Long term, we seek to achieve a 15% return on the aggregate purchase price. However, we do not view increased size as an objective in its own right, and we will evaluate both organic growth opportunities and potential acquisitions with a view to maximizing financial performance.

- ***Strong operational discipline.*** Risk management is at the heart of all our operations, as we continually seek to improve the asset quality of our loan portfolio and minimize trading losses. We control risk centrally, with local risk managers reporting from each market area, and maintain a robust credit approval process. This is manifested in strong credit quality and sustained cost discipline, notwithstanding the rapid growth of our business. We have, in part due to more favorable conditions in the credit cycle in the countries in which we operate, been able to decrease the ratio of non-performing loans to loans to customers from 3.7% at December 31, 2003 to 1.0% at December 31, 2006.

Key Financial Objectives

We have set certain key financial objectives for ourselves which we seek to achieve over the long-term.

These include:

- Achieving a 15% return on equity for the group as a whole;
- Maintaining a Tier I capital ratio in excess of 8.0% and a CAD ratio in excess of 11.0%; and
- Maintaining a dividend payout ratio of between 10% and 30%.

While these are long-term goals and we can give no assurances as to whether they will be attained, we believe that these obligations impose an important discipline both on our strategic planning as well as on our day-to-day operations.

Organizational Structure

Kaupthing hf. is the parent company of the group and holds a controlling interest in all of its subsidiaries. The group CEO and senior management create group-wide policy and choose managers for the subsidiaries. Kaupthing and its subsidiaries each have their own management.

The following chart illustrates our corporate structure as of December 31, 2006.

Banking

We are one of the leading lenders in Iceland and FIH is one of the top three corporate banks in Denmark, with a market share of 12% based on the year-end 2006 MFI-statistics. At December 31, 2006, our total loan portfolio was ISK 2,423 billion, of which 34.8% was held in Denmark through FIH. The Banking division provides general banking services to individuals in Iceland as well as services such as advising and assisting in financing to small, medium-sized and large companies, particularly in Iceland, Sweden, the United Kingdom and Denmark, with a focus on the SME segment. We believe that we have a well diversified corporate banking portfolio between markets, sectors and products, and a strong retail foothold in Iceland. The Banking division provides 95% of our loans to customers. At December 31, 2006 approximately 13.8% of our total loan portfolio at that date was denominated in Icelandic króna and 30.8% of the portfolio were loans to Icelandic borrowers. The Banking division generated 35% of our business segments' operating income and 39% of our business segments' profit before cost allocation in 2006, compared to 38% of operating income and 42% of profit before cost allocation for the year ended December 31, 2005. Excluding net financial income from the disposal of Exista shares in 2006, Banking generated 42% of our business segments' operating income and 52% of profit before cost allocation.

The following table sets forth the distribution of our loans to customers by jurisdiction and by sector at December 31, 2006. For further information regarding our loan portfolio, see "Selected Statistical Data".

	At December 31, 2006	
	(ISK millions)	(%)
Iceland	573,238	22.6
Other Scandinavian countries	1,085,119	42.7
United Kingdom	506,626	20.0
Luxembourg	271,469	10.7
Others	102,157	4.0
Total	2,538,609	100.0

	At December 31, 2006	
	(ISK millions)	(%)
Service	505,183	19.9
Industry	616,882	24.3
Real Estate	396,023	15.6
Holding Companies[(1)]	342,712	13.5
Trade	215,782	8.5

	At December 31, 2006	
	(ISK millions)	(%)
Transportation	40,618	1.6
Individuals	421,409	16.6
Total	2,538,609	100.0

(1) Represents investment companies.

The Banking division was previously two separate business segments: Corporate Banking and Retail Banking. The two are now treated as one division. There have been no changes to the activities of these units, and they continue to operate as separate units within the Banking division.

Corporate Banking

Our Corporate Banking unit offers a range of financing services and products to corporate clients, from smaller businesses to larger companies operating in complex international environments. We focus on developing long-term relationships with our customers and gain a thorough understanding of their businesses and the competitive environment in which they operate, in order to tailor our products to their needs.

We are a leading corporate lender in Iceland, with approximately a 25% market share according to internal estimates, and one of the top three corporate banks in Denmark, where we have a 12% market share, based on the 2006 MFI-statistics.

The majority of the unit's assets are currently held within FIH in Denmark, Kaupthing in Iceland and Kaupthing Singer & Friedlander in the United Kingdom, but our aim is to develop and grow our Corporate Banking activities in other countries. Accordingly, Corporate Banking also has operations in our subsidiaries in Luxembourg and Sweden and, having obtained a banking license in Finland at the beginning of 2005, is developing its activities there as well.

Our Corporate Banking unit provides a wide range of services, including:

- Term loans;
- Bridge financing;
- Credit lines, revolvers and other kinds of working capital facilities;
- Structured finance;
- Mezzanine financing;
- Property and asset finance; and
- Investment financing.

In Iceland, Corporate Banking also provides comprehensive cash management and other complementary products and services, such as cash pooling, cash sweeping and comprehensive Internet banking. At December 31, 2006, Corporate Banking employed 281 people.

Corporate Banking is involved in a number of large financing projects, often in collaboration with other financial institutions. Projects completed by Corporate Banking in 2006 include a DKK 210 million acquisition and working capital facility provided in connection to Iceland Telecom's acquisition of Sirius IT Partner, an acquisition facility for the acquisition of Dustin AB in Sweden and a bridge loan facility in connection with the €101 million acquisition of Gibaud by Össur hf. Earlier in 2006, we also provided U.S. $40 million funding in connection with Össur hf.'s U.S. $38 million acquisition of Innovation Sports, Inc. in the United States.

Corporate Banking has also played an important role in the financing of merger and acquisition projects arranged by our Investment Banking division. In 2006 this included the £430 million merger of Mosaic and Rubicon in the United Kingdom and the £29 million underwriting for Nature Way Foods Limited to support its expansion into the United States. We also provided a €350 million commitment to Nycomed as Joint Lead Arranger in connection with its acquisition of Altana Pharma AG.

Corporate Banking has completed a number of property financing projects in 2006 including the £365 million refinancing of Laurel Propco in the United Kingdom, in which Kaupthing acted as the joint lead arranger with RBS; the financing of Propinvest's NOK 670 million acquisition of a portfolio of 17 properties in Germany, Sweden and Norway; PMS Holding's SEK 720 million financing of a 130,000 square meter property portfolio consisting of seven offices and four industrial properties in Sweden, six of which are located in and around Stockholm; and development projects such as the £175 million financing of Candy & Candy's acquisition of Middlesex Hospital in London; as well as the financing, in a club deal with Nationwide Building Society, of a £198 million site purchase and scheme enhancement prior to construction of a prominent mixed-use development project in the City of London, which will be a 72-story building known as the "Shard of Glass" located at London Bridge Station.

Other projects in 2006 include the acquisition of Matka Vekka by Heimsferdir in Finland, in which Kaupthing acted as financial advisor and mandated lead arranger of senior and subordinated debt facilities, the financing of Fram Food's acquisition of a substantial stake in Fjord King in France, and an acquisition facility provided for UK Fisheries, a joint venture undertaken by Samherji and Parlevliet & Van der Plas, in connection with its acquisition and refinancing of J. Marr Ltd. in the United Kingdom.

We are a large provider of corporate loans in Iceland. Our main competitors in corporate banking in Iceland are Glitnir Banki hf. (formerly Íslandsbanki hf.) and Landsbanki Íslands hf., as well as the Icelandic savings banks for small corporate borrowers.

At December 31, 2006 FIH had a market share in corporate loans in Denmark of approximately 12%, based on the 2006 MFI-statistics. It is the third largest participant in this market, behind Danske Bank and Nordea. At December 31, 2006, FIH's loan portfolio was ISK 841,897 million (DKK 66,359 million). The following table sets forth the distribution of FIH's loans to customers by sector at December 31, 2006.

	At December 31, 2006	
	(DKK millions)	(%)
Holding companies	4,019	6.1
Industry	20,746	31.3
Real estate	19,804	29.8
Services	15,404	23.2
Trade	4,899	7.4
Transportation	1,486	2.2
Total	66,359	100.0

At December 31, 2006, FIH Erhvervsbank had a CAD ratio of 9.7% and a Tier 1 ratio of 8.1%, compared to a CAD ratio of 10.2% and a Tier 1 ratio of 8.4% at December 31, 2005.

Retail Banking

We have retail banking operations in two countries, Iceland and Sweden, with the majority of activity taking place in Iceland. The Retail Banking unit is responsible for traditional retail banking activities, with a focus on individual customers and smaller businesses. Larger businesses, such as medium-sized and large companies, are customers of the Corporate Banking unit. Retail Banking offers comprehensive banking services such as loans, deposits, credit card issuing, cash management and clearing. As of December 31, 2006, we operated a network of 33 branches and service points in Iceland, including 13 branches in the Reykjavík area. We estimate our market share in Iceland in retail banking for private customers to be approximately 25% at year-end 2006, which is an increase of over 2% from the beginning of 2005. At December 31, 2006, our Retail Banking unit employed 431 people.

Our retail banking activities in Iceland have undergone considerable changes, transforming from a traditional lending institution into a modern bank which provides comprehensive financial solutions for its customers. We stress continuous product development and innovation. Services at our branches have been continually updated during the last ten years, with the latest new product offering, mortgages (as further discussed below), transforming the role of branches. The role played by financial advisers has grown significantly, while traditional clearing has become less important as automation and self service on the internet are replacing traditional teller services to some degree. We also have increased our range of services by selling and advising on personal insurance and pension products. The objective of our Retail Banking unit is to advise our customers on a set of comprehensive financial services which are tailored to their personal requirements.

Mortgage lending

The majority of housing in Iceland has traditionally been financed through the state-sponsored Housing Financing Fund ("HFF"), which finances its mortgage lending through the issuance of securities, known as Housing Financing Fund bonds. The HFF bonds form the benchmark curve in the largely inflation-indexed bond market in Iceland. We have traditionally been the largest underwriter and trader of HFF bonds, but had participated little in the direct financing of private homes.

The outstanding principal amount under mortgages in Iceland are linked to the Icelandic consumer price index and adjusted for inflation on a monthly basis. Consequently, the amount of the principal and interest payments under these mortgages and the size of our Icelandic inflation-linked mortgage loan portfolio may increase or decrease depending on the development of inflation in Iceland. Increases or decreases in our net interest income resulting from the impact of fluctuations in inflation on our Icelandic inflation-linked mortgage portfolio are reflected in our Treasury division, as opposed to our Banking division.

In 2004, we entered the Icelandic mortgage market and became the first Icelandic bank to substantially lower interest rates on mortgage loans, from 5.30% to 4.40%, undercutting the rates offered by the HFF. As a result, we currently have an approximately 14.6% share of the Icelandic mortgage lending market, according to our research department's calculations, based on information provided from the Central Bank of Iceland and HFF, while the state sponsored HFF's current market share is approximately 50%. Following our entry, competition in the retail banking sector has increased sharply in Iceland maintaining pressure on rates. The maximum amount of individual mortgage loans also increased. We are able to grant larger mortgage loans than the HFF and, compared to HFF's maximum loan-to-value ratio of 80%, our lower loan-to-value ratio, which was an average of 58.7% for our Icelandic mortgage loans at December 31, 2006, makes us less vulnerable to downturns in the housing market.

Because the HFF is a quasi-sovereign entity, it has access to lower cost funding than we do, which it can pass on to its customers in lower-rate mortgages. As a result, to the extent we try to match or undercut the mortgage rates of the HFF, our margins on our mortgage loans in Iceland will be adversely affected. However, we believe that mortgage lending is an important component of our retail banking operation, as it allows us to build long-term relationships with our customers, to whom we can cross-sell other products and services. We have established a covered bond program, rated Aaa by Moody's, to finance the mortgage portfolio and to reduce the risk of fluctuation in inflation.

We had a total of ISK 91.4 billion of mortgage loans to customers in Iceland outstanding at December 31, 2005 and ISK 117.5 billion at December 31, 2006. ISK 8.2 billion or 31.5% of this increase was due to increases in the Icelandic consumer price index. At December 31, 2006, non-performing Icelandic mortgage loans represented 0.29% of our total Icelandic mortgage loan portfolio.

Insurance

The Retail Banking unit co-operates closely with our subsidiary, Kaupthing-Líf, in offering a range of personal insurance products in Iceland. Kaupthing-Líf offers a broad range of life insurance and health insurance products in Iceland. Kaupthing-Líf only operates in personal insurance. To meet increasing competition, we have established a co-operation arrangement with a leading non-life insurance company, Vátryggingafélag Íslands ("The Icelandic Insurance Company"), and now offer a collaborative service named Vöxtur ("Growth"), under which mutual customers receive improved terms by purchasing certain products from Kaupthing-Líf and Vátryggingafélag Íslands. Members also receive discounts at the leasing company Lýsing Ltd. and the security company, Öryggismiðstöðin ("Security Center of Iceland").

On-line banking

We believe we offer one of the leading on-line banking services in Iceland, which we have operated since 1997. These services provide a detailed overview of a customer's personal finances and allow users to perform a range of tasks over the internet, such as paying most types of bills. The number of customers using our on-line banking services is steadily increasing, and at the end of 2005 more than 56,000 customers were active users.

Investment Banking

Our Investment Banking division is an integrated financial service provider to the Northern European and the UK SME market, operating in most of our international offices and is centrally managed from our London office.

Investment Banking generated 29.5% of our business segments' operating income and 45.1% of our business segments' profit before cost allocation for 2006, compared to 23.3% of operating income and 35.3% of profit before cost allocation for the year ended December 31, 2005. Excluding capital gains from our disposal of Exista shares in the year ended December 31, 2006, Investment Banking generated 16.4% of our business segments' operating income and 26.1% of profit before cost allocation. Although we recorded capital gains from the disposal of our 24.7% stake in VÍS, these gains were not included in Investment Banking or any of our other business segments because VÍS was one of our associated companies.

Investment Banking maintains a significant presence in the northern European investment banking market, and provides various services to SME clients through its four main product areas:

- M&A advisory;
- Capital Markets advisory;

- acquisition and leveraged finance; and
- principal investments.

We have investment banking operations in the United Kingdom, Iceland, Norway, Sweden, Denmark, Finland and the Faroe Islands. At December 31, 2006, our Investment Banking division employed 94 people.

A key characteristic of the Investment Banking division is its unique ability to combine the group's financing capabilities with its collaborative, cross-border product offerings. This arrangement enables us to provide clients with comprehensive financing solutions coupled with an extensive, locally focused advisory business.

In 2006, our Investment Banking division underwent further development. Our London office expanded with the addition of new Equity Capital Markets and Real Estate advisory teams. Our Investment Banking operations in Denmark and Norway have also been strengthened by M&A advisory teams. Both of these teams are already generating results above our expectations. Within the Norwegian team's first six months of operation, five equity placements had been executed, in addition to advising Apax on its acquisition of Telenor Satellite Services for $400 million and Schibsted on the sale of its television assets for approximately NOK 2.5 billion.

M&A advisory

Investment Banking's M&A advisory team structures and executes transactions involving all aspects of mergers, acquisitions, divestitures, spin-offs, leveraged buy-outs and recapitalizations. The total value of all transactions in which our Investment Banking division provided M&A advisory services during 2006 was approximately ISK 420 billion.

Historically, a large part of our M&A advisory services has been provided to Icelandic clients undertaking domestic or cross-border acquisitions. This has changed in recent years with a significant and increasing proportion of transactions originating outside Iceland and involving non-Icelandic clients.

Significant M&A transactions for which we served as adviser in 2006, included Mosaic Fashions' £320 million acquisition of Rubicon Retail, Missouri Bidco's successful £817 million management buyout acquisition of low-price retailer Matalan, Apax Partners France's U.S. $400 million acquisition of Telenor Satellite Services, Exista's acquisition of a large majority stake in VÍS eignarhaldsfélag ehf. for ISK 53.2 billion, FL Group's €480 million acquisition of Refresco (a pan-European private label soft drink manufacturer, in which we are also an investor), the £98 million management buyout of Costcutter (in which we are also an investor), a private investor's trade sale of Dustin AB in Sweden, an investor group's acquisition of a 9.5% stake in Ventelo, Schibsted's sale of its stakes in media companies TV2 and TV4 and A /S Atlantis Vest's NOK 2.2 billion mandatory offer for Rieber & Son.

Capital Markets advisory

Our Capital Markets advisory team advises on and executes IPOs, rights issues, convertible debentures and private placements. In 2006, our most significant capital markets transaction has been our role as the sole manager in connection with the sale of a 10.1% stake in Exista and the listing of the company's shares on the OMXI in September 2006. Exista's market capitalization was ISK 233 billion at the time of the IPO.

Acquisition and leveraged finance

Our acquisition and leveraged finance team supplies asset and commercial-backed debt, often in conjunction with Principal Investments or our M&A advisory team. The team's primary work includes structuring, arranging and underwriting senior, mezzanine and equity-related products. Our acquisition and leveraged finance team targets mid-market transactions and has an underwriting capacity of ISK 115 billion.

In 2006, our acquisition and leveraged finance team had a total of £1.8 billion in underwriting, a 110% increase from 2005. Our acquisition and leveraged finance portfolio amounted to ISK 458.3 billion at December 31, 2006 and represented approximately 18% of our total loan portfolio. Our acquisition and leveraged finance portfolio is relatively diversified. At December 31, 2006, other than manufacturing at 21.5%, and retail at 21.4%, no one industry segment accounted for more than 10% of the total portfolio. Based on the origination of the loan, our largest geographic exposures of the portfolio at December 31, 2006 were 29% in the United Kingdom and 17% in Scandinavia.

Recent transactions in 2006 include £508 million senior and subordinated credit facilities in connection with the management buyout of Matalan, €430 million senior and subordinated credit facilities used to fund FL Group's acquisition of Refreso (in which we are an investor), £430 million senior and subordinated credit facilities used to fund Mosaic Fashions' acquisition of Rubicon Retail Group, £360 million senior, mezzanine and acquisition credit facilities for R20 Ltd.'s acquisition of Laurel Pubs (in which we are an investor), €125 million senior and subordinated credit facilities used to finance Gilde's acquisition of the pet food producer Arovit, £55 million senior and subordinated credit facilities used in the management buyout of Costcutter and the financing of A/S Atlantis Vest's NOK 2,200 million mandatory offer for Rieber & Son.

Principal Investments

Our Principal Investments team invests equity in listed and unlisted companies with a strong cash flow and high growth potential. Investments are often related to advisory work or debt financing where clients have shown interest in having us co-invest with them. Our objective is to take minority stakes along with our clients in connection with management buy-outs, mergers, restructurings or acquisitions, so that we share the risk with our clients and further establish long-term relationships. Our principal investments activities form an important element in our integrated offering of investment banking products and provide a unique solution in the Nordic and United Kingdom mid-cap market environment.

Net financial income from the Investment Banking division is principally due to the results of our principal investment portfolio. Net financial income from the Investment Banking division was ISK42,984 million in 2006 representing 87.3% of operating income from the Investment Banking division.

In 2006 we made principal investments in Refresco, Costcutter and Ventelo, while we sold our remaining interests in Baugur Group hf. and Bakkavör Group.

At December 31, 2006, our total holdings in listed companies represented 4.0% of total assets and unlisted companies represented approximately 1.1% of total assets, compared to 5.0% and 1.6%, respectively, at December 31, 2005. The table below sets out our largest principal unlisted investments at December 31, 2006. These five holdings represented approximately 34% of the total value of our unlisted share portfolio at December 31, 2006.

Company	Country	Sector	Shareholding
Síminn hf.	Iceland	Telecommunications	27%
Somerfield	United Kingdom	Retail	6%
Ferskur Holding 1 B.V.	Holland	Consumer retail	26%
Spron Stofnbréf	Iceland	Financial institutions	5%
LD Equity IK/S	Denmark	Investment company	23%

Capital Markets

The activities of the Capital Markets division are broadly divided into three parts: Institutional Sales, Trading and Research. Institutional Sales executes orders for institutional clients and places equity and bond offerings, with superior knowledge of the Nordic and United Kingdom markets based on close collaboration with Research. Trading has two main functions: Proprietary Trading and Client Facilitation. Proprietary Trading trades for the Bank's own account in bonds and equities on the international securities markets as well as managing a portfolio of diversified international positions. Client Facilitation makes markets in a number of bonds and equities in our main regions in order to enable clients to conduct large and complex transactions efficiently. At December 31, 2006, our Capital Markets division employed 226 people.

Capital Markets posted a gross profit of ISK 7,467 million in 2006, compared with ISK 16,540 million in 2005, representing a decrease of ISK 9,073 million or 54.9%. Net fee and commission income amounted to ISK 7,396 million in 2006, representing an increase of ISK 2,666 million or 56.4% from ISK 4,730 million in 2005. Net financial income in 2006, which included our proprietary trading activities, decreased ISK 8,095 million or 50.6% from ISK 16,008 million in 2005 to ISK 7,913 million. This decrease is due to a decline in trading gains (both realized and unrealized) as a result of the negative performance of the Nordic equity markets in 2006 compared to 2005.

We have a substantial market share of debt and equity trading in the Nordic region, with a 3.7% market share in terms of turnover in equities trading on the Nordic stock exchanges, making us the seventh largest participant in the market for 2006. In Stockholm and Helsinki, the two largest Nordic equities markets, our market share for 2006 was 3.3% and 5.5%, respectively. On the OMXI we were the largest participant in the market both in equities and bonds trading with a 27.5% and 28.2% market share, respectively, for 2006.

New Capital Markets activities were established at the Bank's two largest subsidiaries in 2006. Kaupthing Singer & Friedlander Capital Markets in the United Kingdom commenced trading in September 2006 and FIH Capital Markets in Denmark began their operations in August 2006.

We have recently integrated our Capital Markets activities within equities even further, creating a sector-based research platform focusing across all the Nordic countries and the United Kingdom. This product is also marketed in other territories, including the United States. The new position of Global Head of Equities was established to oversee these efforts and steer the positive development of these activities.

Institutional Sales

Institutional Sales offers a full-service product, with local know-how and expertise coupled with the strengths inherent in a larger group. Our client base consists primarily of financial institutions such as mutual funds, pension funds, investment companies and insurance companies, as well as hedge funds and, in certain markets, high net-worth individuals. Our strategy is to capitalize on our high quality, cross-border Nordic research team to build our market position in the Nordic region.

In cooperation with our Investment Banking division, Institutional Sales participates in share buy-back programs, IPOs and block trades as well as new issues of equities and bonds and other corporate-finance related transactions.

We are a member of the London Stock Exchange, all the Nordic Exchanges and the Tallinn Stock Exchange through our subsidiary in Helsinki. Through our subsidiary Kaupthing Securities Inc., we are also a member of the National Association of Securities Dealers (NASD) in the United States, enabling us to trade directly on NASDAQ. In addition, we are a listing agent authorized by the Luxembourg Stock Exchange to list securities, such as bonds, shares, and other instruments.

Research

Our Research department, an independent unit, has approximately 81 research analysts located in the United Kingdom, Sweden, Finland, Norway, Denmark and Iceland engaging in equity analysis and fixed income research as well as macroeconomic and strategy research. The equity research analysts are based locally and provide in-depth research, including sector and company reports, overall recommendations and strategic guidance.

Trading

Trading consists of Proprietary Trading and Client Facilitation in many instruments and markets.

Proprietary Trading

Proprietary Trading involves managing positions for our own account. Some are strategic, medium-term positions, while others are short-term positions aimed at taking advantage of price discrepancies or spreads in different markets, within a clearly defined risk framework based on various factors such as liquidity, legal framework and our risk policy.

In October 2006, as part of our ordinary course proprietary trading, we also increased our investment in Storebrand, a Norwegian insurance company, to a 7.8% interest in Storebrand's share capital. Our holding in Storebrand was valued at approximately €165 million at the time we increased our investment in the company, which is the largest amount we hold on our balance sheet in any one entity within our Proprietary Trading portfolio.

The Proprietary Trading units within the group have a complimentary focus on different instruments and markets. The different units also vary in terms of strategy and timeframe. Each unit is awarded a risk budget based upon past performance and its current business case.

On January 1, 2007, Proprietary Trading was moved into our Treasury division in order to further separate securities brokerage for clients and proprietary trading for our own account. From January 1, 2007, the results of Proprietary Trading will be included with those of Treasury.

Client Facilitation

In Client Facilitation, market making involves our committing to buy and sell certain classes of securities in accordance with pre-determined rules, to ensure a liquid market in those securities. Our market making activities include trading with numerous companies and institutions, especially in Iceland. We are an active market maker in both equities and bonds, particularly for Icelandic issuers. Our most extensive market making is currently in benchmark bonds for the National Debt Management Agency of Iceland and the Icelandic Housing Financing Fund.

Treasury

Our Treasury Division is responsible for group funding, including management of liquidity and foreign exchange exposure as well as providing exchange, interest rate and other risk management products to third parties and inter-bank trading. In addition, increases or decreases in our net interest income resulting from the impact of fluctuations in inflation on our Icelandic inflation-linked mortgage portfolio are reflected in our Treasury division. Our Treasury division is divided into Inter-Bank Trading, Foreign Exchange (FX) and Derivatives Sales, Derivatives Trading and Funding. Our Treasury division's largest operations are in Iceland, but there also are operations in Luxembourg, Denmark, the United Kingdom, Sweden and Finland. In 2006, new local heads of Treasury were recruited in the United Kingdom and Sweden. At December 31, 2006 our Treasury division employ 74 people.

The Treasury division generated 13.7% of our operating income and 19.6% of our profit before cost allocation in 2006 compared to 8.6% of our operating income and 11.7% of our gross profit in 2005. This increase is largely due to rising inflation in Iceland.

Inter-Bank Trading

The Inter-Bank Trading desk manages our currency exposure and interest rate exposure, including all of our trading with other banks on the Icelandic and international money and currency markets. We are one of three banks in Iceland to act as a market maker on the Icelandic currency and money markets and are a leading player in these markets.

Derivatives Trading

The Derivatives Trading desk is responsible for trading all derivatives. We are a leading market maker for equity, interest rate and foreign exchange derivatives related to the Icelandic króna. A large and growing part of our business is in the area of structured products, where we offer customized solutions to a wide variety of investors.

FX and Derivatives Sales

FX and Derivatives Sales offer companies and institutional investors foreign exchange services and a range of interest rate and currency derivatives for position taking and risk management. We believe our greatest strength is being innovative in customizing these services to our clients' needs. We help our clients manage their risks and offer a comprehensive range of derivative products. We also offer a variety of structured products to institutional investors and private banking clients. In addition, our Treasury division provides monitoring and advisory services on currency and interest rate risk management for its customers.

Funding and Group Treasury

The Group Treasury is the central coordination unit responsible for the overall treasury strategy of the group. Operations in the Group Treasury division is comprised of three teams: a funding team focusing on our funding activities; a financial institution team responsible for building relationships with other financial institutions, investors, and credit analysts; and an asset liability management team focusing on liquidity and capital management for the group in cooperation with risk management and finance. This team also handles our securitization projects, liquidity investments and internal funding to subsidiaries. The Group Treasury division also maintains an ongoing dialogue with rating agencies.

Funding

The Treasury division is responsible for the overall funding of the group and internally between business units, divisions and subsidiaries. Funding is based on deposits and borrowings in the Icelandic and international markets, which includes the issuance of commercial paper, bonds and syndicated loans. Funding operations have increased steadily in line with our growth and international expansion, and with the acquisition of FIH, wholesale funding of the group further increased in size. With the acquisition of Singer & Friedlander, we diversified our sources of funding and approximately doubled our customer deposit base. FIH funds itself independently and it will continue to issue notes under its own operating European medium-term note program in close co-ordination with headquarters in Iceland.

Our growing financial strength and improved credit rating from Moody's and a recent credit rating from Fitch in November 2005 have reinforced our position on the international finance markets and resulted in improved access to international financing and lower cost of capital. By decreasing our total cost of capital, we can offer our customers better financing terms, thus strengthening our competitive position.

We have recently accessed a variety of capital markets worldwide for our funding needs. As a result of these and prior capital markets issuances, we believe we have sufficient funds to cover our current maturing financial liabilities through 2007. See "Management's Discussion and Analysis of Financial Condition and Results of Operations — Liquidity, Capital and Funding".

Asset Management and Private Banking

Our Asset Management and Private Banking division manages financial assets for institutional, corporate and private clients. Asset Management is organized into five units: Alternative Investments, Mutual Fund Management, Asset Management for Institutional Investors, Services for Institutional Investors and Consultants. Private Banking consists of two units: Customer Relations and Portfolio Management.

Asset Management and Private Banking services are offered in eight different countries: the Faroe Islands, Norway, Finland, Luxembourg, Sweden, Switzerland, the United Kingdom and Iceland. At December 31, 2006 we had ISK 1,403 billion of assets under management. Our asset and fund management activities are primarily based in the United Kingdom and Iceland, and our private banking activities are concentrated in Iceland, Luxembourg, the United Kingdom and Sweden. At December 31, 2006 Asset Management and Private Banking employ 380 people.

Assets under management

In 2006, we experienced growth in all markets in which we operate our Asset Management and Private Banking services. There was an increase in assets under management and in custody during 2006 as well as in the number of clients.

During the year ended December 31, 2006, we experienced increases in assets under management from institutional investors, customers in private banking and private pension savings. Assets under management increased 30.7% from ISK 1,074 billion at year end 2005 to ISK 1,403 billion at year end 2006.

Since 2004, we have experienced increases in assets under management from institutional investors, customers in private banking and private pension savings. Assets under management increased 112.0% from ISK 508 billion in 2004 to ISK 1,074 billion at the end of 2005 and a further 30.7% to ISK 1,403 billion at the end of 2006. Assets in custody increased 56.8% from ISK 910 billion at the end of 2004 to ISK 1,426 billion at the end of 2005 and a further 36.9% to ISK 1,953 billion at the end of 2006.

At December 31, 2006, 30% of our assets under management were for clients in the United Kingdom, 44% in Iceland, 13% in Finland and 8% in Sweden, compared to 36% in the United Kingdom, 36% in Iceland, 14% in Finland and 8% in Sweden at December 31, 2005. At December 31, 2006, 35% of our assets under management were attributable to private banking, 33% to institutional investors, 23% to mutual funds and 9% to alternative investments, compared to 39% to private banking, 35% to institutional investors, 22% to mutual funds, 1% to alternative investments and 3% to others at December 31, 2005.

Asset management

The Asset Management division offers a comprehensive range of mutual funds, as well as alternative investment vehicles. In addition, it offers customized asset allocation strategies and managed accounts, designed to meet the diverse needs of corporate, institutional and private clients. Special emphasis is placed on asset and liability management of pension funds and professional services in identifying client needs, structuring portfolios accordingly, managing risk and monitoring processes.

The Asset Management division employs its market experience and proprietary tools in asset allocation, security selection, portfolio risk management and related services. In an international, competitive environment, our focus is on developing competent staff, efficient IT processes and highly effective teamwork between our international asset managers, researchers and analysts. This emphasis is aimed at obtaining the best results for clients and ensuring that they are offered comparable services and return on investments.

The Asset Management division has signed mandates with a wide range of institutional clients, located mainly in Finland, Sweden and Iceland. These include mandates for local bonds, equities and balanced mandates, and also a wide range of global and specialized mandates. At the end of 2006, assets under management by the Asset Management division amounted to ISK 912 billion.

Private Banking

Private Banking provides its individual clients with a range of investments and portfolios to match their requirements. Account managers focus on customer relations with the aim of maintaining high quality service and financial advice to clients. Account managers also play a role in managing their clients' assets through co-operation with the Asset Management team. Each client has its own dedicated account manager who is selected to match the individual client's needs and service expectations. The services we offer range from the custody of shares or deposits to complex and tailor-made investments, as well as certain tax and legal services for high net worth individuals. By identifying the current and future financial requirements of clients, our Private Banking team is able to offer guidance and advice on how best to achieve those goals. We offer private banking services from our offices in Iceland, Sweden, Luxembourg, Switzerland, the Faroe Islands, Finland and the United Kingdom. The offices co-operate closely in the development of new products and services to match the demanding and changing requirements of the clientele. At the end of 2006, assets under management by the Private Banking division amounted to ISK 491 billion.

Other Divisions

Our business support operations consist of ancillary departments such as Sales and Marketing, Legal, Risk Management, Finance and Accounting, IT and Research. At December 31, 2006 a total of 1,234 people, or 45% of our total personnel, worked in management and ancillary departments, of which the majority were based in Reykjavík. These are principally cost centers although they generate net fee and commission income through Arion Custody Services hf. and other income through our real estate companies. See "Management's Discussion and Analysis of Financial Condition and Results of Operations".

Competition

We operate in a number of markets, competing with various financial institutions providing banking services, corporate finance, brokerage and asset management services. In Iceland, our principal competitors are the two other local banks, Glitnir Banki and Landsbanki, and we also compete with the 22 savings banks for retail banking. In the Nordic region, we mainly compete with the Nordic investment banks, such as Carnegie and ABN AMRO (formerly known as Alfred Berg), and the corporate and capital market divisions of the larger Nordic banks, such as Danske Bank and Jyske Bank in Denmark, SEB and Handelsbanken in Sweden, Sampo and OKO in Finland and Nordea across the Nordic countries where it operates. In the United Kingdom, we face competition from a range of international banks and investment institutions, such as HBOS, RBS, HSBC and Barclays. In Luxembourg, we compete with other international banks operating there, such as Nordic and German banks. However, we believe that our focus on providing fully integrated corporate and investment banking services to medium sized companies distinguishes us from our competitors in most of the markets in which we operate.

Principal Subsidiaries

Kaupthing Singer & Friedlander

We acquired Singer & Friedlander in July 2005 at a time when our operations in the United Kingdom consisted solely of our investment banking business through Kaupthing Ltd. The acquisition formed part of our strategy to expand our product offering in the United Kingdom in order to be able to provide SMEs and wealthy individuals with an integrated and a wide range of banking services. Singer & Friedlander specialized in banking, asset finance and fund management, which, combined with their focus on SMEs and high net worth individuals, made them a good fit with Kaupthing's operations in the United Kingdom. The banking business primarily focused on lending to private clients and their corporate vehicles, and constituted more than half of Singer & Friedlander's revenues in 2004 (including corporate banking, private banking and property finance). At December 31, 2004, the Investment Management business had approximately £3.8 billion (ISK 448 billion) of funds under management, of which £2.9 billion (ISK 319 billion) was owned by private clients.

Following our acquisition of Singer & Friedlander, we have been integrating and restructuring the operations with those of Kaupthing Ltd. in order to achieve:

- more efficient use of capital;
- reduced bureaucracy with shorter communication lines and faster decision making;
- increased transparency in our operations and fewer inter-company transactions;
- increased focus on business and income generation and on cost efficiency; and
- increased economies of scale in support functions.

To further add to our product offering we have established a capital markets division at Kaupthing Singer & Friedlander and expanded our treasury division. This expansion of our product offerings in the United Kingdom is expected to bring revenue synergies, for example, from cross-selling products.

Today, Kaupthing Singer & Friedlander provides corporate banking services to SMEs as well as a full range of investment banking services, including treasury, asset finance and capital markets services, in addition to a wide range of wealth management services to high net worth individuals. Kaupthing Singer & Friedlander is headquartered in central London, with three branch offices in Glasgow, Manchester and Dorking, and seven satellite sales offices in Leicester, York, Truro, Kent, Cheltenham, Leeds and Birmingham. International private banking services are offered from an office in the Isle of Man. For the year ended December 31, 2006, Kaupthing Singer and Friedlander had operating income of £134 million compared to £97 million for 2005. Kaupthing Singer & Friedlander employs 679 people as at December 31, 2006.

Kaupthing Singer & Friedlander operates in six principal business areas:

- *Banking*. Kaupthing Singer & Friedlander's banking operations are split into five principal areas and had £2.0 billion of interest earning assets at March 31, 2007. Corporate Banking, which includes corporate banking, structured and leverage finance, bill discounting and trade finance, represented 28% of Kaupthing Singer & Friedlander's banking operations' total loans to customers at March 31, 2007. Property Lending includes lending for investment properties, residential development, commercial development, student accommodation and overseas properties and represented 25% of Kaupthing Singer Friedlander's banking operations' total loans at March 31, 2007. Private Banking includes domestic mortgages, international mortgages, yacht mortgages, aircraft lending, art lending, stock lending and unsecured lending, and represented 26% of Kaupthing Singer & Friedlander's banking operations' total loans at March 31, 2007. Commodity Trade Finance provides transactional finance to metal trades, and represented 10% of Kaupthing Singer & Friedlander's banking operations' total loans at March 31, 2007.

- *Asset Finance*. Asset finance covers three broad product categories and had £559.7 million of loans to customers outstanding at December 31, 2006. Corporate Asset Finance provides lending and hire-purchase facilities to SMEs, partnerships, sole traders and individuals, in addition to wholesale financing to smaller finance companies for onward lending into similar markets. It represented 56% of Asset Finance's total loans at December 31, 2006. Health Care provides operating lease facilities to NHS Trusts and Foundation Trusts and represented 30% of Asset Finance's total loans at December 31, 2006. Premium Finance, provides short-term lending for the payment of insurance policy premiums. It represented 14% of Asset Finance's total loans at December 31, 2006.

- *Asset Management*. Kaupthing Singer & Friedlander operates its investment management activities through Singer & Friedlander Investment Management Ltd., one of the United Kingdom's longest established investment managers. Singer & Friedlander Investment Management Ltd. is a discretionary and non-discretionary investment manager which focuses on long-only UK equity investments, and manages funds for private clients, institutional clients, charities and pension funds in the United Kingdom and internationally. Our services for private clients and professional intermediaries include a range of discretionary portfolio management services, tax efficient investment services, investment funds, multi-asset portfolios, pension management, and portfolios of funds. Our charities services include the management of segregated portfolios to meet the individual investment needs of each charity, as well as pooled funds to enable participation in a full range of asset classes where segregated investments are not appropriate. Singer & Friedlander Investment Management Ltd. had £3.1 billion of funds under management at March 31, 2007. Investment management will not be re-branded along with the other companies within the UK Group.

- *Investment Banking*. Kaupthing Singer & Friedlander's investment banking operations provide a mix of advisory services to SMEs and high net worth individuals, including M&A advisory services and advisory services in connection with acquisitions and leveraged finance, debt syndication and principal investments. Acquisition & Leveraged Finance provides both senior and a range of subordinated debt instruments to support both M&A driven transactions and refinancings/recapitalisations. We have had a long tradition of co-investing with our clients to support the growth of entrepreneurial businesses. Kaupthing Singer & Friedlander's Principal Investments invests alongside our clients, and is able to underwrite the full debt and equity requirement of any transaction with an enterprise valuation ranging from €30 million to €500 million, while participating in larger deals through partnership arrangements.

- *Capital Markets*. We recently established Kaupthing Singer & Friedlander Capital Markets Limited ("KSFCM") to offer a range of brokerage services to mid and small capital companies in the United Kingdom. We have agreed to conduct all of our U.K. brokerage activities through KSFCM. The business comprises Corporate Finance (including tax-efficient products, corporate finance and pre-IPO funding), Corporate Broking (including IPOs, secondary offerings and investor relations services), Sales (both to institutions and hedge funds) and Equity Research and Trading (including sales trading, market making and proprietary trading) and Contracts for Differences. The business commenced trading in September 2006. Kaupthing Singer & Friedlander owns approximately 67% of the issued ordinary share capital of KSFCM and 100% of its voting shares, with the remaining shares ("KSFCM Employee Shares") held by certain senior professionals (the "Management Shareholders") recruited to increase KSFCM's presence in the United Kingdom broking market and by an employee benefit trust for future grants to KSFCM's senior employees. The Management Shareholders are employed by Kaupthing Singer & Friedlander. The KSFCM Employee Shares are subject to certain vesting and forfeiture provisions customary for employee share incentive schemes. The KSFCM Employee Shares may be called by us and the Management Shareholders may put their KSFCM Employee Shares to us during the first quarter of 2010 or upon a change of control of Kaupthing Bank at a price based upon the division's post tax profits, subject to certain maximum amounts.

- *Treasury*. Treasury is a recently created business division mandated with the responsibility to manage Kaupthing Singer & Friedlander's balance sheet as well as offering Kaupthing Singer & Friedlander's customers the widest access to financing, interest rate and foreign exchange financial markets solutions. While operating in a low market risk environment, Treasury is progressively expanding its trading activities to cover short-term securities, money market and interest rate derivative products. Our Treasury Solutions team is focused on providing hedging solutions on interest rate and foreign exchange risks to our customers. The marked development in Treasury activities is highlighted through the recent completion of a number of landmark deals on behalf of a few key customer accounts.

FIH

We acquired FIH in July 2004 as part of our strategy to grow our corporate banking capabilities and expand our presence in the Nordic region. The acquisition doubled the size of our balance sheet at the time and gave us a leading position in the Danish corporate banking sector. Since the acquisition, we have focused on realizing revenue synergies through cross-border transactions and cross-selling products.

FIH is one of the leading commercial banks in Denmark specializing in corporate lending, providing Danish companies with a broad range of financing services. In 2006, it had approximately 4,000 clients, including approximately 60% of Denmark's 200 largest industrial companies and a number of municipalities, giving it a corporate banking market share of approximately 12%, based on the MFI-statistics. For the year ended December 31, 2006, FIH had operating income of DKK 1,695 million and it had total assets of DKK 96 billion and employed 286 people at that date. Net profit at FIH has grown from DKK 567 million in 2003 to DKK 935 million in 2006. Our return on equity from our investment in FIH has grown from 9.7% in 2003 to 13.1% in 2005, and our return on equity for 2006 was 15%.

FIH operates in five principal areas:

- *Corporate Banking*, which provides a wide range of banking services to approximately 250 of the largest companies in Denmark, as well as to other large companies in Sweden and Norway. At December 31, 2006, Corporate Banking had total loans to customers outstanding of DKK 66,359 million, up from DKK 57,683 million at December 31, 2005.

- *Structured Finance*, which provides financing solutions for various types of financings in the Nordic region, including equity-related financings, such as acquisition finance to private equity funds, management buy-outs, management buy-ins, refinancings and delisting transactions. The financing solutions are tailored to meet the requirements of the individual transaction, with pricing to match the risk and terms of the financing. FIH Structured Finance cooperates with leading private equity funds in the Nordic region. In 2006, FIH Structured Finance arranged 12 transactions and co-arranged 5 further transactions. At December 31, 2006, FIH Structured Finance's loan portfolio totalled DKK 12,471 billion.

- *Investment Banking*, which provides advisory services as well as funding in connection with mergers and acquisitions. During 2006, advisory services for a number of successful transactions were provided, including the provision of financial advice to the owner of Sterling Airways in connection with the acquisition of the passenger airline activities of Maersk Air and in connection with the subsequent sale of Sterling to the Icelandic FL Group. Financial advice was also provided to Swedish telecommunications company Ventelo in connection with its acquisition of the Danish company Webpartner. In early 2006, FIH hired a number of senior investment bankers with the intention of increasing its investment banking activities going forward.

- *Private Equity*, which makes minority equity investments in unlisted companies. FIH Private Equity invests both directly as a passive investor in large Danish companies as well as indirectly in large Danish and other Scandinavian companies through private equity funds. Direct investments are made with FIH Private Equity in the role of co-investor, typically in collaboration with private equity funds.

- *Capital Markets*, which was established in 2006 and provides sales, trading and brokerage services for Nordic equities. The establishment of FIH Capital Markets is expected to strengthen other business segments' positions. For example, Investment Banking will now be able to provide advice in connection with initial public offerings and other capital market issuances.

Property, Plant and Equipment

As of December 31, 2006, we owned about 50 properties, which include office buildings and other buildings for our own operational uses, as well as properties we have acquired as a result of foreclosures on the collateral of defaulted loans, that are held for a relatively short period of time. The properties we use in our operations are generally held free of encumbrances. Most of our properties are attributable to branches and offices of the group through which we maintain our customer relationships and administer our operations. Kaupthing also rents or leases 15 buildings for offices and branches. We are not aware of any environmental issues that could affect our real estate assets.

The table below identifies our most significant real property holdings, at December 31, 2006. Other properties for our own operational use do not exceed ISK 100 million (book value).

Address	Type of Property	Use	Area
Borgartún 19, Reykjavík, Iceland	Building	Corporate HQ	42,937 ft^2
Borgartún 17, Reykjavík, Iceland	Building (in progress)	Corporate HQ	71,505 ft^2
Hamraborg 9, Kópavogur, Iceland	Building	Offices/Branch	15,123 ft^2
Austurvegur 8-10, Selfoss, Iceland	Building	Offices/Branch	9,569 ft^2
21 New Street, London, UK	Building	Kaupthing Singer & Friedlander	60,000 ft^2
31 Park Square Leeds, London, UK	Building	Investment Management HQ	3,121 ft^2

Intellectual Property Rights

We have no significant intellectual property rights.

Litigation

Although companies within the group are involved in a number of claims and disputes in the ordinary course of business, we are not involved in any claims or disputes which we believe could have a material adverse effect on our business, financial condition or results of operations taken as a whole.

Employees

We believe that one of our principal strengths is the quality and dedication of our employees and their shared sense of teamwork. We strive to maintain a work environment that fosters high ethical standards, mutual respect, honesty, professionalism, creativity and teamwork. At December 31, 2006, we had a total of 2,719 employees, compared to 2,368 employees at December 31, 2005, 1,606 at December 31, 2004 and 1,271 at December 31, 2003.

The table below sets forth the number of our employees, by division and location at December 31, 2006.

Location	Banking	Investment Banking	Capital Markets	Treasury	Asset Mgmnt & Private Banking	Mangmnt & Other	Total
Iceland	484	12	21	33	63	481	1,094
United Kingdom	95	38	45	12	88	378	656
Sweden	22	14	58	7	118	118	337
Denmark	89	14	38	6	—	141	288
Luxembourg	11	—	12	12	76	43	154
Finland	7	7	17	4	26	39	100
Norway	—	6	28	—	5	25	64
Faroe Islands	3	3	1	—	3	7	17
United States	—	—	6	—	—	3	9
Switzerland	—	—	—	—	—	—	—
Total	712	94	226	74	379	1,234	2,719

Employee shareholding

A large number of Kaupthing's employees are shareholders in Kaupthing. At December 31, 2006, our employees and board members held an aggregate of approximately 7.2% of our outstanding share capital, of which our CEO and the members of our board of directors held an aggregate of 1.9% of our shares. Our CEO and Chairman of our board of directors had options in aggregate exercisable in 2007 and 2008 for a further 0.4% of our shares.

In 2006, our board of directors decided to grant 564 employees in the group stock options to buy our shares on the basis of our stock option scheme. Stock option holders are entitled to exercise one third of their total stock option every year for three years between January 20 and February 20, with the first period in which options can be exercised from January 20, 2008 to February 20, 2008. The options have an exercise price of ISK 840 per share. The board of directors granted options on a total of 636,000 shares.

In November 2005, our board of directors decided to grant all employees in the group stock options to buy our shares on the basis of our stock option scheme. Stock option holders are entitled to exercise one third of their total stock option every year for three years between January 20 and February 25, with the first period in which options can be exercised from January 20, 2007 to February 25, 2007. The options have an exercise price of ISK 600 per share. The board of directors granted options on a total of 3.9 million shares.

At the same time as the stock options were granted to all employees, the board of directors also granted to 455 employees stock options to buy a total of 21.7 million shares over a three-year period, during which one-third of the stock options may be exercised each year. The period in which options can be exercised is also from January 20 to February 25 of each year, with the first exercise period in 2010. The options have an exercise price of ISK 830 per share during the first exercise period, ISK 872 per share during the 2011 exercise period and ISK 916 per share during the 2012 exercise period. The exercise of the options may be postponed each year until the last exercise date, but the strike price will increase to the price indicated by the relevant exercise date.

These options were approved at our shareholders' annual general meeting on March 27, 2004. In March 2004 the chairman of our board of directors and our CEO were granted call options on 812,000 Shares annually for five years at a strike price equal to the market price on the date of the first offering.

Prior to the merger of Kaupthing with Búnadarbanki in 2003, both banks had entered into stock option plans with their respective employees, which provided for stock option grants to all employees as well as to senior management only. As a result of the merger, shareholders of Búnadarbanki received our shares in exchange for their interests in Búnadarbanki, and their stock options on Búnadarbanki shares were similarly converted into stock options on our shares.

The following table includes all outstanding options at December 31, 2006, both as a result of the options granted in November 2005 and as a result of options granted by us and Búnadarbanki prior to the merger. The terms and conditions of the grants are as follows, and all options are settled by physical delivery of shares. On May 3, 2006, our CEO and the chairman of our board of directors each exercised a call option on 1,624,000 of our shares at a price of ISK 303 per share in accordance with a stock option plan approved at our shareholders' annual general meeting on March 27, 2004.

Grant date / employees entitled:	Number of shares (in thousands)	Vesting conditions:	Contractual life of options	Exercise price
October 2002	180	Five years of service. Exercisable 2007.	5 years	120
March 2004	3,248	Four years of service. Exercisable 2007-2008	4 years	303
December 2002	887	Six years of service. One third exercisable each year 2007-2008.	6 years	65.22
November 16, 2005	3,593	Three years of service. One third exercisable each year 2007-2009.	3 years	600
November 16, 2005	7,815	Three years of service. One third exercisable each year 2007-2009.	3 years	600 /630 /660
December, 2006	636	Three years of service. One third exercisable each year 2008-2010.	3 years	840
December, 2006	21,675	Five years of service. One third exercisable each year 2010-2012.	5 years	830 /872 /916
Total share options outstanding	38,034			

The number and weighted average exercise prices of share options is as follows:

	2006		2005	
	Weighted average exercise price	**Number of option contracts**	**Weighted average exercise price**	**Number of option contracts**
Outstanding at the beginning of the year....	494	20,811	209	12,630
Forfeited during the year	521	(1,447)	112	(376)
Exercised during the year	278	(3,641)	108	(4,085)
Granted during the year	871	22,311	641	12,642
Outstanding at the end of the year	735	38,034	494	20,811

The options outstanding at December 31, 2006 had an exercise price in the range of ISK 65.22 to ISK 916 per share, a weighted average exercise price of ISK 735 and a weighted average contractual life of 3.9 years. See note 53 "Executive employment terms" and note 99 "Stock options" to our audited consolidated financial statements as at and for the years ended December 31, 2006 and 2005 included elsewhere in this Offering Circular for more information regarding our stock option plan.

In 2003, Kaupthing had granted its employees and board members put options on its shares. On December 30, 2005, the employees and board members of Kaupthing waived the put options on our shares they had purchased, and as a result, they no longer have any exercisable put options.

In February, 2005 the Board of Directors of FIH Erhvervsbank granted certain of its key employees FIH Erhvervsbank stock options which may be exercised in 2008, 2009 and 2010. The options may only be exercised for 30 days after the financial statements of FIH Erhvervsbank have been published. The stock options may be exercised in the form of shares in FIH Erhvervsbank or may be settled in cash. The exercise price of these shares is DKK 362 in 2008, DKK 388 in 2009 and DKK 416 in 2010. During 2006, stock options worth DKK 29.5 million were entered as salaries and related expenses, DKK 5 million were redeemed as a result of employee departures and the remaining DKK 28.4 million was booked as liabilities on our balance sheet.

A supplementary plan was launched in 2006 for employees subsequently hired by FIH Erhvervsbank. Options under this plan are allocated over a three-year period in the form of three tranches of a nominal value of DKK 1.6 million. Options are allocated individually for each employee in 2006, 2007 and 2008. Options may be exercised in the following way: tranche 1 may be converted during the years 2010 to 2012, tranche 2 during the years 2011 to 2012 and tranche 3 in the year 2012. During the years in question, execution may be effected only during a 60-day period after the publishing of the company's interim report. The conversion price is revalued by 7% a year and amounts to DKK550, DKK589 and DKK631, respectively, for the years 2010, 2011 and 2012. At the time of conversion, shares are provided or settled in cash, as determined by the company. Shares are measured on the date of conversion based on established multiples for price/earnings and price/book value based on the company's current earnings and capital positions.

REGULATION

We operate in ten countries. In eight of these countries, Iceland, the United Kingdom, Denmark, Sweden, Finland, the Faroe Islands, Norway and Luxembourg, we operate under full banking licenses. In other countries, such as the United States (where Kaupthing Securities Inc. is licensed as a broker-dealer and is subject to the rules and regulations of the NASD and the SEC), we operate under other licenses. Our Swiss subsidiary Kaupthing Asset Management S.A., due to its activities, is a self-regulated entity which is not required to be licensed by the Swiss authorities. We believe we have all the necessary licences to carry out our business in all the jurisdictions in which we operate.

The following is a brief summary of certain laws and regulations which govern the financial markets in Iceland, Denmark and the United Kingdom. This summary is not exhaustive, as other laws or regulations not specifically mentioned here also may be applicable. All references to laws apply to those laws as amended. In addition, our subsidiaries are subject to laws and regulations governing their activities and the financial markets of their respective jurisdictions.

These laws and regulations require us, among other things, to disclose certain information likely to have a impact on our share price, as well as to provide certain notifications regarding employee stock option plans and certain payments to our senior management and members of our board of directors. In addition, we are required to provide to OMXI notification of changes (or plans to make changes) in our financing and we are required to submit to the FME regulatory reports and other documents, such as annual reports and interim financial statements, reports on significant exposures, auditor's reports, reports on related party loans and biannual notifications of non-financial services and ancillary activities.

European Union Regulations

Iceland has been a member of the European Economic Area (EEA) since 1994. Through the EEA agreement, the framework for supervision and regulation of banking and financial services in Iceland has been, and continues to be, heavily influenced by EU regulations, most of which are required to be implemented in EEA member states through national Institutions.

Primary Icelandic Regulation

The principal law governing the establishment, supervision and regulation of financial institutions in Iceland is Act No. 161/2002 on Financial Institutions.

The Icelandic Financial Supervisory Authority ("FME") supervises the activities of financial institutions in Iceland, as well as the activities of Icelandic financial institutions abroad, unless otherwise provided for by law or international agreements to which Iceland is a party. It also supervises the subsidiaries, affiliated companies and funds of financial institutions, to the extent that their activities are subject to supervision. The FME may require the production of information or documentation from subsidiaries, affiliates or other parties regarded as having a close connection with a financial institution that it views as necessary in fulfilling its duties. The supervision of the FME is applied on a consolidated basis where the parent company is a financial institution or a holding company in the financial sector.

Supervisory authorities in other EEA member states are authorized to conduct checks of the Icelandic branches of financial institutions established in their countries upon prior notification to the FME. Foreign subsidiaries in Iceland are supervised by the financial supervisory authorities in each home state.

The FME has the authority to grant operating licenses pursuant to the Act. A financial institution may commence operations upon receiving an operating license from the FME and must operate as a limited liability company.

A financial institution must have an auditing department to handle internal auditing. This department must be part of a financial institution's organizational structure and one aspect of its internal surveillance system. A financial institution must also have a secure risk management system for all its activities. Rules on ownership of its own shares and large exposures can be found in Chapter IV, Title C of the Act.

The Act specifies standards of suitability for the members of the board of directors and the managing directors of a financial institution, as well as of the suitability of personnel involved in securities transactions. The Act also specifies that parties who propose to acquire a qualifying holding in a financial institution must seek the approval of the FME in advance.

The board of directors of a financial institution, its managing directors, auditors, personnel and any persons undertaking tasks on its behalf are bound by an obligation of confidentiality concerning any information of which they may become aware in the course of their duties concerning business dealings or private concerns of the financial institution's customers. This obligation continues even after termination of employment. Anyone receiving this type of information will be bound by an obligation of confidentiality in the same manner as described above.

Other Relevant Laws and Regulations

Act. No. 89/2006, amending Act. No. 2/1995, on Limited Liability Companies.

On October 1, 2006 Act No. 89/2006, amending Act No. 2/1995 on Limited Liability Companies, entered into force. According to the Act the board of directors of a company of a certain size must approve the company's remuneration policy concerning wages and other payments to the chief executive officer and other senior officers of the company as well as its directors. The remuneration policy should disclose the basic items concerning the remuneration of officers and directors and the company's policy concerning agreements with officers and directors. It should also disclose whether and under what circumstances and within what framework it is permissible to pay or compensate officers and directors in addition to basic wages, including in the form of the following:

- shares;
- performance-linked payments;
- stock options, purchase and sale rights, priority purchase rights and other kinds of payments which are linked to shares in the company or development of the price of shares in the company;
- loan agreements (with special credit terms), provided that these are permitted under current laws;
- pension agreements; and
- retirement agreements.

Other than point three above, which is mandatory, the remuneration policy is guidance for the company's board of directors (unless it has been determined in the company's Articles of Association that the policy shall be binding). A company's board of directors is required to publish the remuneration policy in connection with the company's annual general meeting.

The remuneration policy shall be approved at a company's annual general meeting with or without amendments. At the annual general meetings, a company's board of directors must also give an account of the remuneration of the company's officers and directors and the estimated costs on account stock options and explain the implementation of a previously approved remuneration policy.

Any deviations from the remuneration policy by the company's board of directors are to be recorded individually in the board minutes.

Act. No. 87/1998 on Official Supervision of Financial Operations

Under this Act, we are obliged to grant the FME access to all of our accounts, minutes, documents and other material in our possession regarding our activities to whatever extent the FME considers necessary. The FME may perform spot checks or request information in such a manner and as often as it deems necessary. If an inspection carried out by the FME reveals that parties subject to supervision are not in compliance with the law or other regulations governing their activities, the FME must insist on corrective action being taken within a certain time limit, and if the party subject to supervision does not provide requested information or obey requests for corrective action within a certain time limit, the FME may impose daily fines. The FME can also impose liquidated damages on a party subject to supervision in violation of its orders. In the event of a serious infringement, where the party subject to supervision has in the opinion of the FME committed a criminal offence, the FME is obliged to notify the State Police Commissioner (*Ríkislögreglustjóri*).

Act No. 34/1998 on Activities of Stock Exchanges and Regulated OTC Markets

Activities of stock exchanges and regulated over-the-counter markets operating in Iceland are subject to Act No. 34/1998. According to the Act, the Minister of Commerce (*vidskiptarádherra*) will grant an operating license pursuant to the act upon receiving the opinion of the FME.

The Act further contains provisions on membership of the stock exchange. The term "members of a stock exchange" (*kauphallaraðilar*) refers to parties having the right to submit bids and accept offers for securities on a stock exchange. The stock exchange's board of directors sets detailed rules on exchange membership. Written applications for membership are sent to the stock exchange board and it examines whether or not an applicant fulfils the requirements for membership. Issuers of securities which have been accepted for public listing on a stock exchange must immediately disclose publicly any material information which could have an effect on the price of the securities or which must be made public in accordance with the rules set by the stock exchange.

The FME supervises the activities of stock exchanges and regulated over-the-counter markets to ensure they comply with the provisions of the Act and the rules and regulations issued in accordance with it.

As described below, further rules regarding securities transactions are contained in Act No. 33/2003.

Act No. 33/2003 on Securities Transactions

Financial institutions are required to maintain impartiality towards their customers and should always conduct their work in such a manner that customers receive equal treatment with regard to information, prices and other terms of business.

A financial institution must keep its customers' capital and financial instruments segregated from its own assets. A financial institution that is authorized to hold financial instruments owned by its customers may hold these in a special nominee account and accept payment on behalf of its customers from individual issuers of financial instruments, provided the financial institution has explained to the customer the legal effects of this arrangement and the customer has given its approval. The financial institution must keep a record of the holdings of each individual customer. In the event that a financial institution is put into receivership, granted a debt moratorium, is wound up or comparable measures are taken, the customer can withdraw its financial instruments from the nominee account, provided there is no dispute as to the holding.

A financial institution must demonstrate that conflicts of interest in securities transactions are prevented by a clear separation of individual areas of operation. It must also adopt rules to implement certain requirements of the Act regarding trading for its own account (for the company, management, employees, owners of qualified holdings and financially related parties), which must be approved by the FME. The financial institution must inform the FME of any violation of the provisions of its rules.

The Act stipulates the rules which govern public offers of securities and listing of securities. Public offers of securities and listing of securities must be subject to the prior publication of a prospectus in accordance with the provisions of the Act.

The Act also stipulates the rules which apply to changes in the ownership of substantial holdings in a company which has had one or more classes of its shares listed on a regulated securities market. According to the Act, a substantial holding is 5% of voting rights or the nominal value of share capital, and multiples thereof of up to 90%. When a party acquires a substantial holding, or increases a holding to exceed or reduces a holding to fall below this limit, the party must immediately give notice to both the relevant registered securities market and the company.

The provisions of the Act which govern takeover bids apply to a takeover of a company which has had one or more classes of its shares listed on a regulated securities market in Iceland. The Act stipulates, among other things, the circumstances under which it is compulsory for a person to make a takeover bid to other shareholders, when the takeover bid must be made and the terms of such a bid, the obligations of the board of directors of the target company in such circumstances and the available sanctions when the provisions of the Act are not met. Generally, the Act requires a person, or persons acting in concert, to complete a takeover once 40% of the voting rights of a company have been acquired by such person. A Takeover Panel was established in 2005 by the OMXI, the FME, Icelandic Financial Services Association (formerly the Bankers' and Securities Dealers' Association of Iceland) (*Samtök banka og verdbréfafyrirtækja*), the Association of Small Investors (*Samtök fjárfesta*), the Icelandic Chamber of Commerce (*Viðskiptarád Íslands*), the Ministry of Commerce and others. The Panel does however not have a legal status.

Rules regarding the treatment of insider information and insider trading are also covered in the Act, including a primary insider's obligation to consult with the relevant compliance officer as to whether inside information is available within a company before trading in the company's securities. A primary insider is also obliged to notify the relevant compliance officer when a trade has taken place. The same applies to parties financially connected to primary insiders. The meanings of the phrases "insider information", "primary insider", "temporary insider" and "other insider" are defined in the Act, which also covers rules on market abuse.

The Act stipulates the rules which govern squeeze-outs and sell-outs. The Act stipulates, among other things, that if the offering party has acquired more than 90% of the share capital of the company, the offering party and the board of the company may jointly agree to acquire the shares of the remaining shareholders. The remaining shareholders must be paid the same compensation offered in the takeover bid, subject to the squeeze-out taking place within three months from the expiry of the takeover bid. Furthermore, if the offering party has acquired more than 90% of the outstanding share capital of the company, the remaining shareholders may demand that the offering party acquire their remaining shares at the same price offered in the takeover bid.

The FME supervises the application of the Act and the rules and regulations thereunder.

The most recent amendments to the Act have implemented relevant directives (and sub-directives or regulations) of the European Union regarding securities markets, for example, the Prospectus Directive, the Market Abuse Directive and the Take Over Directive.

Act No. 87/1992 on Foreign Exchange

According to Act No. 87/1992 on Foreign Exchange, foreign exchange transactions relating to the import and export of goods and services are unrestricted, as are capital movements and foreign exchange transactions relating to them, unless otherwise stipulated in statutes. The Central Bank of Iceland (*Sedlabanki Íslands*) may decide in consultation with the Ministry of Commerce to restrict or suspend for a period of up to six months any or all of the following categories of capital movements if short-term capital movements to and from Iceland create, in the Central Bank's opinion, exchange-rate and monetary instability:

- sale or purchase of short-term securities;
- deposits in and withdrawals from accounts with depositary institutions;
- the issue, sale or purchase of unit shares in mutual funds which invest in short-term securities;
- lending or borrowing for a period of less than one year not relating to international trade in goods and services;
- the import and export of short-term securities and of domestic and foreign currency; and
- other short-term capital movements analogous to those stated above.

The Minister of Commerce may issue regulations imposing restrictions upon foreign exchange transactions relating to any or all of the following categories of capital movements, provided that the provisions of the Act on Investment by Non-residents in Business Enterprises and the Act on the Rights of Ownership and Use of Real Estate are considered, as well as international agreements to which Iceland is party:

- direct investment by non-residents in business operations in Iceland;
- sale or purchase by non-residents of shares in domestic enterprises; and
- real estate purchases in Iceland by non-residents.

Such restrictions may not, however, extend to the transfer from Iceland of capital realized by a non-resident on the sale of a share in an enterprise, liquidation of an enterprise or sale of real estate in Iceland.

Agreement on the Use of Guarantees for the Debts of Individuals

In 2001, the Icelandic Financial Services Association , on behalf of its members, the Association of Icelandic Savings Banks (*Samband íslenskra sparisjóða*) on behalf of the savings banks, the Consumers' Association of Iceland (*Neytendasamtökin*) and the Minister of Commerce, on behalf of the Icelandic authorities, entered into an agreement on the use of guarantees for the debts of individuals. The objective of the agreement was to reduce the relative importance of guarantees issued by individuals and to base the granting of credit on the ability of the borrower to pay and on the collateral provided.

The agreement applies to all guarantees of debt and when an individual grants permission to mortgage his or her property as collateral for the debts of another individual. According to the agreement, a financial institution must assess the ability of the borrower to pay when a guarantee of debt or a mortgage is given as collateral for a financial obligation, unless the guarantor specifically requests in writing that this not be done. Such a request may only be made in respect of amounts of less than ISK 1 million. A financial institution must ensure that a guarantor has access to the results of a credit rating before providing a guarantee, provided that the borrower has agreed to this.

We are a member of the Icelandic Financial Services Association.

Act No. 98/1999 on Deposit Guarantees and Investor-Compensation Scheme

According to Act No. 98/1999 on Deposit Guarantees and Investor Compensation Scheme, commercial banks, savings banks, companies providing investment services, and other parties engaging in securities trading pursuant to law and established in Iceland, must be members of the Depositors' and Investors' Guarantee Fund (*Tryggingarsjódur innstædueigenda og fjárfesta*). A member company must make payments into the fund as specified in the Act.

The fund will pay a customer of a member company, which in the opinion of the FME is unable to make payment of the amount of deposits, securities or cash, the amount of the customer's deposit from the deposit department (*Innistædudeild*) and the value of their securities and cash in connection with securities trading from the securities department (*Verdbréfadeild*). The obligation of the fund to pay also applies if the estate of a member company is subject to bankruptcy proceedings in accordance with the Act on Financial Institutions and the Act on Securities Trading. In the event that payment is made from the fund, the claims made on the relevant member company or insolvent estate will be assumed by the fund.

Act No. 36/2001 on the Central Bank of Iceland

The Central Bank of Iceland is an independent institution, owned by the Icelandic state but under separate administration. Its governance is subject to the provisions of Act No. 36/2001. The main objective of the Central Bank of Iceland is to promote price stability. By agreement with the Prime Minister, the Central Bank can declare a numerical target for inflation. The Governor of the Central Bank of Iceland currently has declared an aim to keep inflation, which is calculated as the annual increase in the 12-month Consumer Price Index (*vísitala neysluverds*), as close as possible to 2.5%. The Central Bank promotes the implementation of the economic policy of the government as long as it does not regard it to be inconsistent with its main objective of promoting price stability. For the purpose of pursuing its monetary policy objectives, the Central Bank of Iceland is authorized to buy and sell government bonds and other securities on an organized securities market or in direct transactions with credit institutions. The Central Bank also undertake other tasks, such as maintaining external reserves and promoting an efficient and secure financial system, including domestic and international payment systems.

Act No. 34/1991 on Investment by Non-residents in Business Enterprises

According to this Act, non-residents are permitted to invest in business enterprises in Iceland within the limitations stipulated by the act or in special legislation and upon the fulfilment of other conditions and the acquisition of licenses required by law.

According to the Act, investment in Icelandic enterprises by foreign states, local authorities or other foreign authorities involved in enterprises is prohibited except with special permission from the Minister of Commerce. Non-residents may acquire title to real estate in Iceland for direct use in their enterprise in accordance with the provisions of the Act governing the ownership and utilization rights of real estate.

Act No 64/2006 on Measures to Counteract Money Laundering and Terrorist Financing

On June 2, 2006, the Icelandic parliament, Althingi, passed a new Act on Measures to Counteract Money Laundering and Terrorist Financing. This new act transposes into Icelandic law the provisions of Directive 2005/60/EC of the European Parliament and the Council of October 26, 2005, on the prevention of the use of the financial system for purposes of money laundering and terrorist financing.

According to this Act each entity subject to its provisions (including us) must adopt a series of strict rules regarding business relationships, in particular upon opening an account or depositing assets, such as requiring a customer to prove his identity by presenting personal identification documents, preserving photocopies of the personal identification documents and carefully examining any transactions suspected of being traceable to money laundering activity and notifying the State Police Commissioner of any transaction considered to be so related. These entities must also operate a system of internal controls designed to prevent use of their operations for crime-related transactions. The FME is responsible for supervising the activities of the persons subject to this Act. The Act implements the provisions of the Third EU Money Laundering Directive.

We have adopted new internal rules which reflect the directive and, to a greater extent, the intergovernmental Financial Action Task Force (FATF) recommendations on money laundering and terrorist financing, as a result of which we believe we are in full compliance with the requirements of the Third EU Money Laundering Directive and Act No. 64/2006.

Act No. 60/1994 on Insurance Activities

Our subsidiary Kaupthing Líftryggingar hf., an insurance company, is subject to Act No. 60/1994 on Insurance Activities and Act No. 30/2004 on Insurance Contracts.

The FME supervises parties carrying out activities subject to the provisions of the act and the branches of foreign insurance companies which have obtained operating licences in Iceland.

Life insurance activities may not be carried out together with non-life insurance activities. A company may, however, offer life re-insurance products along with other insurance offerings. A life insurance company may also be granted an operating licence for sickness and accident insurance.

An operating licence for life insurance and health insurance, as well as related accident and sickness insurance, is limited to specific insurance classes or sub-classes including:

- life insurance on death and survival without investment risk;
- couples' and children's insurance;
- life insurance on death and survival with investment risk;
- private health insurance;
- other life insurance; and
- re-insurance of life and health insurance.

Before concluding an insurance contract with an individual, an insurance company, or the party concluding the contract on its behalf, must provide the policyholder with certain specified information.

Act No. 30/2003 on Undertakings for Collective Investment in Transferable Securities ("UCITS") and Investment Funds

According to this Act, only UCITS and investment funds may accept funds from members of the public for collective investment in financial instruments and other assets on the basis of spreading risk, in accordance with a prior-stated investment policy. Administration and safekeeping of the financial instruments of UCITS shall be entrusted to depositaries which have been approved by the FME.

The FME ensures that the activities of UCITS, investment funds, management companies and depositaries comply with the act and regulations issued under its authority. The FME also grants accreditation to UCITS. Activities may commence only after accreditation has been received from the FME. A foreign UCITS established and accredited in another member state of EEA may market its unit shares in Iceland two months after the foreign UCITS has notified the FME of its proposed activity.

Management companies which operate UCITS or investment funds may, according to the Act, establish funds for collective investment which do not accept funds from members of the public (institutional investor funds) and issue unit shares or shares. The management companies must notify the FME of the establishment of institutional investment funds but the funds are not subject to the surveillance of the FME.

Other Relevant Legislation in Iceland

Other relevant legislation includes Act No. 121/1994 on Consumer Credit, Act No. 77/2000 on The Protection of Privacy as regards the Processing of Personal Data and Act No. 38/2001 on Price and Indexation. The list is not exhaustive as other rules and regulations may apply to our operations.

Proposed Regulation

New legislation was adopted in June 2007 by the Icelandic parliament (Althingi) in order to fulfill Iceland's obligation to implement the Markets in Financial Instruments Directive ("MIFID") and the Transparency Directive ("TD"). The new legislation will come into force November 1, 2007 and comprises: Act 108/2007 on Securities Transactions, which replaces Act 33/2003; Act 110/2007 on Security Exchanges, which replaces Act no: 34/1998 and Act 111/2007 which amends previous legislation on financial institutions, including Act 161/2002 on Financial Institutions and Act 87/1998 on official supervision of Financial Operations.

The Markets in Financial Instruments Directive

MIFID sets out more detailed requirements governing the organization and conduct of investment firms and how regulated markets and multilateral trading facilities ("MFTs") operate. They improve investor protection by increasing transparency, requiring investment firms to assess whether clients have the capacity to make a trade or not. Firms are also placed under a duty to ensure that all reasonable steps are taken to get the best possible result for their client (known as the best execution).

Under MIFID any advice that involves a personal recommendation and operating a MTF will become a licensed activity and thus may be passported on a stand-alone basis. The main purpose of Act 111/2007 is to include these activities in the list of activities which are required to be licensed and subject them to the supervision of financial authorities.

Compared to the previous rules, MIFID widens the range of core investment services that firms may passport by describing more clearly how firms must allocate responsibility between their home state and the host state for passported branches. MIFID also clarifies some of the more general jurisdictional uncertainties that arose under the previous rules.

The Transparency Directive

Harmonisation

The TD has increased the information required to be published by issuers whose securities are admitted to trading on a regulated market in the European Union. Following implementation of the TD, issuers will be required to disclose annual and half-yearly financial reports, and in the case of issuers of shares, interim financial statements.

Disclosure of Major Shareholders' Transactions

Current Icelandic regulations require the notification of any change in voting rights or interest in share capital if such change causes the percentage voting or ownership interest to reach, exceed or fall below certain thresholds. In Iceland the percentages triggering such notification requirements (known as the flagging obligations) are 5% and multiples thereof up to 90%. Once Act 108/2007 on Securities Transactions comes into force, only a change in voting rights will trigger the notification requirements.

MANAGEMENT

Directors

The board of directors is composed of nine members, to be elected at our annual general meeting for a term of one year. Nine substitute members are also elected. The board of directors appoints our chief executive officer and determines the terms of his employment. Our management structure is in accordance with Icelandic Law No. 2/1995 on Limited Liability Companies, our articles of association, and the working procedures adopted for our board of directors.

The board of directors has established working procedures setting out further details of the performance of its duties. In particular, these procedures address the authorization of the board to make decisions on individual dealings, the eligibility of board members, the handling of information on individual customers by the board and the participation of board members in the boards of directors of subsidiaries and associated companies.

The business address of each member of the board of directors is Borgartún 19, 105 Reykjavik, Iceland. Set forth below are details about the members of our board of directors:

Sigurdur Einarsson—Chairman of the Board of Directors. Mr Einarsson, born in 1960, graduated as an economist from the University of Copenhagen in 1987. Between 1982 and 1988 he worked in the International Department and the Financial Department of Danske Bank. In 1988, he became Deputy Director of the International Division at Íslandsbanki hf. (now Glitnir banki hf.) and later served as Deputy Director of Treasury until he became Executive Director of Capital Markets at Íslandsbanki hf. in 1994. He joined us in 1994 and was our chief executive officer ("CEO") from 1997 to 2003. Mr Einarsson was appointed Executive Chairman in May 2003.

Mr Einarsson is chairman of the board of Arion Custody Services hf., Kaupthing Bank Luxembourg S.A., Kaupthing Bank Oyj, Kaupthing Föroyjar Virdisbrefamæklarafelag, Kaupthing Ltd., Kaupthing New York Inc., Kaupthing Norge AS, Kaupthing ASA, Kaupthing Securities Inc., Kaupthing Singer & Friedlander Group plc, Kaupthing Singer & Friedlander Ltd., Kaupthing Singer & Friedlander Capital Markets Ltd., Singer & Friedlander Investment Management Ltd., and a member of the board of directors of FIH Erhvervsbank A/S, Norvestia Plc., Kaupthing Bank Sverige AB and Veidilækur ehf.

Hjörleifur Thór Jakobsson—Deputy Chairman of the Board of Directors. Mr Jakobsson, born in 1957, graduated with a degree in mechanical engineering from the University of Iceland in 1981 and later received his MSc in engineering from Oklahoma State University in 1982. He worked for 15 years at Eimskip in various management positions, including Senior Director of Operations. Between 1999 and 2002, he served as the CEO of Hampidjan and was the CEO of Olíufélagid hf. from 2000 to 2006. Mr Jakobsson currently acts as the CEO of Ker hf. (which plans to merge with Kjalar ehf., the sole shareholder of our second largest shareholder, Kjalar Invest B.V., according to an announcement by Egla hf. to the OMXI on September 28, 2006). Mr Jakobsson was elected to our board in 2003.

Mr Jakobsson acts as CEO of Kjalar hf., Ker hf., Stallasel ehf., Vatnsholt ehf., Bláfeldarhraun ehf., Egla hf., and Heidarás ehf. He is member of the board of directors of Samskip hf., Stallasel ehf., Vatnsholt ehf., Bláfeldarhraun ehf., Tankurinn ehf., D-3 Eignarhaldsfélag ehf., Heidarás ehf., Jónar transport hf., Orkuveita Stadarsveitar ehf., Hekla fasteignir ehf., and Framleidendur ehf. and chairman of the board of Hekla hf., Iceland Seafood International ehf. Festing ehf., Bio Vörur ehf., Madur lifandi ehf., and Hafrahlíd ehf.

Niels de Coninck-Smith – Diretor. Mr de Coninck-Smith, born 1956, graduated with a MSc in 1980 from the Copenhagen School of Business and later received a Masters of Business Administration with a concentration in finance from the Wharton School of Business of the University of Pennysylvania in 1982. From 1982 to 2002, he worked with McKinsey & Co. in a variety of capacities, including as a consultant, engagement manager, principal and director. Since 2002 he has acted as the CEO of Ferrosan A/S. Mr de Coninck-Smith was elected to our board in 2005.

Mr de Coninck-Smith also currently serves as a board member of Contura A/S, Carefarm A/S, and FVS A/S.

Brynja Halldórsdóttir—Director. Ms Halldórsdóttir, born in 1957, graduated with a degree in business administration, specializing in macroeconomics from the University of Iceland in 1981. She was CFO of Verslunarbanki (Bank of Commerce) when it merged with three other Icelandic banks in 1989. In 2000, she became the CEO of Norvik hf., one of Iceland's premier international holding companies. In addition to her role as the CEO, she serves as the CFO of all of Norvik's subsidiaries. Ms Halldórsdóttir was elected to our board in 2004.

Ms Halldórsdóttir is the CEO of Norvik hf., Depo ehf., Ares fjárfestingarfélag ehf. and Byko Lettland ehf. She is a member of the board of Nóatún ehf., 11-11 ehf., Byko hf., EXPO Kópavogur ehf., Kostakaup ehf., Norvik fasteignir ehf., Krónubúdin ehf., Smáragardur ehf., Kaupás hf., CW Ltd. UK and Wayland timber Ltd. UK.

Bjarnfredur H. Ólafsson—Director. Mr Ólafsson, born in 1967, graduated with a Cand. Jur. degree from the University of Iceland in 1993, 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. From 1993 to 1996, he acted as senior attorney for the Icelandic Internal Revenue Directorate. In 1999, he co-founded and began work as a managing partner for Taxis Attorneys, which specializes in tax and company legislation and commercial agreements. He recently joined Logos Legal Services as a partner and head of the tax division. He serves as the national representative of the International Business and Tax Committee of the International Bar Association and is an attorney to the District Court of Iceland. Mr Ólafsson was elected to our board in 2003.

Mr Ólafsson serves as CEO of Einsær hf. He currently is a chairman of the board of Generated Investments Íslandi ehf., OneSource Finance Íslandi ehf., Medalfell ehf. and Ex-Ice Íslandi ehf. and a board member of Einsær hf. and Ufsastadir ehf.

Gunnar Páll Pálsson—Director. Mr Pálsson, born in 1961, graduated with a degree in business administration from the University of Iceland in 1987. He has worked for the Commercial Workers' Union of Reykjavík (Verzlunarmannafélag Reykjavíkur) for twelve years as an economist, as the CFO and now the CEO of the union. He was elected to our board in 2001.

Mr Pálsson serves as a chairman of the board of Lífeyrissjódur verslunarmanna, Lífeyrissjódur starfsmanna Áburdarverksmidju ríkisins and Máttarstólpar ehf. He is a member of the board of Janus endurhæfing ehf.

Tommy Persson—Director. Mr Persson, born in 1948, is the CEO of Länsförsäkringar AB for which he also serves as a member of the board. In addition, he is vice-chairman of the Swedish Insurance Employers' Federation and EurAPCO AG and a member of the board of the Stockholm Chamber of Commerce.

Ásgeir Thoroddsen—Director. Mr Thoroddsen, born in 1942, graduated with a Cand. Jur. degree from the University of Iceland in 1967 and later received a degree in public administration from New York University in 1971. Since 1977, he has been an attorney to the Supreme Court of Iceland. Mr Thoroddsen was elected to our board in 2003.

Mr Thoroddsen serves as chairman of the board of Frjálsi lífeyrissjódurinn, Intrum á Íslandi ehf. and Íshestar ehf. and as member of the board of Liftryggingafelag Islands hf., ÁGT ehf., Vátryggingafelag Islands hf., Lysing hf. and Bakkavör Group hf.

Antonios P. Yerolemou—Director. Mr Yerolemou, 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 Yerolemou currently serves as a non-executive director for a number of companies, including Bakkavör Group hf. He was elected to our board in 2007.

Mr Yerolemou currently serves as a board member of the following companies, in addition to Bakkavör, A.C. Properties Ltd., Etchlord Ltd., Hellenic Community Trust Ltd., Katsouris Brothers Ltd., (chairman), Katsouris Investments Ltd., (chairman), London Greek Radio (1987) Ltd., Voidtree Ltd., Wine & Mousaks Ltd., Radio Marathon (for children with special needs) Ltd., Cyprus British Chamber of Commerce & industry Ltd., Lanitis Development Public Ltd., Cyprus.

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. Mr Sigurdsson, born in 1970, graduated with a degree in business administration from the University of Iceland in 1994 and joined our Asset Management Division later that year. He was appointed as our Deputy CEO in 1998 and served as Managing Director of Kaupthing New York Inc. from its founding in 2000 until 2001. In 2003, Mr Sigurdsson was appointed as the CEO of Kaupthing Bank. He also served as the CEO of our operations in Iceland until September 2005, when a separate CEO was appointed for Iceland and Mr Sigurdsson's responsibilities shifted focus to directing operations for the Kaupthing Bank group.

Mr Sigurdsson is currently a board member of Kaupthing ASA, Kaupthing Forvaltning AS, Kaupthing Norge AS, FIH Erhvervsbank A/S, FI-Holding A/S, Kaupthing Bank Sverige AB, Norvestia OY, Arion Custody Services hf., Kaupthing Securities Inc., Kaupthing New York Inc., Kaupthing Bank Luxembourg S.A. and Hreidar Már Sigurdsson ehf., as well as chairman of the board of directors of Kaupthing fjarmögnun ehf.

Mr. Sigurdsson is related to Dröfn Hreidarsdóttir, who is married to Mr. Skarphédinsson, our CIO.

Gudný Arna Sveinsdóttir—Chief Financial Officer (CFO). Ms Sveinsdóttir, born in 1966, graduated with a degree in business administration from the University of Iceland in 1991 and later received a masters degree in finance and accounting from the University of Uppsala in 1996. From 1996 to 1997, she performed auditing work for several large international companies in Stockholm while working for Öhrlings Coopers & Lybrand (now ÖhrlingsPWC). Between 1997 and 2001, she worked as a Director of Accounting at Eimskip. In 2001, Ms Sveinsdóttir became our Director of Accounting and was appointed as our Director of Finance & Accounting in May 2003. In 2005, Ms Sveinsdóttir became our Chief Financial Officer.

Steingrímur Kárason—Chief Risk Officer (CRO). Mr Kárason, born in 1968, graduated with a degree in mechanical engineering from the University of Iceland in 1991, and later received a MSc in engineering in 1993 and a Ph.D. in 1997, both from the Massachusetts Institute of Technology. Mr Kárason joined us in 1997 and worked in our Derivatives and Currency department before becoming our Chief Risk Officer in 1998.

Ásgrímur Skarphédinsson—Chief Information Officer (CIO). Mr Skarphédinsson, born in 1958, graduated with a Bachelor of Science in electrical engineering from Odense Teknikum in Denmark in 1982. After working as Head of the Systems Department for Skrifstofuvélar hf., he founded and managed Traffice Software. After that company was sold in 1995, he joined EJS to establish its Microsoft Consultancy Department. In 1997, Mr Skarphédinsson joined us as Head of Information Technology and, in 2004, he was assigned to oversee the integration of the computer systems for all of our subsidiaries. In 2005, Mr Skarphédinsson became our Chief Information Officer.

Mr Skarphédinsson is married to Dröfn Hreidarsdóttir, who is related to Mr. Sigurdsson, our CEO.

Gudni Níels Adalsteinsson—Group Treasurer. Mr Adalsteinsson, born in 1967, graduated with a Bachelor of Science in economics from the University of Iceland in 1991, and later received a Masters of Business Administration from Cambridge University in 1998. During his education, he worked as an economist for the Federation of Icelandic Employers, from 1992 to 1997. Between 1998 and 2004, he served as a Director in the Fixed Income Division of Lehman Brothers in London and Frankfurt and between 2004 and 2005 he was a Director in the Fixed Income Division of Credit Suisse in Frankfurt. Mr Adalsteinsson became our Group Treasurer in 2005.

Jónas Sigurgeirsson—Chief Communications Officer. Mr Sigurgeirsson, born in 1968, graduated with a degree in history from the University of Iceland in 1992 and later pursued a Masters of Business Administration at the University of Tampa from 1999 to 2000. Between 1993 and 1999, he managed a private publishing company. Mr Sigurgeirsson joined our Investment Banking division in 2000, became our Head of Investor Relations in 2003 and in 2005 he was appointed as our Chief Communications Officer.

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 practiced law as a solicitor in Reykjavik from 1993 to 1999 and joined Kaupthing Bank in 2000. He became co-head of Corporate Finance (currently Investment Banking) in Iceland in 2002 and Managing Director of Corporate Banking at the end of 2003. Mr Diego became our Chief Credit Officer in 2007.

CEOs of our Operational Units in Iceland and Denmark

Along with our CEO, Hreidar Már Sigurdsson, we have defined the CEO of Kaupthing Bank hf. in Iceland (the "CEO of Kaupthing Iceland") and the CEO of FIH Erhvervsbank A/S (the "CEO of FIH"), as the only senior managers of the group relevant to establishing that we have the appropriate expertise and experience for the management of our business, as they are heads of the only operational units comprising more than 25% of our equity or our profits. We expect that from the year 2007, the CEO of Kaupthing Singer & Friedlander Group plc. also will be defined as such a senior manager.

Set forth below are details about the CEO in Iceland and the CEO of FIH. The business address of the CEO of Kaupthing Bank hf. in Iceland is Borgartún 19, 105 Reykjavík, Iceland. The business address 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. Mr Helgason, born in 1967, graduated with a degree in business administration from the University of Iceland in 1993, and in 1998 he became a licensed stockbroker. He joined Kaupthing in 1993, first as a private investor adviser and later in brokerage. Ingólfur was the Director of Capital Markets from 1997 to 2005, when he assumed the position of CEO of Kaupthing Bank in Iceland.

Mr Helgason serves as the CEO of Kirna ehf. He currently is chairman of the board of Sparisjódur Kaupthings hf. and Kaupthing Liftryggingar hf. and a board member of Arion Custody Services hf. and Kirna ehf.

Lars Johansen—CEO of FIH Erhvervsbank A/S. Mr Johansen, 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. From 1967 to 1993 Lars worked for Privatbanken and Unibank in Copenhagen. From 1977 to 1985 he managed their capital markets and trading operations and from 1985 to 1993 he was a member of the Executive Board of Privatbanken and later Unibank A/S. From 1993 to 1996 Lars ran his own advisory company, Johansen & Co., consulting on matters of corporate finance, and in 1996 he became CEO of the Copenhagen Stock Exchange. Since 1998, Mr Johansen has served as the CEO in FIH Erhvervsbank A/S.

Mr Johansen is currently a board member of Axcel IndustriInvestor Invest A/S (chairman), the Investment Committee of Dania Capital (chairman), Axcel IndustriInvestor a.s., Axcel II A/S, Axcel II Management A/S and Johan Schrøders Erhvervs- og Familiefond.

Corporate Governance

Corporate governance at Kaupthing is defined as the framework by which we direct and control our business and the relationships between our management, our board of directors, our shareholders and other possible stakeholders.

The aim of our corporate governance framework is to ensure disclosure and transparency, to define the responsibilities of our board of directors and our management, to define the rights and role of our shareholders and other parties which may be considered as stakeholders, to ensure the equitable treatment of our shareholders and to avoid conflicts of interests. It is the objective of our management and our board of directors to have transparent and effective internal controls. An Internal Control and Procedural Handbook reflects the most recent rules and procedures in effect at Kaupthing. The Internal Control and Procedural Handbook is reviewed annually and approved by the board of directors, and all changes and updates are presented to the board of directors for review and approval. The latest version of the Internal Control and Procedural Handbook was approved in December 2006.

In 2004, the Iceland Chamber of Commerce, the OMXI and the Confederation of Icelandic Employers issued Guidelines on Corporate Governance, which were later reviewed in 2005. It is the opinion of the board of directors that Kaupthing is in full compliance with these guidelines.

Shareholders' meetings

The highest authority in our affairs, within the limits established by our articles of association and statutory law, rests with legitimate shareholders' meetings. Shareholders' meetings may be attended by shareholders, their proxies and advisors. Furthermore, our CEO has full rights to speak and submit motions at shareholders' meetings. Shareholders' meetings are open to representatives of the press and the stock exchanges. Our Annual General Meeting is held before the end of April each year. At shareholders' meetings each share carries one vote. Decisions at shareholders' meetings are taken by majority vote unless there are provisions otherwise in our articles of association or statutory law.

Our board of directors

Our board of directors is the highest authority in our affairs between shareholders' meetings. It handles our affairs and ensures that its organization and operation are at all times in correct and appropriate order. The board of directors ensures adequate supervision of the accounts and disposal of our property. The board of directors is, among other things, responsible for confirming key aspects of the internal organization and making decisions on the establishment or closure of foreign branches and foreign subsidiaries and on mergers. The board of directors is also responsible for deciding which employees are authorized to enter into certain obligations on our behalf. The board of directors may not involve itself in decisions on individual dealings, unless their scope is substantial in relation to the size of our business. Individual board members must not involve themselves in decisions on individual dealings.

Our board of directors is composed of nine members, to be elected at the Annual General Meeting for a term of one year. Nine alternate members are also elected. The board of directors elects a Chairman of the board from among its members, and allocates tasks in other respects as required. The board of directors is authorized to entrust the Chairman of the board of directors with special responsibilities on behalf of Kaupthing. The Chairman of the board of directors (the Executive Chairman) is the public representative of the board of directors, unless otherwise decided by the board of directors.

The board of directors appoints our CEO and decides the terms of his employment.

The board of directors has established working procedures, setting out in further detail the performance of its duties. These procedures discuss, e.g., the area of responsibility of the board of directors and Chairman, board meetings, board sub-committees, confidentiality, the authorization of the board of directors to make decisions on individual dealings, the eligibility of board members, the handling of information on individual customers by the board and the participation of board members in the boards of directors of subsidiaries and associated companies.

The working procedures state that in the event of a decision regarding a board member serving on the board of a subsidiary or an associated company, there shall be detailed discussion on the effect of this on the surveillance role of the relevant board member and on the necessity of the board member serving on the relevant board.

Our board of directors has established a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of our Executive Chairman and our CEO. No director is involved in deciding his or her own remuneration. Furthermore, the Annual General Meeting in 2004 adopted a proposal on options for employees and management.

The role of the Executive Chairman is to coordinate the activities of our subsidiaries, pursue opportunities to increase efficiency by merging with other companies or to seek out potential acquisitions in Iceland and abroad. The Chairman convenes meetings of our board of directors and presides at board meetings. The Chairman ensures that agendas of meetings of our board of directors include items which are important to our operations and are prerequisites for the supervisory duties of the board of directors. The Chairman ensures that all of the members of our board of directors are properly briefed on issues arising at board meetings. The Chairman has direct access to our risk management in order to facilitate the supervision of our activities by the board of directors. The Chairman makes proposals on the manner in which our board of directors conduct supervision of our loan portfolio, securities holdings and operations. This ensures that the board of directors will receive regular information on risk in our operations.

Queries by the board of directors or individual board members shall generally be raised at meetings of the board of directors and shall be addressed to our CEO or others present at the meeting. Otherwise, queries shall be sent to the Chairman of our board of directors. It is not permitted to request information or direct queries directly to other of our employees between meetings of the board of directors. These provisions do not, however, apply to the Chairman of our board of directors if he is an Executive Chairman.

According to the working procedures of the board of directors, the board shall regularly evaluate its activities and procedures, as well as our progress, with the assistance of outside parties if appropriate.

The working procedures of the board of directors state that board members should familiarize themselves with the provisions of law, our articles of association, general regulations of the securities market, special regulations of Kaupthing on the handling of inside information and insider trading and other rules.

The majority of the members of our board are independent of Kaupthing, according to an evaluation by the board of directors. The criteria for independence are in accordance with the Guidelines on Corporate Governance mentioned above.

Those who wish to stand for election to the board of directors must announce their intention with at least seven days' notice, according to our articles of association.

Management

Our CEO and the board of directors are jointly responsible for the management of Kaupthing. Our CEO and the members of the board of directors and the other members of our senior management listed above have the appropriate expertise and experience for the management of our business. The CEO is responsible for day-to-day operations, and in this regard he observes the policies and directions of the board of directors. Day-to-day operations do not include measures which are unusual or extraordinary, which are only taken by the CEO pursuant to special authorization from the board of directors, unless it is impossible to wait for decisions of the board without seriously disadvantaging our operations. In such cases the board of directors is promptly notified of the measures taken. The CEO ensures that our accounts and finances conform to law and accepted standards and that the disposal of our assets are properly monitored.

Accounts and auditing

A state authorized public accountant or accounting firm is elected auditor at each of our Annual General Meetings for a term of one year. The auditor examines our accounts and all relevant account documents for each year of operation, and has access to all of our books and documents for this purpose. Auditors are not elected from among the members of our board of directors or our employees. The qualifications and eligibility of the auditor at elections are in other respects governed by law. Our current auditor is KPMG hf.

Committees of our Board of Directors

Our board of directors has established four committees: the audit committee, the compensation committee, the credit committee and the underwriting & investment committee.

Audit Committee

The audit committee maintains regular contact with both external and internal auditors and ensures that action is taken upon recommendations from and observations of these auditors. The audit committee reviews the scope and results of internal audits and their cost-effectiveness, as well as the independence and objectivity of our external auditors. Furthermore, the audit committee discusses accounting principles and any changes to them and consults with and advises the board as to the scope of internal audits. In the event that our external auditors provide us with a substantial amount of non-audit services, the audit committee reviews the nature and extent of such services.

The audit committee shall consist of at least three directors. Executive board members and employees are not permitted to be members of the committee. Members of the audit committee are Hjörleifur Jakobsson (chairman), Bjarnfredur Ólafsson and Brynja Halldórsdóttir.

Compensation Committee

The compensation committee discharges the board's responsibility in matters relating to executive compensation and administration of our incentive compensation and equity-based plans, in accordance with applicable rules and regulations. The principal responsibility in compensating our executives is to align the incentives of the executives with actions that will enhance long-term shareholder value. The compensation committee also outlines our policies with respect to employee stock options.

The compensation committee is composed of three directors: Ásgeir Thoroddsen (chairman), Tommy Persson and Niels de Coninck-Smith.

Group Board Credit Committee

All credit exposures over 10% (€165 million) of the group's risk capital are referred to the credit committee of the board of directors for approval, taking into consideration exposure to related parties.

The credit committee is composed of three directors and our CEO: Sigurdur Einarsson (chairman), Bjarnfredur Ólafsson, Gunnar Páll Pálsson and Hreidar Már Sigurdsson. Our CRO, Steingrímur Páll Kárason, also attends these meetings as an observer.

Group Board Underwriting & Investment Committee

All underwriting decisions exceeding certain limits and all investment decisions exceeding certain limits are referred to the underwriting & investment committee of the board of directors for approval.

The underwriting & investment committee is composed of three directors and our CEO: Sigurdur Einarsson (chairman), Bjarnfredur Ólafsson, Gunnar Páll Pálsson and Hreidar Már Sigurdsson. Our CRO, Steingrímur Páll Kárason, also attends these meetings as an observer.

In addition, we have the following internal committees:

- ***Executive Committee***. The CEO consults the executive committee on matters of special importance.
- ***Credit Committee***. The Credit Committee is our second highest credit granting body, after the credit committee of the board of directors. The CEO chairs the committee, which includes the managing directors of corporate banking and risk management.
- ***IT Committee***. The CEO consults the IT committee on information-technology related issues and IT strategy.
- ***ALCO Committee***. The ALCO committee maintains oversight over our balance sheet, and proposes policies concerning the structure of assets and liabilities, and co-ordination on risk, capital, funding and liquidity matters.

Internal Auditor, Compliance Officer and AMLRO

We have an independent internal auditor, who is appointed by and reports directly to the board of directors. The internal auditor is responsible for evaluating the efficiency and effectiveness of 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. In August 2006, Lilja Steinthórsdóttir was appointed as our internal auditor, to replace Gudjón Jóhannesson, who gave notice of his resignation in June. Ms. Steinthórsdóttir joined us in October 2006 from the Icelandic Central Bank.

A special compliance officer is employed within Kaupthing. The compliance officer is directly responsible to the CEO and is independent in his or her duties. The compliance officer monitors the implementation of working procedures, including rules regarding trading by employees and primary insiders. The compliance officer makes proposals for improved working procedures for various positions within the group and helps develop and maintain the monitoring system.

In addition, from September 1, 2006 we have employed an anti-money laundering reporting officer ("AMLRO") who is responsible for ensuring the Bank's compliance with applicable anti-money laundering legislation, best practices and its internal rules and procedures. The AMLRO is directly responsible to our board of directors and independent in his or her duties in the same way as our compliance officer.

Director and Management Compensation

The table below provides a breakdown of the remuneration that we paid to certain members of our management and our board of directors in 2006. The table includes the members of our board of directors, our CEO, five group managing directors and the CEOs in Iceland and Denmark.

	As at and for the year ended December 31, 2006					
	Salaries	**Benefits**	**Bonuses**	**Pension fund payment**	**Stock options shares**	**Shares at year-end**
	(ISK Millions)	**(ISK Millions)**	**(ISK Millions)**	**(ISK Millions)**	**(Millions)**	**(Millions)**
CEO:						
Hreidar Már Sigurdsson	69.5	2.1	69.5	27.8	1.6	6,4
Directors:						
Sigurdur Einarsson, Chairman	69.5	30.5	69.5	27.8	1.6	7.4
Ásgeir Thoroddsen	4.6	—	—	—	—	—
Bjarnfredur Ólafsson	5.3	—	—	—	—	—
Brynja Halldórsdóttir...........	4.6	—	—	—	—	—
Finnur Ingólfsson(1)	4.6	—	—	—	—	—
Antonio P. Yerolemou(2)......	—	—	—	—	—	—
Gunnar Páll Pálsson.............	4.6	—	—	—	—	—
Hjörleifur Thór Jakobsson...	4.6	—	—	—	—	—
Tommy Persson..................	4.6	—	—	—	—	—
Niels de Coninck-Smith	3.5	—	—	—	—	—
María Sólbergsdóttir...........	1.2	—	—	—	—	—
CEOs in Iceland and Denmark:						
Ingólfur Helgason................	30.0	2.0	40.0	—	0.5	3.3
Lars Johansen	57.0	3.2	25.4	—	—	—
Five group Managing Directors	99.9	9.0	97.0	3.5	1.6	4.6

(1) Mr Ingólfsson stepped down from his position on our Board of Directors at our Annual General Meeting of shareholders on March 16, 2007.
(2) Mr Yerolemou was appointed to our Board of Directors at our Annual General Meeting of shareholders on March 16, 2007

Our CEO, the Chairman of our board of directors and five Group Managing Directors exercised in 2005 stock options that were granted 2002. The gains received as a result of the difference in exercise price and market price were ISK 191 million, ISK 407 million and ISK 183 million respectively.

On May 3, 2006, Hreidar Már Sigurdsson, our CEO, and Sigurdur Einarsson, the Chairman of our board of directors, each exercised a call option on 1,624,000 of our shares at a price of ISK 303 per share in accordance with a stock option plan approved at our annual general meeting on March 27, 2004. The aggregate exercise price for these call options was ISK 492 million, and each party received gains of ISK 674 million as a result of the difference between the exercise price and the closing price of our Shares on the OMXI at the date of exercise.

Should the Chairman of the board of directors resign, he is entitled to receive salary payments for 12 months after his resignation, but otherwise his salary payments shall continue for 48 months from the date of the termination of his employment. The CEO's term of notice is 12 months, but should his employment terminate due to other reasons his salary payments shall continue for 48 months. There are no other service contracts providing for benefits upon termination of employment for the members of our board of directors or senior management.

As of December 31, 2006, we had set aside or accrued for pension retirement or similar benefits ISK 4 billion as a result of agreements entered into by certain of our subsidiaries prior to their acquisition by us.

At the Annual General Meeting of shareholders on March 16, 2007 ("AGM"), the shareholders approved the compensation for the members of our board of directors in the following amounts: the directors other than the chairman of the board will receive ISK 400,000 per month and the chairman of our board of directors will receive ISK 800,000 per month. Members of our board of directors who also serve on sub-committees of the board will receive an additional ISK 150,000 per month. Sigurdur Einarsson also receives additional compensation, as decided by the compensation committee, for certain duties he performs in addition to his duties associated with his roles as chairman of the board and chairman of both the Group Board Credit Committee and the Group Board Underwriting & Investment Committee. For a description of the duties of the Chairman of our board of directors and the roles of the Group Board Credit Committee and the Group Board Underwriting & Investment Committee, see "—Corporate Governance—Our board of directors" and "—Committees of our Board of Directors", respectively.

Furthermore, the AGM confirmed a remuneration policy adopted by our board of directors following recommendations from the Compensation Committee which has been drawn up in accordance with recently enacted provisions in the Act on Limited Liability Companies on Good Corporate Governance. According to this policy, our employees, which include members of our senior management and the chairman of our board of directors, may be entitled to bonuses and stock options in addition to basic salaries.

For further information on stock options and employment terms, see "Description of Business—Employees" and note 53 "Executive employment terms" and note 99 "Stock options" to our audited consolidated financial statements as at and for the years ended December 31, 2006 and 2005 included elsewhere in this Offering Circular for more information regarding our stock option plan. The AGM approved a three-year extension of the current option scheme for the Executive Chairman and the CEO. The amount of stocks will be the same as in the current option scheme: 812,000 shares annually in 2009, 2010 and 2011. The strike price will be the market price on the date of the AGM.

Potential Conflicts of Interest

Except as described in this Prospectus, there are no potential conflicts of interest between any duties to Kaupthing of any member of the board of directors, our CEO, the CEO of Kaupthing Iceland or the CEO of FIH and their private interests and 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 the administrative, management or supervisory bodies or member of senior management.

RELATED PARTY TRANSACTIONS

We engage in and we expect to continue to engage in transactions with our related parties, including the transactions described below. We define our related parties according to IAS 24. Note 98 to our financial statements for and at the year ended December 31, 2006 provides further information on the definition of related parties under IAS 24.

Loans to Related Parties

Outstanding loans to companies which are considered our related parties amounted to ISK 109,556 million as at December 31, 2006, ISK 3,063 million as at December 31, 2005 and ISK 3,128 million as at January 1, 2005, when related parties was first defined under IAS 24 in our accounts and published for the first time in our Financial Statements for 2005. The increase from the beginning of 2006 was due to a change in our definition of related parties under IAS 24, which accounted for approximately ISK 33.8 billion of the change, in addition to an increase in new loans to companies that we consider our related parties, which accounted for approximately ISK 91.3 billion of the change offset by reductions of about ISK 18.6 billion. The largest borrower among these companies was Lýsing hf., a subsidiary of Exista hf. Lýsing hf. is a financial institution supervised by the FME. Lýsing hf. had an aggregate of approximately ISK 40 billion in outstanding loans with us at December 31, 2006. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Recent Developments—Exista hf.".

In addition, we have granted loans to members of our board of directors, our key management and their immediate family members. The outstanding balance of loans granted to these individuals amounted to ISK 17,716 million as at December 31, 2006, ISK 7,545 million as at December 31, 2005, ISK 1,955 million as at January 1, 2005 and ISK 1,315 million as at December 31, 2003. The terms and conditions of these loans are similar to loans granted to our other customers. Further, we may from time to time grant loans related to the independent business activities in which the board members may be involved. To date, no board members have any loans granted from us related to independent business activities. The members of our key management are required to certify that they do not have independent business activities.

In May 2006, our board of directors approved lines of credit granted to Hreidar Sigurdsson, our CEO, and Sigurdur Einarsson, the Chairman of our board of directors, in the amount of ISK 1,236 million to each, to allow them to exercise call options granted to them pursuant to a stock option plan and to purchase our Shares in the open market. The exercise of the call options on 1,624,000 shares each for an aggregate price of ISK 492 million, and the open market purchases of 1,000,000 shares each at the price of ISK 740 per share, were announced on the OMXI on May 3, 2006.

Other Related Party Transactions

In August 2003, Scandinavian Holding, an investment company owned by Kaupthing, Icebank and seven savings banks, was acquired by Exista (then Meidur ehf.). At the same time Bakkabraedur Holdings S.A.R.L was acquired by Exista. The acquisitions were paid for with new issued shares in Exista. Immediately following these mergers, Kaupthing held a 19% stake in Exista, which in turn held a 16% stake in Kaupthing.

In preparation for the disposal of our holding in Exista, in May 2006 we sold our remaining 24% stake in VÍS eignarhaldsfélag hf., the holding company of Vátryggingafélag Íslands hf. (the Icelandic insurance company), to Exista for ISK 15.9 billion. The purchase price was paid with new shares in Exista, which raised our holding in Exista from 19% to 21%. Finnur Ingólfsson, one of the members of our board of directors, was the CEO of VÍS eignarhaldsfélag hf., at the time when we sold this remaining stake to Exista. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Recent developments—Disposal of a Substantial Portion of our Stake in Exista hf.".

In May 2004, we entered into a limited liability partnership governed by English law with eight individual partners to form New Bond Street Asset Management LLP ("NBSAM"). NBSAM is regulated by the UK Financial Service Authority and provides independent advice, asset management services and fund products. As at December 31, 2006, NBSAM managed for us an account in excess of ISK 320 billion, covering sovereign, financial institution and asset-backed securities with an average credit quality of A1.

Bjarnfredur Ólafsson, one of the members of our board of directors, was until the end of 2005 a partner of the law firm Taxis, which has provided us with legal services. The total fees paid by us to Taxis in 2004 was ISK 24 million and in 2005 was ISK 16 million. He is now a partner in the law firm Logos which also has provided us legal services and the total fee paid to Logos in 2006 was ISK 31.7 million.

We believe that all of our related party transactions were conducted on arm's length bases.

PRINCIPAL SHAREHOLDERS

We are a publicly listed company, with our shares listed on the Nordic Stock Exchange in Iceland and the Stockholm Stock Exchange. At December 31, 2006, we had 740,453,053 shares outstanding held by 31,730 shareholders of record. No shareholder other than Exista hf., which held 18.9% of our outstanding voting shares as at December 31, 2006, held more than 10% of our voting shares outstanding at that date.

DESCRIPTION OF THE NOTES

The following description sets forth the material terms and provisions of the Notes to which any Pricing Supplement may relate. The particular terms of the Notes offered by any Pricing Supplement and the extent, if any, to which the general provisions described below may apply to the Notes so offered will be described in the Pricing Supplement relating to such Notes. Capitalized terms used but not defined herein shall have the meanings given to them in the Notes or the Indentures (as defined below), as the case may be. The following summaries do not purport to be complete and are subject to, and are qualified in their entirety by reference to, the terms and conditions of the Indentures, the Notes of each Series (as defined below) and the Pricing Supplement related to the Notes of such Series. The terms and conditions of a Series of Notes, when combined with the applicable Pricing Supplement, will comprise the complete terms and conditions of such Series.

General

The Senior Notes offered hereby will be issued under a Senior Indenture between Kaupthing Bank hf. (the "Issuer") and Deutsche Bank Trust Company Americas, as Trustee (the "Senior Trustee"); together with the Trustees (as defined below) in their capacity as principal paying agents, the "Paying Agents", each a "Paying Agent") (such Indenture, as supplemented or amended from time to time, is referred to herein as the "Senior Indenture"). The Subordinated Notes offered hereby will be issued under a Subordinated Indenture between the Issuer and Deutsche Bank Trust Company Americas as trustee and principal paying agent (the "Subordinated Trustee") (such Indenture, as supplemented or amended from time to time, is referred to herein as the "Subordinated Indenture"). The Capital Notes offered hereby, will be issued under a Capital Notes Indenture between the Issuer and Deutsche Bank Trust Company Americas as trustee and principal paying agent (the "Capital Notes Trustee" and together with the Senior Trustee, and the Subordinated Trustee, the "Trustees") (such Indenture, as supplemented or amended from time to time, is referred to herein as the "Capital Notes Indenture"; the Capital Notes Indenture, the Subordinated Indenture and the Senior Indenture are referred to herein collectively as the "Indentures" and individually as an "Indenture"). In connection with the listing of the Program on the Luxembourg Stock Exchange, the Issuer will appoint Fortis Banque Luxembourg, S.A., as Luxembourg paying agent (the "Luxembourg Paying Agent", which expression includes any additional or successor Luxembourg paying and transfer agents) pursuant to a Luxembourg Paying Agency Agreement (as supplemented or amended from time to time, the "Luxembourg Paying Agency Agreement"), between the Issuer and the Luxembourg Paying Agent. References to the "Indentures" shall be construed to include references to the Luxembourg Paying Agency Agreement. In acting under the Luxembourg Paying Agency Agreement, the Luxembourg Paying Agent will act solely as agent of the Issuer and will not assume any obligations or relationships of agency or trust to or with the Holders. The Senior Notes, the Subordinated Notes and the Capital Notes are limited to an aggregate principal amount of up to US$10,000,000,000 outstanding at any time (including, in the case of Notes denominated in one or more other currencies or composite currencies, the equivalent thereof at the Market Exchange Rate in the Specified Currency on the Original Issue Date (each as defined below)), subject to reduction by or pursuant to action of the Board of Directors of the Issuer, provided that no such reduction will affect any Note already issued or as to which an offer to purchase has been accepted by the Issuer. The foregoing limits, however, may be increased by the Issuer without the consent of the Holders if in the future it determines that it may wish to sell additional Notes.

The Senior and Subordinated Notes will be offered on a continuing basis and each Note will mature nine months or more from its Original Issue Date and may be subject to redemption at the option of the Issuer or repayment at the option of the Holder prior to the date on which such Senior and Subordinated Notes will mature (the "Stated Maturity") all as set forth in the applicable Pricing Supplement. Each Note will be denominated in U.S. dollars or in such other Specified Currency as is specified in the applicable Pricing Supplement. See "Payment of Principal, Premium, if any, and Interest, if any". Each Note will be either (i) a Fixed Rate Note or (ii) a Floating Rate Note which will bear interest at a rate determined by reference to the interest rate basis or combination of interest rate bases specified in the applicable Pricing Supplement, which may be adjusted by a Spread and/or Spread Multiplier (each as defined below). To the extent that Holders of the Notes are entitled to any recovery with respect to the Notes in any bankruptcy, winding up or liquidation, it is unclear whether Holders would be entitled in those proceedings to recovery in U.S. dollars and may be entitled only to a recovery in Icelandic currency. As a general matter, the right to claim for any amounts payable on Notes may be limited by applicable insolvency law.

Status of Senior Notes

The Senior Notes will constitute direct, unconditional, unsubordinated and (subject to the provisions set forth under "Negative Pledge" herein) unsecured obligations of the Issuer without any preference among themselves and (save for certain obligations preferred by law) will rank at least equally with all other unsecured and unsubordinated obligations of the Issuer, subject, in the event of insolvency, to laws of general applicability relating to or affecting creditors' rights, provided that such other unsecured and unsubordinated indebtedness may contain covenants, events of default and other provisions which are different from or which are not contained in the Senior Notes.

Status and Subordination of Subordinated Notes

The Subordinated Notes will constitute direct, unconditional, unsecured and subordinated obligations of the Issuer without any preference among themselves. The rights of Holders of Subordinated Notes will be subordinated in accordance with and for the purposes of Chapter X; Liquid Assets and Own Funds; Article 84 of the Act on Financial Undertakings No. 161/2002 (the "Act on Financial Undertakings") of the Icelandic Parliament and accordingly, on the insolvency or voluntary or involuntary liquidation of the Issuer, the Subordinated Notes rank in right of payment:

(i) after payment of all obligations of the Issuer which are not expressed to be subordinated in accordance with and for the purposes of Chapter X; Liquid Assets and Own Funds; Article 84 of the Act on Financial Undertakings (or any provision in any other Act of the Icelandic Parliament which modifies or replaces those provisions) ("Senior Obligations");

(ii) at least pari passu with all other obligations of the Issuer (other than obligations of the Issuer in respect of Tier 1 Capital of the Issuer) (as defined below) which are expressed to be subordinated in accordance with and for the purposes of Chapter X; Liquid Assets and Own Funds; Article 84 of the Act, on Financial Undertakings (or any provision in any other act of the Icelandic Parliament which modifies or replaces those provisions) ("Subordinated Obligations");

(iii) before all obligations of the Issuer in respect of its Capital Securities;

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

So long as any of the Subordinated Notes remain Outstanding, the Issuer will not create any subordinated obligation other than in accordance with and for the purposes of Chapter X; Liquid Assets and Own Funds; Article 84 of the Act on Financial Undertakings or any provision in any other act of the Icelandic Parliament which modifies or replaces those provisions). The provisions of this subsection shall be governed by, and construed in accordance with Icelandic law.

The Holder of any Subordinated Note by such Holder's acceptance thereof will be deemed to have waived any right of set-off or counterclaim that such Holders might otherwise have against the Issuer whether prior to or in any winding up of the Issuer.

Status and Subordination of Capital Notes

The Capital Notes are unsecured and unconditional obligations of the Issuer subordinated as described below.

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

(a) the holders of the Capital Notes to payments of the principal amount of the Capital Notes and any other amounts including interest due in respect of the Capital Notes; and

(b) where the whole or any part of the principal amount of the Capital Notes has been converted into conditional capital contributions as described below and such conditional capital contributions have not been reconverted and reinstated as provided below, the providers of such conditional capital contributions, in respect of such conditional capital contributions,

shall rank:

(i) *pari passu* without any preference among the holders of the Capital Notes and such providers;

(ii) at least *pari passu* with the rights of the holders of any other outstanding Capital Securities whether or not such Capital Securities have been converted in the manner described below and at least *pari passu* with the rights of the holders of any other Parity Securities of the Issuer, in each case in relation to their rights as such holders and to payments in respect thereof;

(iii) in priority to the rights of holders of all Junior Securities, in each case in relation to their rights as such holders and to payments in respect thereof; and

(iv) junior in right of payment to the payment of any present or future claims under Senior Obligations and Subordinated Obligations.

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

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

No holder of a Capital Note or provider of any conditional capital contribution who shall in the event of the insolvency or voluntary or involuntary liquidation of the Issuer be indebted to the Issuer shall be entitled to exercise any right of set-off or counterclaim against moneys owed by the Issuer in respect of the Capital Notes or conditional capital contributions held or provided by such holder or provider, as the case may be.

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

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

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

"FSA" means the Financial Supervisory Authority of Iceland (*Fjármálaeftirlitid*) or any successor thereto.

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

The provisions of this subsection shall be governed by, and construed in accordance with Icelandic law.

Utilization and Conversion of Capital Notes

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

Upon utilization of the Converted Amount as above the Issuer shall give notice to the holders of Capital Notes in accordance with the requirements found under the subsection "—Notices".

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

Where, pursuant to this subsection, writing down and conversion applies to part only of the principal amount of the Capital Notes, the part of the principal amount of each Capital Note to be subject to such writing down and conversion shall bear the same proportion to the total amount of the principal amount in respect of such Capital Note as the aggregate amount of the principal amount of all the Capital Notes to be subject to such writing down and conversion bears to the aggregate outstanding principal amount of all the Capital Notes respectively. Any reconversion and reinstatement as provided below will be made on the same basis.

Beneficial interests in the Capital Notes written down and converted or reconverted and translated will be adjusted accordingly.

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

(a) that the Capital Note Trustee has received prior to such utilization a certificate signed by two Directors of the Issuer confirming that, following such conversion to a Converted Amount, the rights of the providers thereof in respect of such amounts will rank as provided above in "—Status and Subordination of Capital Notes" (copies of such certificate will be available for inspection at the specified office of the Capital Note Trustee);

(b) that the FSA shall have given its approval thereto (provided that such approval can be validly given in accordance with the rules, regulations and policies of the FSA); and

(c) that the Capital Note Trustee has received prior to such utilization a certificate signed by two Directors of the Issuer confirming that following such conversion to a Converted Amount, such amount will be a conditional capital contribution and will be accounted for as such in the balance sheet of the Issuer (copies of such certificate will be available for inspection at the specified office of the Capital Note Trustee).

Utilization as described above of the whole or part of the principal amount of the Capital Notes shall not constitute an Event of Default.

Reconversion and Reinstatement of Capital Notes

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

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

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

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

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

Upon reconversion and reinstatement as obligations in respect of the Notes of the Converted Amount as described above the Issuer shall give notice to the holders of Capital Notes in accordance with the requirements found under the subsection "—Notices".

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

The provisions of this subsection shall be governed by, and construed in accordance with Icelandic law.

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

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

Certain Definitions

"Business Day" means a day which is both:

(A) a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in London and any additional Principal Financial Center specified in the applicable Pricing Supplement; and

(B) either (1) in relation to any sum payable in a Specified Currency other than euro, a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in the Principal Financial Center of the country of the relevant Specified Currency (if other than London and any additional Principal Financial Center and which if the Specified Currency is Australian dollars or New Zealand dollars shall be Sydney or Auckland, respectively) or (2) in relation to any sum payable in euro, a day on which the Trans-European Automated Real- Time Gross Settlement Express Transfer (TARGET) System (the "TARGET System") is open (a "TARGET Settlement Date").

"Principal Financial Center" means, unless otherwise defined in any Note, (i) the capital city of the country issuing the Specified Currency or (ii) the capital city of the country to which the Designated LIBOR Currency relates, as applicable, except, that with respect to U.S. dollars, Australian dollars, pounds sterling, Canadian dollars, South African rand and Swiss francs, the "Principal Financial Center" shall be New York City, Sydney and (solely in the case of the Specified Currency) Melbourne, London (solely in the case of the Designated LIBOR Currency), Toronto, Johannesburg and Zurich, respectively.

As used herein, "Specified Currency" means a currency issued and actively maintained as a country's or countries' recognized unit of domestic exchange by the government of any country and such term shall also include the euro.

Form, Transfer, Exchange and Denomination

Notes offered in the United States to qualified institutional buyers ("QIBs") in reliance on Rule 144A will be represented by one or more U.S. global notes ("U.S. Global Notes") and Notes offered outside the United States in reliance on Regulation S will be represented by one or more international global notes ("International Global Notes"). If the applicable Pricing Supplement so provides, Notes may be offered to Institutional Accredited Investors, as defined in Rule 501(a)(l), (2), (3) or (7) under the Securities Act, and such Notes initially will be represented by physical registered certificates ("Certificated Notes"). If any such Certificated Notes are thereafter transferred to QIBs in reliance on Rule 144A or offered outside the United States in reliance on Regulation S, then the Certificated Notes will be represented by one or more U.S. Global Notes or International Global Notes, as the case may be. Except as set forth below under "—Book-Entry System", physical registered certificates will not be issued in exchange for Global Notes.

Notes will be issued only in fully registered form. Global Notes representing Notes of a Series will be deposited with a custodian for DTC and held by or on behalf of DTC for the benefit of participants in DTC.

A Certificated Note will be exchangeable for other Certificated Notes of any authorized denominations and of a like aggregate principal amount and tenor. Certificated Notes may be presented to the Trustee, the Paying Agent or the Luxembourg Paying Agent for registration of transfer or exchange at its Corporate Trust Office which at the date hereof is located at Winchester House, 1 Great Winchester Street, London EC2N 2BB, England or, in the case of the Luxembourg Paying Agent, at its office located at 50 Avenue JF Kennedy, L-2951 Luxembourg. Certificated Notes may be presented for exchange and transfer in the manner, at the places and subject to the restrictions set forth in the respective Indenture and the Notes.

Transfers of ownership interests in Global Notes will be made as set forth below under "—Book-Entry System".

The Notes have not been registered under the Securities Act or with any securities regulatory authority of any jurisdiction and accordingly transfers of the Notes will be subject to the restrictions set forth below under "Notice to Investors".

Certificated Notes and interests in the U.S. Global Notes may be transferred to a person who takes delivery in the form of interests in an International Global Note only upon receipt by the applicable Trustee and any relevant transfer agent, of written certifications (in the form provided in the Indentures) to the effect that such transfer is being made in accordance with Regulation S or Rule 144 under the Securities Act.

Certificated Notes and interests in International Global Notes may be transferred to a person who takes delivery in the form of interests in a U.S. Global Note only upon receipt by the applicable Trustee of written certifications (in the form provided in the Indentures) to the effect that such transfer is being made in accordance with Rule 144A to a person whom the transferor reasonably believes is purchasing for its own account or for an account as to which it exercises sole investment discretion and that such person and such account or accounts are "qualified institutional buyers" within the meaning of Rule 144A and agree to comply with the restrictions on transfer set forth under "Notice to Investors".

Certificated Notes may be transferred to a person who takes delivery in the form of Certificated Notes (other than transfers to the Issuer or a Dealer and transfers by or through or approved by a Dealer) only upon receipt by the Trustee of written certifications (in the form provided in the applicable Indenture) to the effect that such Certificated Note is being acquired by an Institutional Accredited Investor for investment purposes and not for distribution in violation of the Securities Act, and containing such other evidence of compliance with the Securities Act as may be required by the Issuer or the Trustee.

In the event of any redemption of Notes, the Issuer will not be required to (i) register the transfer of or exchange the Notes during a period of 15 calendar days next preceding the date of redemption; or (ii) register the transfer of or exchange the Notes, or any portion thereof, called for redemption, except the unredeemed portion of any of the Notes being redeemed in part.

Each Trustee has been appointed as paying agent pursuant to each of the Indentures. The Issuer may at any time designate additional Paying Agents or rescind the designation of any Paying Agent.

Unless otherwise specified in the applicable Pricing Supplement, Notes will be issuable in U.S. dollars in denominations of US$100,000 and integral multiples of US$1,000 in excess thereof. The authorized denominations of any Note denominated in other than U.S. dollars will be the equivalent amount of the Specified Currency for such Note translated, at the noon dollar buying rate in New York City by the Federal Reserve Bank of New York (the "Market Exchange Rate") on the first Business Day in New York City and the country issuing such currency (or, in the case of euro, the first TARGET Settlement Date) next preceding the date on which the Issuer accepts the offer to purchase such Note, to US$100,000, or such other minimum denomination as may be allowed or required from time to time by any relevant central bank or equivalent governmental body, however designated, or by any laws or regulations applicable to the Notes or to such Specified Currency. The Notes will be issued in integral multiples of 1,000 units of any such Specified Currency in excess of their minimum denominations. If any of the Notes are to be denominated in a Specified Currency other than U.S. dollars, or if the principal of and premium, if any, and interest, if any, on any of the Notes not denominated in U.S. dollars are to be payable at the option of the Holder or the Issuer in U.S. dollars, the applicable Pricing Supplement will provide additional information, including applicable exchange rate information, pertaining to the terms of such Notes and other matters of interest to the Holders thereof.

Payment of Principal, Premium, if any, and Interest, if any

Payments of principal, premium, if any, and interest, if any, to owners of beneficial interests in Global Notes are expected to be made in accordance with those procedures of DTC and its participants in effect from time to time as described below under "—Book-Entry System".

Unless otherwise specified in the applicable Pricing Supplement, with respect to any Certificated Note, payments of interest, if any, will be made by mailing a check to the Holder at the address of such Holder appearing on the register for the Notes on the applicable regular record date (the "Regular Record Date"). Notwithstanding the foregoing, at the option of the Issuer, all payments of interest on the Notes may be made by wire transfer of immediately available funds to an account at a bank located within the United States as designated by each Holder which has a right to so request not less than 15 calendar days prior to the applicable Interest Payment Date. A Holder of US$10,000,000 (or, if the Specified Currency is other than U.S. dollars, the equivalent thereof in such Specified Currency) or more in aggregate principal amount of Notes of like tenor and terms with the same Interest Payment Date may demand payment by wire transfer but only if appropriate payment instructions have been received in writing by any Paying Agent with respect to such Note appointed by the Issuer, not less than 15 calendar days prior to the applicable Interest Payment Date. In the event that payment is so made in accordance with instructions of the Holder, such wire transfer shall be deemed to constitute full and complete payment of such principal, premium and/or interest on the Notes. Payment of the principal of, premium, if any, and interest, due with respect to any Certificated Note at Maturity will be made in immediately available funds upon surrender of such Note at the principal office of any Paying Agent, including the Luxembourg Paying Agent, with respect to such Notes appointed by the Issuer accompanied by wire transfer instructions, provided that the Certificated Note is presented to such Paying Agent in time for such Paying Agent to make such payments in such funds in accordance with its normal procedures.

Unless otherwise specified in the applicable Pricing Supplement, payments of principal, premium, if any, and interest, with respect to any Note to be made in a Specified Currency other than U.S. dollars will be made by check mailed to the address of the person entitled thereto as such address appears in the register or by wire transfer to such account with a bank located in a jurisdiction acceptable to the Issuer and the respective Trustee as shall have been designated at least 15 calendar days prior to the Interest Payment Date or Maturity, as the case may be, by the Holder of such Note on the relevant Regular Record Date or at Maturity, provided that, in the case of payment of principal of, and premium, if any, and interest, due at Maturity, the Note is presented to any Paying Agent with respect to such Note appointed by the Issuer in time for such Paying Agent to make such payments in such funds in accordance with its normal procedures. Such designation shall be made by filing the appropriate information with the Trustee at its Corporate Trust Office, and, unless revoked, any such designation made with respect to any Note by a Holder will remain in effect with respect to any further payments with respect to such Note payable to such Holder. If a payment with respect to any such Note cannot be made by wire transfer because the required designation has not been received by the applicable Trustee on or before the requisite date or for any other reason, a notice will be mailed to the Holder at its registered address requesting a designation pursuant to which such wire transfer can be made and, upon such Trustee's receipt of such a designation, such payment will be made within 15 calendar days of such receipt. The Issuer will pay any administrative costs imposed by banks in connection with making payments by wire transfer, but any tax, assessment or governmental charge imposed upon payments will be borne by the Holders of such Notes in respect of which such payments are made.

If so specified in the applicable Pricing Supplement, except as provided below, payments of principal, premium, if any, and interest, with respect to any Note denominated in other than U.S. dollars will be made in U.S. dollars (as set forth below). If the Holder of such Note on the relevant Regular Record Date or at Maturity, if any, as the case may be, requests payments in other than U.S. dollars, the Holder shall transmit a written request for such payment to any Paying Agent with respect to such Note appointed by the Issuer at its principal office on or prior to such Regular Record Date or the date 15 calendar days prior to Maturity, if any, as the case may be. Such request may be delivered by mail, by hand, by cable or by telex or any other form of facsimile transmission. Any such request made with respect to any Note by a Holder will remain in effect with respect to any further payments of principal, and premium, if any, and interest, with respect to such Note payable to such Holder, unless such request is revoked by written notice received by such Paying Agent on or prior to the relevant Regular Record Date or the date 15 calendar days prior to Maturity, if any, as the case may be (but no such revocation may be made with respect to payments made on any such Note if an Event of Default has occurred with respect thereto or upon the giving of a notice of redemption). Holders of Notes denominated in other than U.S. dollars whose Notes are registered in the name of a broker or nominee should contact such broker or nominee to determine whether and how an election to receive payments in other than U.S. dollars may be made.

The U.S. dollar amount to be received by a Holder of a Note denominated in other than U.S. dollars who elects to receive payments in U.S. dollars will be based on the highest indicated bid quotation for the purchase of U.S. dollars in exchange for the Specified Currency obtained by the Currency Determination Agent (as defined below) at approximately 11:00 A.M., New York City time, on the second Business Day next preceding the applicable payment date (the "Conversion Date") from the bank composite or multicontributor pages of the Quoting Source for three (or two if three are not available) major banks in New York City. The first three (or two) such banks selected by the Currency Determination Agent which are offering quotes on the Quoting Source will be used. If fewer than two such bid quotations are available at 11:00 A.M., New York City time, on the second Business Day next preceding the applicable payment date, such payment will be based on the Market Exchange Rate as of the second Business Day next preceding the applicable payment date. If the Market Exchange Rate for such date is not then available, such payment will be made in the Specified Currency. As used herein, the "Quoting Source" means Reuters Monitor Foreign Exchange Service, or if the Currency Determination Agent determines that such service is not available, Telerate Monitor Foreign Exchange Service, or if the Currency Determination Agent determines that neither service is available, such comparable display or other comparable manner of obtaining quotations as shall be agreed between the Issuer and the Currency Determination Agent. All currency exchange costs associated with any payment in U.S. dollars on any such Note will be borne by the Holder thereof by deductions from such payment. The currency determination agent (the "Currency Determination Agent") with respect to any such Notes will be specified in the applicable Pricing Supplement.

If the Specified Currency for a Note denominated in other than U.S. dollars is not available for the required payment of principal, premium, if any, and/or interest, in respect thereof due to the imposition of exchange controls or other circumstances beyond the control of the Issuer, the Issuer will be entitled to satisfy its obligations to the Holder of such Note by making such payment in U.S. dollars on the basis of the Market Exchange Rate, computed by the Currency Determination Agent, on the second Business Day prior to such payment or, if such Market Exchange Rate is not then available, on the basis of the most recently available Market Exchange Rate, or as otherwise specified in the applicable Pricing Supplement. Any payment made in U.S. dollars under such circumstances where the required payment was to be in a Specified Currency other than U.S. dollars will not constitute an Event of Default under the applicable Indenture with respect to the Notes.

All determinations referred to above made by the Currency Determination Agent shall be at its sole discretion and in accordance with its normal operating procedure and shall, in the absence of manifest error, be conclusive for all purposes and binding on all Holders and beneficial owners of Notes.

Unless otherwise specified in the applicable Pricing Supplement, if the principal of any Discount Note (as defined below) is declared to be immediately due and payable as described herein under "Events of Default—Senior Notes" and "—Subordinated Notes," the amount due and payable with respect to such Note shall be the Amortized Face Amount of such Note as of the date of such declaration and any unpaid interest accrued thereon to the acts of such declaration. The "Amortized Face Amount" of a Discount Note that does not bear stated interest shall be an amount equal to the sum of (i) the principal amount of such Note multiplied by the price (which may be expressed as a percentage of the aggregate principal amount thereof) at which such Note is issued (the "Issue Price") set forth in the applicable Pricing Supplement plus (ii) the portion of the difference between the U.S. dollar amount determined pursuant to the preceding clause (i) and the principal amount of such Note that has accrued at the yield to maturity set forth in the Pricing Supplement (computed in accordance with generally accepted financial practices) to such date of declaration, but in no event shall the Amortized Face Amount of a Discount Note exceed its principal amount.

The Issuer is entitled to vary or terminate the appointment of any Trustee or Paying Agent appointed under the terms of the Indentures and pursuant to the terms of the Indentures and/or appoint additional or other trustees or paying agents, including affiliates of the Issuer in either case, and/or approve any change in the specified office through which any paying agent acts, provided that:

(i) so long as the Notes of a Series are listed, quoted and/or traded on or by the Luxembourg Stock Exchange, or any other stock exchange or competent listing authority and/or quotation system, there will at all times be a Paying Agent with a specified office in Luxembourg, if applicable, and/or each location required by the rules and regulations of the relevant stock exchange, competent listing authority and/or quotation system; and

(ii) if European Council Directive 2003/48/EC or any other Directive implementing the conclusions of the ECOFIN Council meeting of 26-27 November 2000 is brought into force, the Issuer will ensure that it maintains a paying agent in an EU Member State that will not be obliged to withhold or deduct tax pursuant to such Directive.

For so long as the Notes of any Series are listed, quoted and/or traded on or by the Luxembourg Stock Exchange and the rules and regulations of the stock exchange so require, notice of any change in the appointment of any Trustee or Paying Agent appointed under the terms of the Indentures will be published in a leading newspaper of general circulation in Luxembourg (which is expected to be *d'Wort*).

Interest and Interest Rates

Each Note other than certain Discount Notes will bear interest from the date on which such Note will be issued (the "Original Issue Date") or from the most recent Interest Payment Date to which interest on such Note has been paid or duly provided for at a fixed rate or rates per annum, or at a rate or rates determined pursuant to an Interest Rate Base or Bases stated therein and in the applicable Pricing Supplement that may be adjusted by a Spread and/or Spread Multiplier, until the principal thereof is paid or made available for payment. Interest will be payable on each Interest Payment Date and at Maturity. "Maturity" means the date, if any, on which the principal of a Note becomes due and payable in full in accordance with its terms and the terms of the applicable Indenture, whether at Stated Maturity (if applicable) or earlier by declaration of acceleration, call for redemption, request for redemption repayment at the option of the Holder (in the case of a Senior Note or Subordinated Note only, or the Issuer in the case of a Capital Note) pursuant to any sinking fund provision or otherwise. Interest (other than Defaulted Interest which may be paid as of a Special Record Date) will be payable to the Holder of record at the close of business on the Regular Record Date next preceding such Interest Payment Date; *provided*, *however*, that interest payable at Maturity will be payable to the person to whom principal shall be payable. The first payment of interest on any Note originally issued between a

Regular Record Date for such Note and the succeeding Interest Payment Date will be made on the Interest Payment Date following the next succeeding Regular Record Date for such Note to the Holder.

The Interest Payment Dates for each Fixed Rate Note shall be as described below under "Fixed Rate Notes". The Interest Payment Dates for each Floating Rate Note shall be as described below under "Floating Rate Notes" and in the applicable Pricing Supplement. The Regular Record Date for a Note will be the fifteenth day (whether or not a Business Day) next preceding each Interest Payment Date or Maturity, as the case may be.

Fixed Rate Notes

Interest on Fixed Rate Notes will be payable semi-annually in arrears on such dates as are specified in the applicable Pricing Supplement (each, an "Interest Payment Date" with respect to Fixed Rate Notes) and on the date of Maturity. Unless otherwise specified in the applicable Pricing Supplement, interest on Fixed Rate Notes will be computed on the basis of a 360-day year of twelve 30-day months.

If any Interest Payment Date or the date of Maturity of a Fixed Rate Note falls on a day that is not a Business Day, the required payment of principal, premium, if any, and interest, if any, with respect to such Note will be made on the next succeeding Business Day as if made on the date such payment was due, and no interest will accrue on such payment for the period from and after such Interest Payment Date or the date of Maturity, as the case may be, to the date of such payment on the next succeeding Business Day.

Floating Rate Notes

Interest on Floating Rate Notes will be determined by reference to the applicable Interest Rate Basis or Bases, which may, as described below, include:

- the CD Rate;
- the CMT Rate;
- the Commercial Paper Rate;
- the Eleventh District Cost of Funds Rate;
- EURIBOR;
- the Federal Funds Rate;
- LIBOR;
- the Prime Rate;
- the Treasury Rate; or

such other Interest Rate Basis or Bases or interest rate formula as may be specified in the applicable Pricing Supplement.

The applicable Pricing Supplement will specify certain terms with respect to which each Floating Rate Note is being delivered, including: whether such Floating Rate Note is a "Regular Floating Rate Note," a "Floating Rate/Fixed Rate Note" or an "Inverse Floating Rate Note," the Fixed Rate Commencement Date, if applicable, Fixed Interest Rate, if applicable, Interest Rate Basis or Bases, Initial Interest Rate, if any, Initial Interest Reset Date, Interest Reset Dates, Interest Payment Dates, Index Maturity, Maximum Interest Rate and/or Minimum Interest Rate, if any, and Spread and/or Spread Multiplier, if any, as such terms are defined below. If one or more of the applicable Interest Rate Bases is the CMT Rate, EURIBOR or LIBOR, the applicable Pricing Supplement will also specify the Designated CMT Maturity Index and Designated CMT Telerate Page, the Designated EURIBOR Page or the Designated LIBOR Currency and Designated LIBOR Page respectively, as such terms are defined below.

The interest rate borne by the Floating Rate Notes will be determined as follows:

(i) Unless such Floating Rate Note is designated as a "Floating Rate/Fixed Rate Note" or an "Inverse Floating Rate Note", or as having an Addendum attached or having "Other/ Additional Provisions" apply, in each case relating to a different interest rate formula, such Floating Rate Note will be designated as a "Regular Floating Rate Note" and, except as described below or in the applicable Pricing Supplement, will bear interest at the rate determined by reference to the applicable Interest Rate Basis or Bases (a) plus or minus the applicable Spread, if any, and/or (b) multiplied by the applicable Spread Multiplier, if any. Commencing on the Initial Interest Reset Date, the rate at which interest on such Regular Floating Rate Note shall be payable shall be reset as of each Interest Reset Date; provided, however, that the interest rate in effect for the period, if any, from the Original Issue Date to the Initial Interest Reset Date will be the Initial Interest Rate.

(ii) If such Floating Rate Note is designated as a "Floating Rate/Fixed Rate Note," then, except as described below or in the applicable Pricing Supplement, such Floating Rate Note will bear interest at the rate determined by reference to the applicable Interest Rate Basis or Bases (a) plus or minus the applicable Spread, if any, and/or (b) multiplied by the applicable Spread Multiplier, if any. Commencing on the Initial Interest Reset Date, the rate at which interest on such Floating Rate/Fixed Rate Note shall be payable shall be reset as of each Interest Reset Date; provided, however, that (y) the interest rate in effect for the period, if any, from the Original Issue Date to the Initial Interest Reset Date will be the Initial Interest Rate and (z) the interest rate in effect (the "Fixed Interest Rate") for the period commencing on the date specified therefor in the applicable Pricing Supplement (the "Fixed Rate Commencement Date") to the Maturity Date shall be the interest rate so specified in the applicable Pricing Supplement or, if no such rate is specified, the interest rate in effect thereon on the day immediately preceding the Fixed Rate Commencement Date.

(iii) If such Floating Rate Note is designated as an "Inverse Floating Rate Note," then, except as described below or in the applicable Pricing Supplement, such Floating Rate Note will bear interest at the Fixed Interest Rate minus the rate determined by reference to the applicable Interest Rate Basis or Bases (a) plus or minus the applicable Spread, if any, and/or (b) multiplied by the applicable Spread Multiplier, if any; provided, however, that, unless otherwise specified in the applicable Pricing Supplement, the interest rate thereon will not be less than zero. Commencing on the Initial Interest Reset Date, the rate at which interest on such Inverse Floating Rate Note shall be payable shall be reset as of each Interest Reset Date; provided, however, that the interest rate in effect for the period, if any, from the Original Issue Date to the Initial Interest Reset Date will be the Initial Interest Rate.

The "Spread" is the number of basis points to be added to or subtracted from the related Interest Rate Basis or Bases applicable to such Floating Rate Note. The "Spread Multiplier" is the percentage of the related Interest Rate Basis or Bases applicable to such Floating Rate Note by which such Interest Rate Basis or Bases will be multiplied to determine the applicable interest rate on such Floating Rate Note. The "Index Maturity" is the period to maturity of the instrument or obligation with respect to which the related Interest Rate Basis or Bases will be calculated.

Unless otherwise specified in the applicable Pricing Supplement, the interest rate with respect to each Interest Rate Basis will be determined in accordance with the applicable provisions below. Except as set forth above or in the applicable Pricing Supplement, the interest rate in effect on each day shall be (i) if such day is an Interest Reset Date, the interest rate determined as of the Interest Determination Date (as defined below) immediately preceding such Interest Reset Date or (ii) if such day is not an Interest Reset Date, the interest rate determined as of the Interest Determination Date immediately preceding the most recent Interest Reset Date.

The applicable Pricing Supplement will specify whether the rate of interest on the related Floating Rate Note will be reset daily, weekly, monthly, quarterly, semi-annually or annually or at such other specified intervals as specified in the applicable Pricing Supplement (each, an "Interest Reset Period") and the dates on which such rate of interest will be reset (each, an "Interest Reset Date"). Unless otherwise specified in the applicable Pricing Supplement, the Interest Reset Dates will be, in the case of Floating Rate Notes which reset:

- daily, each Business Day;
- weekly, the Wednesday of each week (with the exception of weekly reset Floating Rate Notes as to which the Treasury Rate is an applicable Interest Rate Basis, which will reset the Tuesday of each week);
- monthly, the third Wednesday of each month (with the exception of monthly reset Floating Rate Notes as to which the Eleventh District Cost of Funds Rate is an applicable Interest Rate Basis, which will reset on the first calendar day of the month);
- quarterly, the third Wednesday of March, June, September and December of each year
- semi-annually, the third Wednesday of the two months of each year specified in the applicable Pricing Supplement; and
- annually, the third Wednesday of the month of each year specified in the applicable Pricing Supplement;

provided however, that, with respect to Floating Rate/Fixed Rate Notes, the rate of interest thereon will not reset after the applicable Fixed Rate Commencement Date. If any Interest Reset Date for any Floating Rate Note would otherwise be a day that is not a Business Day, such Interest Reset Date will be postponed to the next succeeding Business Day, except that in the case of a Floating Rate Note as to which EURIBOR or LIBOR is an applicable Interest Rate Basis and such Business Day falls in the next succeeding calendar month, such Interest Reset Date will be the immediately preceding Business Day.

The interest rate applicable to each Interest Reset Period commencing on the related Interest Reset Date will be the rate determined by the Calculation Agent as of the applicable Interest Determination Date and calculated on or prior to the Calculation Date (as defined below), except with respect to the Eleventh District Cost of Funds Rate, EURIBOR and LIBOR, which will be calculated on such Interest Determination Date. The "Interest Determination Date" with respect to:

- the CD Rate, the CMT Rate, the Commercial Paper Rate, the Federal Funds Rate and the Prime Rate will be the second Business Day immediately preceding the applicable Interest Reset Date;
- the Eleventh District Cost of Funds Rate will be the last Business Day of the month immediately preceding the applicable Interest Reset Date on which the Federal Home Loan Bank of San Francisco (the "FHLB of San Francisco") publishes the Index (as defined below);
- EURIBOR will be the second TARGET Settlement Date immediately preceding the applicable Interest Reset Date;
- LIBOR will be the second London Business Day immediately preceding the applicable Interest Reset Date, unless the Designated LIBOR Currency is pounds sterling, in which case the "Interest Determination Date" will be the applicable Interest Reset Date; and
- the Treasury Rate will be the day in the week in which the applicable Interest Reset Date falls on which day Treasury Bills (as defined below) are normally auctioned (Treasury Bills are normally sold at an auction held on Monday of each week, unless such Monday is a legal holiday, in which case the auction is normally held on the immediately succeeding Tuesday although such auction may be held on the preceding Friday); provided, however, that if an auction is held on the Friday of the week preceding the applicable Interest Reset Date, the "Interest Determination Date" will be such preceding Friday.

The "Interest Determination Date" pertaining to a Floating Rate Note the interest rate of which is determined by reference to two or more Interest Rate Bases will be the most recent Business Day which is at least two Business Days prior to the earliest applicable Interest Reset Date on which any applicable Interest Rate Basis is determinate. Each Interest Rate Basis will be determined as of such date, and the applicable interest rate will take effect on the applicable Interest Reset Date.

Notwithstanding the foregoing, a Floating Rate Note may also have, if specified in the applicable Pricing Supplement, either or both of the following: (i) a Maximum Interest Rate, or ceiling, that may accrue during any Interest Reset Period and (ii) a Minimum Interest Rate, or floor, that may accrue during any Interest Reset Period. In addition to any Maximum Interest Rate that may apply to any Floating Rate Note, the interest rate on Floating Rate Notes will in no event be higher than the maximum rate permitted by New York law, as the same may be modified, or other applicable law.

Except as provided below or in the applicable Pricing Supplement, the date(s) on which interest on Floating Rate Notes is payable (each, an "Interest Payment Date" with respect to Floating Rate Notes) will be, in the case of Floating Rate Notes which reset:

- daily, weekly or monthly, the third Wednesday of each month or on the third Wednesday of March, June, September and December of each year, as specified in the applicable Pricing Supplement;
- quarterly, the third Wednesday of March, June, September and December of each year;
- semi annually, the third Wednesday of the two months of each year specified in the applicable Pricing Supplement;
- annually, the third Wednesday of the month of each year specified in the applicable Pricing Supplement; and
- the Maturity Date.

If any Interest Payment Date other than the Maturity Date for any Floating Rate Note would otherwise be a day that is not a Business Day, such Interest Payment Date will be postponed to the next succeeding Business Day, except that in the case of a Floating Rate Note as to which EURIBOR or LIBOR is an applicable Interest Rate Basis and such Business Day falls in the next succeeding calendar month, such Interest Payment Date will be the immediately preceding Business Day. If the Maturity Date of a Floating Rate Note falls on a day that is not a Business Day, the required payment of principal, premium, if any, and interest will be made on the next succeeding Business Day as if made on the date such payment was due, and no interest will accrue on such payment for the period from and after the Maturity Date to the date of such payment on the next succeeding Business Day. The Regular Record Date for each Floating Rate Note will be the fifteenth day (whether or not a Business Day) preceding each Interest Payment Date or Maturity, as the case may be.

All percentages resulting from any calculation on Floating Rate Notes will be rounded, if necessary, to the nearest one hundred-thousandth of a percentage point, with five- or more one millionths of a percentage point rounded upwards (e.g., 9.876545% (or .09876545) would be rounded to 9.87655% (or .0987655)), and all amounts used in or resulting from such calculation on Floating Rate Notes will be rounded, in the case of U.S. dollars, to the nearest cent or, in the case of a Specified Currency, to the nearest unit (with one-half cent or unit being rounded upwards).

With respect to each Floating Rate Note, accrued interest is calculated by multiplying its principal amount by an accrued interest factor. Such accrued interest factor is computed by adding the interest factor calculated for each day in the applicable Interest Period but excluding the date for which accrued interest is being calculated. Unless otherwise specified in the applicable Pricing Supplement, the interest factor for each such day will be computed by dividing the interest rate applicable to such day by 360, in the case of Floating Rate Notes for which an applicable Interest Rate Basis is the CD Rate, the Commercial Paper Rate, the Eleventh District Cost of Funds Rate, EURIBOR, the Federal Funds Rate, LIBOR or the Prime Rate, or by the actual number of days in the year in the case of Floating Rate Notes for which an applicable Interest Rate Basis is the CMT Rate or the Treasury Rate. Unless otherwise specified in the applicable Pricing Supplement, the interest factor for Floating Rate Notes for which the interest rate is calculated with reference to two or more Interest Rate Bases will be calculated in each period in the same manner as if only the applicable Interest Rate Basis specified in the applicable Pricing Supplement applied.

Upon request of the Holder of any Floating Rate Note, the "Calculation Agent" (as specified in the applicable Pricing Supplement) will disclose the interest rate then in effect and, if determined, the interest rate that will become effective as a result of a determination made for the next succeeding Interest Reset Date with respect to such Floating Rate Note. Unless otherwise specified in the applicable Pricing Supplement, the "Calculation Date," if applicable, pertaining to any Interest Determination Date will be the earlier of (i) the tenth calendar day after such Interest Determination Date or, if such day is not a Business Day, the next succeeding Business Day or (ii) the Business Day immediately preceding the applicable Interest Payment Date or the Maturity Date, as the case may be.

Unless otherwise specified in the applicable Pricing Supplement, the Calculation Agent shall determine each Interest Rate Basis in accordance with the following provisions.

The Paying Agent will notify the Issuer and any stock exchange, competent listing authority and/or quotation system on or by which the relevant Floating Rate Notes are for the time being listed, quoted and/or traded of the rate of interest and each amount of interest payable for each interest period and the relevant Interest Payment Date, and will cause the same to be notified to the Holders in accordance with the notice provisions herein as soon as possible after their determination but in no event later than the fourth Business Day thereafter. Each amount of interest payable per Specified Denomination and Interest Payment Date so notified may subsequently be amended (or appropriate alternative arrangements made by way of adjustment) without notification as aforesaid in the event of an extension or shortening of the interest period in accordance with the provisions hereof. Each stock exchange, competent listing authority and/or quotation system on or by which the relevant Floating Rate Notes are for the time being listed, quoted and/or traded shall be promptly notified of any such amendment.

CD Rate

Unless otherwise specified in the applicable Pricing Supplement, "CD Rate" means, with respect to any Interest Determination Date relating to a Floating Rate Note for which the interest rate is determined with reference to the CD Rate (a "CD Rate Interest Determination Date"), the rate on such date for negotiable U.S. dollar certificates of deposit having the Index Maturity specified in the applicable Pricing Supplement as published in H.15(519) (as defined below) under the heading "CDs (secondary market)" or, if not so published by 3:00 P.M., New York City time, on the related Calculation Date, the rate on such CD Rate Interest Determination Date for negotiable U.S. dollar certificates of deposit of the Index Maturity specified in the applicable Pricing Supplement as published in H.15 Daily Update (as defined below), or such other recognized electronic source used for the purpose of displaying such rate, under the caption "CDs (secondary market)". If such rate is not yet published in H.15(519), H.15 Daily Update or another recognized electronic source by 3:00 P.M., New York City time, on the related Calculation Date, then the CD Rate on such CD Rate Interest Determination Date will be calculated by the Calculation Agent and will be the arithmetic mean of the secondary market offered rates as of 10:00 A.M., New York City time, on such CD Rate Interest Determination Date, of three leading nonbank dealers in negotiable U.S. dollar certificates of deposit in New York City (which may include the Dealers or their affiliates) selected by the Calculation Agent for negotiable U.S. dollar certificates of deposit of major United States money center banks for negotiable certificates of deposit with a remaining maturity closest to the Index Maturity specified in the applicable Pricing Supplement in an amount that is representative for a single transaction in that market at that time; provided, however, that if the dealers so selected by the Calculation Agent are not quoting as mentioned in this sentence, the CD Rate determined as of such CD Rate Interest Determination Date will be the CD Rate in effect on such CD Rate Interest Determination Date.

"H.15(519)" means the weekly statistical release designated as such, or any successor publication, published by the Board of Governors of the Federal Reserve System, or its successor, available through the website of the Board of Governors at http://www.federalreserve.gov/releases/h15/update/h15upd.htm.

"H.15 Daily Update" means the daily update of H.15(519), available through the worldwideweb site of the Board of Governors of the Federal Reserve System at http://www.federalreserve.gov/ releases/h15/update/, or any successor site or publication.

CMT Rate

(1) if the Designated Reuters T7051 Page is specified in the applicable Pricing Supplement, as the case may be:

(a) the percentage equal to the yield for United States Treasury securities at "constant maturity" having the Designated CMT Maturity Index specified in the applicable Pricing Supplement, as the case may be, as published in H.15(519) under the caption "Treasury Constant Maturities", as the yield is displayed on Reuters (or any successor service) on page FRBCMT (or any other page as may replace the specified page on that service) ("T7051 Page"), on the particular CMT Rate Interest Determination Date, or

(b) if the rate referred to in clause (a) does not so appear on the T7051 Page, the percentage equal to the yield for United States Treasury securities at "constant maturity" having the particular Designated CMT Maturity Index and for the particular CMT Rate Interest Determination Date as published in H.15(519) under the caption "Treasury Constant Maturities", or

(c) if the rate referred to in clause (b) does not so appear in H.15(519), the rate on the particular CMT Rate Interest Determination Date for the period of the particular Designated CMT Maturity Index as may then be published by either the Federal Reserve System Board of Governors or the United States Department of the Treasury that the Calculation Agent determines to be comparable to the rate which would otherwise have been published in H.15(519), or

(d) if the rate referred to in clause (c) is not so published, the rate on the particular CMT Rate Interest Determination Date calculated by the Calculation Agent as the yield to maturity based on the arithmetic mean of the secondary market bid prices at approximately 3:30 P.M., New York City time, on tat CMT Rate Interest Determination Date of three leading primary United States government securities dealers in The City of New York (which may include the Dealers or their affiliates) (each, a "Reference Dealer"), selected by the Calculation Agent from five Reference Dealers selected by the Calculation Agent and eliminating the highest quotation, or, in the event of equality, one of the highest, and the lowest quotation or, in the event of equality, in the lowest, for United States Treasury securities with an original maturity equal to the particular Designated CMT Maturity Index, a remaining term to maturity no more than one year shorter than that Designated CMT Maturity Index and in a principal amount that is representative for a single transaction in the securities in that market at that time, or

(e) if fewer than five but more than two of the prices referred to in clause (d) are provided as requested, the rate on the particular CMT Rate Interest Determination Date calculated by the Calculation Agent based on the arithmetic mean of the bid prices obtained and neither the highest nor the lowest of the quotations shall be eliminated, or

(f) if fewer than three prices referred to in clause (d) are provided as requested, the rate on the particular CMT Rate Interest Determination Date calculated by the Calculation Agent as the yield to maturity based on the arithmetic mean of the secondary market bid prices as of approximately 3:30 P.M., New York City time, on that CMT Rate Interest Determination Date of three Reference Dealers selected by the Calculation Agent from five Reference Dealers selected by the Calculation Agent and eliminating the highest quotation or, in the event of equality, one of the highest and the lowest quotation or, in the event of equality, one of the lowest, for the United States Treasury securities with an original maturity greater than the particular Designated CMT Maturity Index, a remaining term to maturity closes to that Designated CMT Maturity Index and in a principal amount that is representative for a single transaction in the securities in that market at that time, or

(g) if fewer than two prices referred to in clause (f) are provided as requested, the rate on the particular CMT Rate Interest Determination Date calculated by the Calculation Agent based on the arithmetic mean of the bid prices obtained and neither the highest nor the lowest of the quotations will be eliminated, or

(h) if fewer than two prices referred to in clause (f) are provided as requested, the CMT Rate in effect on the particular CMT Rate Interest Determination Date.

(2) if the T7052 is specified in the applicable Pricing Supplement, as the case may be:

(a) the percentage equal to the one-week average yield for United States Treasury securities at "constant maturity" having the Designated CMT Maturity Index specified in the applicable Pricing Supplement, as the case may be, as published in H.15(519) under the caption "Week Ending" and opposite the caption "Treasury Constant Maturities", as the yield is displayed on Reuters (or any successor service) on page FEDCMT (or any other page as may replace the specified page on that service) ("T7052 Page"), for the week preceding the particular CMT Rate Interest Determination Date, or

(b) if the rate referred to in clause (a) does not so appear on the T7052 Page, the percentage equal to the one-week average yield for United States Treasury Securities at "constant maturity" having the particular Designated CMT Maturity Index and the week preceding the particular CMT Rate Interest Determination Date as published in H.15(519) under the caption "Week Ending" and opposite the caption "Treasury Constant Maturities", or

(c) if the rate referred to in clause (b) does not so appear in H.15(519), the one-week average yield for United States Treasury securities at "constant maturity" having the particular Designated CMT Maturity Index as otherwise announced by the Federal Reserve Bank of New York for the week preceding the particular CMT Rate Interest Determination Date, or

(d) if the rate referred to in clause (c) is not so published, the rate on the particular CMT Rate Interest Determination Date calculated by the Calculation Agent as the yield to maturity based on the arithmetic mean of the secondary market bid prices at approximately 3:30 P.M., New York City time, on that CMT Rate Interest Determinate Date of three Reference Dealers selected by the Calculation Agent from five Reference Dealers and eliminating the highest quotation, or, in the event of equality, one of the highest, and the lowest quotation or, in the event of equality, one of the lowest, for the United States Treasury securities with an original maturity equal to the particular Designated CMT Maturity Index, a remaining term to maturity no more than one year shorter than that Designated CMT Maturity Index, a remaining term to maturity no more than one year shorter than that Designated CMT Maturity Index and in a principal amount that is representative for a single transaction in the securities in that market at that time, or

(e) if fewer than five but more than two of the prices referred to in clause (d) are provided as requested, the rate on the particular CMT Rate Interest Determination Date calculated by the Calculation Agent based on the arithmetic mean of the bid prices obtained and neither the highest nor the lowest of the quotations shall be eliminated, or

(f) if fewer than three prices referred to in clause (d) are provided as requested, the rate on the particular CMT Rate Interest Determination Date calculated by the Calculation Agent as the yield to maturity based on the arithmetic mean of the secondary market bid prices as of approximately 3:30 P.M., New York City time, on that CMT Rate Interest Determination Date, of three Reference Dealers selected by the Calculation Agent from five Reference Dealers and eliminating the highest quotation or, in the event of equality, one of the highest, and the lowest quotation or, in the event of equality, one of the lowest, for United States Treasury securities with an original maturity great than the particular Designated CMT Maturity Index, a remaining term to maturity closest to that Designated CMT Maturity Index and in a principal amount that is representative for a single transaction in the securities in that market at the time, or

(g) if fewer than five but more than two prices referred to in clause (f) are provided as requested, the rate on the particular CMT Rate Interest Determination Date calculated by the Calculation Agent based on the arithmetic mean of the bid prices obtained and neither the highest or the lowest of the quotations will be eliminated, or

(h) if fewer than three prices referred to in clause (f) are provided as requested, the CMT Rate in effect on that CMT Rate Interest Determination Date.

If two United States Treasury securities with an original maturity greater than the Designated CMT Maturity Index specified in the applicable Pricing Supplement, as the case may be, having remaining terms to maturity equally close to the particular Designated CMT Maturity Index, the quotes for the United States Treasury security with the shorter original remaining term to maturity will be used.

“**Designated CMT Maturity Index**” means the original period to maturity of the U.S. Treasury securities (either 1, 2, 3, 5, 7, 10, 20 or 30 years) specified in the applicable Pricing Supplement with respect to which the CMT Rate will be calculated.

Commercial Paper Rate

Unless otherwise specified in the applicable Pricing Supplement, “Commercial Paper Rate” means, with respect to any Interest Determination Date relating to a Floating Rate Note for which the interest rate is determined with reference to the Commercial Paper Rate (a “Commercial Paper Rate Interest Determination Date”), the Money Market Yield (as defined below) on such date of the rate for commercial paper having the Index Maturity specified in the applicable Pricing Supplement as published in H.15(519) under the caption “Commercial Paper—Nonfinancial” or, if not so published by 3:00 P.M., New York City time, on the related Calculation Date, the rate on such Commercial Paper Rate Interest Determination Date for commercial paper having the Index Maturity specified in the applicable Pricing Supplement as published in H.15 Daily Update, or such other recognized electronic source used for the purpose of displaying such rate, under the caption “Commercial Paper-Nonfinancial”. If such rate is not yet published in H.15(519), H.15 Daily Update or another recognized electronic source by 3:00 P.M., New York City time, on the related Calculation Date, then the Commercial Paper Rate on such Commercial Paper Rate Interest Determination Date will be calculated by the Calculation Agent and will be the Money Market Yield of the arithmetic mean of the offered rates at approximately 11:00 A.M., New York City time, on such Commercial Paper Rate Interest Determination Date of three leading dealers of U.S. dollar commercial paper in New York City (which may include the Dealers or their affiliates) selected by the Calculation Agent for commercial paper having the Index Maturity specified in the applicable Pricing Supplement placed for industrial issuers whose bond rating is “Aa”, or the equivalent, from a nationally recognized statistical rating organization; provided, however, that if the dealers so selected by the Calculation Agent are not quoting as mentioned in this sentence, the Commercial Paper Rate determined as of such Commercial Paper Rate Interest Determination Date will be the Commercial Paper Rate in effect on such Commercial Paper Rate Interest Determination Date.

“Money Market Yield” means a yield (expressed as a percentage) calculated in accordance with the following formula:

$$\text{Money Market Yield} = \frac{D \times 360}{360 - (D \times M)} \times 100$$

where “D” refers to the applicable per annum rate for commercial paper quoted on a bank discount basis and expressed as a decimal, and “M” refers to the actual number of days in the applicable Interest Reset Period.

Eleventh District Cost of Funds Rate

Unless otherwise specified in the applicable Pricing Supplement, “Eleventh District Cost of Funds Rate” means, with respect to any Interest Determination Date relating to a Floating Rate Note for which the interest rate is determined with reference to the Eleventh District Cost of Funds Rate (an “Eleventh District Cost of Funds Rate Interest Determination Date”), the rate equal to the monthly weighted average cost of funds for the calendar month immediately preceding the month in which such Eleventh District Cost of Funds Rate Interest Determination Date falls as set forth under the caption “11th District COFI” on the display on Reuters (or any successor service) on page COFI/ARMS (or any other page as may replace such page on such service) (“COFI/ARMS Page”) as of 11:00 A.M., San Francisco time, on such Eleventh District Cost of Funds Rate Interest Determination Date. If such rate does not appear on COFI/ARMS Page on such Eleventh District Cost of Funds Rate Interest Determination Date, then the Eleventh District Cost of Funds Rate on such Eleventh District Cost of Funds Rate Interest Determination Date shall be the monthly weighted average cost of funds paid by member institutions of the Eleventh Federal Home Loan Bank District that was most recently announced (the “Index”) by the FHLB of San Francisco as such cost of funds for the calendar month immediately preceding such Eleventh District Cost of Funds Rate Interest Determination Date. If the FHLB of San Francisco fails to announce the Index on or prior to such Eleventh District Cost of Funds Rate Interest Determination Date for the calendar month immediately preceding such Eleventh District Cost of Funds Rate Interest Determination Date, the Eleventh District Cost of Funds Rate determined as of such Eleventh District Cost of Funds Rate Interest Determination Date will be the Eleventh District Cost of Funds Rate in effect on such Eleventh District Cost of Funds Rate Interest Determination Date.

EURIBOR

Unless otherwise specified in the applicable Pricing Supplement, “EURIBOR” means the rate determined in accordance with the following provisions:

(i) With respect to any Interest Determination Date relating to a Floating Rate Note for which the interest rate is determined with reference to EURIBOR (a "EURIBOR Interest Determination Date"), EURIBOR will be the rate for deposits in euro having the Index Maturity specified in such Pricing Supplement, commencing on such Interest Reset Date, that appears on the Designated EURIBOR Page as of 11:00 A.M., Brussels time, on such EURIBOR Interest Determination Date; or if no such rate so appears, as applicable, EURIBOR on such EURIBOR Interest Determination Date will be determined in accordance with the provisions described in clause (ii) below.

(ii) With respect to a EURIBOR Interest Determination Date on which fewer no rate appears on the Designated EURIBOR Page as specified in Clause (i) above, the Calculation Agent will request the principal Euro-zone office of each of four major reference banks (which may include affiliates of the Dealers) in the Euro-zone interbank market, as selected by the Calculation Agent, to provide the Calculation Agent with its offered quotation for deposits in euro for the period of the Index Maturity specified in the applicable Pricing Supplement commencing on the applicable Interest Reset Date, to prime banks in the Euro-zone interbank market at approximately 11:00 A.M., Brussels time, on such EURIBOR Interest Determination Date and in a principal amount that is representative for a single transaction in euro in such market at such time. If at least two such quotations are so provided, then EURIBOR on such EURIBOR Interest Determination Date will be the arithmetic mean of such quotation. If fewer than two such quotations are so provided, then EURIBOR on such EURIBOR Interest Determination Date will be the arithmetic mean of the rates quoted at approximately 11:00 A.M., Brussels time, on such EURIBOR Interest Determination Date by three major banks (which may include affiliates of the Dealers) in the Euro-zone selected by the Calculation Agent for loans in euro to leading European banks, having the Index Maturity specified in the applicable Pricing Supplement and in a principal amount that is representative for a single transaction in euro in such market at such time; provided, however, that if the banks so selected by the Calculation Agent are not quoting as mentioned in this sentence, EURIBOR determined as of such EURIBOR Interest Determination Date will be EURIBOR in effect on such EURIBOR Interest Determination Date.

"EURIBOR" means the rate for deposits in euro designated as such and sponsored jointly by the European Banking Federation and ACI—The Financial Market Association (or any company established by the joint sponsors for the purposes of compiling and publishing such rates).

"Designated EURIBOR Page" means the display on the page specified in the applicable Pricing Supplement, as the case may be, for the purpose of displaying the euro-zone interbank rates of major banks for the euro; *provided, however*, if no such page is specified in the applicable Pricing Supplement, as the case may be, the display on Reuters (or any successor service) on the EURIBOR 01 page (or any other page as may replace such page on such service) shall be used.

"Euro-zone" means the region comprised of member states of the European Union that have adopted the single currency in accordance with the Treaty on European Union signed at Maastricht on February 7, 1992.

Federal Funds Rate

Unless otherwise specified in the applicable Pricing Supplement, "Federal Funds Rate" means, with respect to any Interest Determination Date relating to a Floating Rate Note for which the interest rate is determined with reference to the Federal Funds Rate (a "Federal Funds Rate Interest Determination Date"), the rate with respect to such date for U.S. dollar federal funds as published in H.15(519) under the heading "Federal Funds (Effective)", and that appears on Reuters (or any successor service) on Reuters Page FEDFUNDS 1 (or any other page as may replace such page or such service) under the heading "EFFECT"or, if such rate does not appear on Reuters Page FEDFUNDS 1 or is not so published by 5:00 P.M. New York City time, on the related Calculation Date, the rate with respect to such Federal Funds Rate Interest Determination Date for U.S. dollar federal funds as published in H.15 Daily Update, or such other recognized electronic source used for the purpose of displaying such rate, under the caption "Federal Funds (Effective)". If such rate does not appear on Reuters Page FEDFUNDS 1 or is not yet published in H.15(519), H.15 Daily Update or another recognized electronic source by 5:00 P.M., New York City time, on the related Calculation Date, then the Federal Funds Rate with respect to such Federal Funds Rate Interest Determination Date will be calculated by the Calculation Agent and will be the arithmetic mean of the rates for the last transaction in overnight U.S. dollar federal funds arranged by three leading brokers of U.S. dollar federal funds transactions in New York City (which may include the Dealers or their affiliates) selected by the Calculation Agent prior to 9:00 A.M., New York City time, on the Business Day following such Federal Funds Rate Interest Determination Date; provided, however, that if the brokers so selected by the Calculation Agent are not quoting as mentioned in this sentence, the Federal Funds Rate determined as of such Federal Funds Rate Interest Determination Date will be the Federal Funds Rate in effect on such Federal Funds Rate Interest Determination Date.

LIBOR

Unless otherwise specified in the applicable Pricing Supplement, "LIBOR" means the rate determined in accordance with the following provisions:

(i) With respect to any Interest Determination Date relating to a Floating Rate Note for which the interest rate is determined with reference to LIBOR (a "LIBOR Interest Determination Date"), LIBOR will be the rate for deposits in the Designated LIBOR Currency having the Index Maturity specified in such Pricing Supplement, commencing on such Interest Reset Date, that appears on the Designated LIBOR Page as of 11:00 A.M., London time, on such LIBOR Interest Determination Date; or if no such rate so appears, as applicable, LIBOR on such LIBOR Interest Determination Date will be determined in accordance with the provisions described in clause (ii) below.

(ii) With respect to a LIBOR Interest Determination Date on which no rate appears on the Designated LIBOR Page as specified in clause (i) above, the Calculation Agent will request the principal London offices of each of four major reference banks (which may include affiliates of the Dealers) in the London interbank market, as selected by the Calculation Agent, to provide the Calculation Agent with its offered quotation for deposits in the Designated LIBOR Currency for the period of the Index Maturity specified in the applicable Pricing Supplement, as the case may be, commencing on the applicable Interest Reset Date, to prime banks in the London interbank market at approximately 11:00 A.M., London time, on such LIBOR Interest Determination Date and in a principal amount that is representative for a single transaction in the Designated LIBOR Currency in such market at such time. If at least two such quotations are so provided, then LIBOR on such LIBOR Interest Determination Date will be the arithmetic mean of such quotations. If fewer than two such quotations are so provided, then LIBOR on such LIBOR Interest Determination Date will be the arithmetic mean of the rates quoted at approximately 11:00 A.M., in the applicable Principal Financial Center, on such LIBOR Interest Determination Date by three major banks (which may include affiliates of the Dealers) in such Principal Financial Center selected by the Calculation Agent for loans in the Designated LIBOR Currency to leading European banks, having the Index Maturity specified in the applicable Pricing Supplement, as the case may be, commencing on that Interest Reset Date and in a principal amount that is representative for a single transaction in the Designated LIBOR Currency in such market at such time; provided, however, that if the banks so selected by the Calculation Agent are not quoting as mentioned in this sentence, LIBOR determined as of such LIBOR Interest Determination Date will be LIBOR in effect on such LIBOR Interest Determination Date.

"Designated LIBOR Currency" means the currency specified in the applicable Pricing Supplement as to which LIBOR shall be calculated or, if no such currency is specified in the applicable Pricing Supplement, U.S. dollars.

"Designated LIBOR Page" means the display on the page specified in the applicable Pricing Supplement, as the case may be, for the purpose of displaying the London interbank rates of major banks for the Designated LIBOR Currency; *provided, however*, if no such page is specified in the applicable Pricing Supplement, as the case may be, the display on Reuters (or any such service) on the LIBOR01 page (or any other page as may replace such page on such service) shall be used.

Prime Rate

Unless otherwise specified in the applicable Pricing Supplement, "Prime Rate" means, with respect to any Interest Determination Date relating to a Floating Rate Note for which the interest rate is determined with reference to the Prime Rate (a "Prime Rate Interest Determination Date"), the rate on such date as such rate is published in H.15(519) under the caption "Bank Prime Loan" or, if not published by 5:00 P.M., New York City time, on the day that is one New York City Banking Day following the applicable Interest Reset Date, the rate on such Prime Rate Interest Determination Date as published in H.15 Daily Update, or such other recognized electronic source used for the purpose of displaying such rate, under the caption "Bank Prime Loan". If such rate is not yet published in H.15(519), H.15 Daily Update or another recognized electronic source by 5:00 P.M., New York City time, on a day that is a New York City Banking Day following the applicable Interest Reset Date, then the Prime Rate shall be the arithmetic mean , as determined by the Calculation Agent, of the rates of interest publicly announced by three major banks (which may include affiliates of the Dealers) in New York City as the U.S. dollar prime rate or base lending rate in effect for such Prime Rate Interest Determination Date. (Each change in the prime rate or base lending rate of any bank so announced by such bank will be effective as of the effective date of the announcement or, if no effective date is specified, as of the date of the announcement.) If fewer than three major banks (which may include affiliates of the Dealers) in New York City have publicly announced the U.S. dollar prime rate or base lending rate for such Prime Rate Interest Determination Date, the Prime Rate with respect to such Prime Rate Interest Determination Date shall be the rate in effect on such Prime Rate Interest Determination Date.

Treasury Rate

Unless otherwise specified in the applicable Pricing Supplement, "Treasury Rate" means, with respect to any Interest Determination Date relating to a Floating Rate Note for which the interest rate is determined by reference to the Treasury Rate (a "Treasury Rate Interest Determination Date"), the rate from the auction held on such Treasury Rate Interest Determination Date (the "Auction") of direct obligations of the United States ("Treasury Bills") having the Index Maturity specified in the applicable Pricing Supplement under the caption "INVEST RATE" on the display on Reuters (or any successor service) or US AUCTION 10 (or any other page as may replace such page on such service) ("Reuters Page US AUCTION 10") or US AUCTION 11 (or any other page as may replace such page on such service) ("Reuters Page US AUCTION 11") or, if not so published by 3:00 P.M., New York City time, on the related Calculation Date, the Bond Equivalent Yield (as defined below) of the rate for such Treasury Bills as published in H.15 Daily Update, or such other recognized electronic source used for the purpose of displaying such rate, under the caption "U.S. Government Securities/Treasury Bills/Auction High" or, if not so published by 3:00 P.M., New York City time, on the related Calculation Date, the Bond Equivalent Yield of the auction rate of such Treasury Bills as announced by the U.S. Department of the Treasury. In the event that the auction rate of Treasury Bills having the Index Maturity specified in the applicable Pricing Supplement is not so announced by the U.S. Department of the Treasury, or if no such Auction is held, then the Treasury Rate will be the Bond Equivalent Yield of the rate on such Treasury Rate Interest Determination Date of Treasury Bills having the Index Maturity specified in the applicable Pricing Supplement as published in H.15(519) under the caption "U.S. Government Securities/Treasury Bills/Secondary Market" or, if not yet published by 3:00 P.M., New York City time, on the related Calculation Date, the rate on such Treasury Rate Interest Determination Date of such Treasury Bills as published in H.15 Daily Update, or such other recognized electronic source used for the purpose of displaying such rate, under the caption "U.S. Government Securities/Treasury Bills/Secondary Market". If such rate is not yet published in H.15(519), H.15 Daily Update or another recognized electronic source, then the Treasury Rate will be calculated by the Calculation Agent and will be the Bond Equivalent Yield of the arithmetic mean of the secondary market bid rates, as of approximately 3:30 P.M., New York City time, on such Treasury Rate Interest Determination Date, of three primary U.S. government securities dealers (which may include the Dealers or their affiliates) selected by the Calculation Agent, for the issue of Treasury Bills with a remaining maturity closest to the Index Maturity specified in the applicable Pricing Supplement; provided, however, that if the dealers so selected by the Calculation Agent are not quoting as mentioned in this sentence, the Treasury Rate determined as of such Treasury Rate Interest Determination Date will be the Treasury Rate in effect on such Treasury Rate Interest Determination Date.

"Bond Equivalent Yield" means a yield (expressed as a percentage) calculated in accordance with the following formula:

$$\text{Bond Equivalent Yield} = \frac{D \times N}{360 - (D \times M)} \times 100$$

where "D" refers to the applicable per annum rate for Treasury Bills quoted on a bank discount basis, "N" refers to 365 or 366, as the case may be, and "M" refers to the actual number of days in the applicable Interest Reset Period.

Sufficiency of Available Distributable Funds in Respect of Capital Notes

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

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

The Issuer covenants that, so long as any Capital Note is outstanding, if the most recent scheduled payments on the Capital Notes have not been made in full or utilization of a Converted Amount has been made, as aforesaid:

(i) it shall not declare (nor shall its Board of Directors propose the declaration of), pay or distribute interest, a dividend or any other amount on, or in respect of, any other Parity Securities or any Junior Securities or make any payment on a Tier I Guarantee (except, subject to the first paragraph of this subsection above, in the case of Capital Securities ranking *pari passu* with the Capital Notes, any payments made on a *pro rata* basis as contemplated above);

(ii) it shall not redeem, purchase or otherwise acquire any other Parity Securities or Junior Securities or purchase or otherwise acquire any security benefiting from a Tier I Guarantee (save where those shares or securities being redeemed, purchased or acquired are replaced contemporaneously by an issue of shares or securities of the same aggregate principal amount and the same ranking in an insolvency or a voluntary or involuntary liquidation of the Issuer to those shares or securities being redeemed, purchased or acquired); and

(iii) it will procure that no payment is made, or any redemption, purchase or acquisition is effected, by any Subsidiary on any security (however named or designated) benefiting from a Tier I Guarantee,

in each case until the Dividend Stopper End Date or, as the case may be, until an amount equal to any Converted Amount has been reconverted and reinstated as an obligation in respect of the Capital Notes in full in the balance sheet of the Issuer, or such amount has been redeemed (such redemption having been approved by the FSA).

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

The Board of Directors of the Issuer is responsible for determining whether the Issuer has Available Distributable Funds or Unallocated Distributable Profits and, on any occasion when the Board of Directors determines that the Issuer has insufficient Available Distributable Funds to pay accrued interest on the next Interest Payment Date or Unallocated Distributable Profits to make a full or partial payment of accrued interest on any deferred Interest Payment Date prior to the Deferral End Date, the Issuer will procure a report by the auditors of the Issuer addressed to the Directors of the Issuer as to the proper extraction of the figures used by the Directors of the Issuer to determine Available Distributable Funds and Unallocated Distributable Profits and the mathematical accuracy of the calculations.

The Issuer also shall give not more than 14 nor less than five days' prior notice to the Holders in accordance with the provisions herein in case of a deferred payment of interest out of Unallocated Distributable Profits.

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

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

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

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

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

The provisions of this subsection shall be governed by, and construed in accordance with Icelandic law.

Other/Additional Provisions; Addendum

Any provisions with respect to the Notes, including the specification and determination of one or more Interest Rate Bases, the calculation of the interest rate applicable to a Floating Rate Note, the Interest Payment Dates, the Stated Maturity, any redemption or repayment provisions or any other term relating thereto, may be modified and/or supplemented as specified under "Supplemental Indentures" herein and under "Other/Additional Provisions; Addendum" in the applicable Pricing Supplement; *provided that* the provisions relating to maturity, redemption, repayment, events of default and subordination of the Subordinated Notes or Capital Notes shall not be so capable of modification under "Other/Additional Provisions: Addendum" in the applicable Pricing Supplement, unless, to the extent required, the prior written consent of the FSA has been obtained or is for the purpose of correcting a manifest error.

Discount Notes

The Issuer may from time to time offer Notes ("Discount Notes") that have an Issue Price (as specified in the applicable Pricing Supplement) that is less than 100% of the principal amount thereof (i.e., par) by more than a percentage equal to the product of 0.25% and the number of full years to the Stated Maturity. Discount Notes may not bear any interest currently or may bear interest at a rate that is below market rates at the time of issuance. The difference between the Issue Price of a Discount Note and par is referred to herein as the "Discount". In the event of redemption, repayment or acceleration of maturity of a Discount Note, the amount payable to the Holder of such Discount Note will be equal to the sum of (i) Amortized Face Amount and (ii) any unpaid interest accrued thereon to the date of such redemption, repayment or acceleration of maturity, as the case may be.

Unless otherwise specified in the applicable Pricing Supplement, for purposes of determining the amount of Discount that has accrued as of any date on which a redemption, repayment or acceleration of Maturity occurs for a Discount Note, such Discount will be accrued using a constant yield method. The constant yield will be calculated using a 30-day month, 360-day year convention, a compounding period that, except for the Initial Period (as defined below), corresponds to the shortest period between Interest Payment Dates for the applicable Discount Note (with ratable accruals within a compounding period), a coupon rate equal to the initial coupon rate applicable to such Discount Note and an assumption that the Maturity of such Discount Note will not be accelerated. If the period from the Original Issue Date to the initial Interest Payment Date for a Discount Note (the "Initial Period") is shorter than the compounding period for such Discount Note, a proportionate amount of the yield for an entire compounding period will be accrued. If the Initial Period is longer than the compounding period, then such period will be divided into a regular compounding period and a short period with the short period being treated as provided in the preceding sentence. The accrual of the applicable Discount may differ from the accrual of issue discount for purposes of the U.S. Internal Revenue Code of 1986, as amended (the "Code"). Certain Discount Notes may not be treated as having original issue discount within the meaning of the Code, and Notes other than Discount Notes may be treated as issued with original issue discount for federal income tax purposes. See "U.S. Taxation—Certain United States Federal Income Tax Considerations".

Indexed Notes

The Issuer may from time to time offer Notes ("Indexed Notes") with the amount of principal, premium and/or interest payable in respect thereof to be determined with reference to the price or prices of specified commodities or stocks, to the exchange rate of one or more designated currencies relative to an indexed currency or to other items, in each case as specified in the applicable Pricing Supplement. In certain cases, a Holder of an Indexed Note may receive a principal payment on Maturity that is greater than or less than the principal amount of such Indexed Note depending upon the relative value on Maturity of the specified indexed item. Information as to the method for determining the amount of principal, premium, if any, and/or interest, if any, payable in respect of Indexed Notes, certain historical information with respect to the specified indexed item and any material tax considerations associated with an investment in Indexed Notes will be specified in the applicable Pricing Supplement. See also "Risk Factors".

Unless otherwise stated in the applicable Pricing Supplement, in the event that the principal, premium and/or interest, if any, or any other amount payable in respect of any Note is to be determined by means of quotations obtained from major banks or other relevant sources, such quotations will be requested on the basis of a representative amount of a normal single transaction in the relevant market and at the relevant time for such quotation.

Additional Notes

The Issuer may issue additional Notes of a Series having identical terms to that of a prior tranche of Notes of the same Series but for the Original Issue Date and the public offering price ("Additional Notes"). The Pricing Supplement relating to any Additional Notes will set forth matters related to such issuance, including identifying the prior tranche of Notes, their Original Issue Date and the aggregate principal amount of Notes then-comprising such Series.

Amortizing Notes

The Issuer may from time to time offer Senior and Subordinated Notes with the amount of principal thereof and interest thereon payable in installments over the term of such Senior and Subordinated Notes ("Amortizing Notes"). Unless otherwise specified in the applicable Pricing Supplement, interest on each Amortizing Note will be computed on the basis of a 360-day year of twelve 30-day months. Payments with respect to Amortizing Notes will be applied first to interest due and payable thereon and then to the reduction of the unpaid principal amount thereof. Further information concerning additional terms and provisions of Amortizing Notes will be specified in the applicable Pricing Supplement, including a table, formula or formulae setting forth repayment information for such Amortizing Notes.

Payment of Additional Amounts

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

(i) presented for payment by or on behalf of a holder who is liable for such taxes or duties in respect of such Note by reason of his having some connection with a Tax Jurisdiction other than the mere holding of such Note; or

(ii) presented for payment more than 30 days after the Relevant Date (as defined below) except to the extent that the holder thereof would have been entitled to an additional amount on presenting the same for payment on such thirtieth day assuming that day to have been a Payment Day (as defined below); or

(iii) where such withholding or deduction is imposed on a payment to an individual and is required to be made pursuant to European Council Directive 2003/48/EC or any law implementing or complying with, or introduced in order to conform to, such Directive; or

(iv) presented for payment by or on behalf of a holder who would have been able to avoid such withholding or deduction by presenting the relevant Note to another Paying Agent in a Member State of the European Union.

As used herein:

"Tax Jurisdiction" means Iceland or any political subdivision or any authority thereof or therein having power to tax or any other jurisdiction or any political subdivision or any authority thereof or therein having power to tax to which the Issuer becomes subject in respect of payments made by it of principal and interest on the Notes; and

"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 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 holders of Notes in accordance with the requirements found under the subsection "—Notices".

"Payment Day" means any day which is a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in:

(A) the relevant place of presentation;

(B) London;

(C) New York;

(D) any additional Principal Financial Center specified in the applicable Pricing Supplement; and

either (1) in relation to any sum payable in a Specified Currency other than euro, a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in the principal financial centre of the country of the relevant Specified Currency (if other than the place of presentation, London and any additional Principal Financial Center and which if the Specified Currency is Australian dollars or New Zealand dollars shall be Sydney or Auckland, respectively) or (2) in relation to any sum payable in euro, a day on which the TARGET System is open.

Redemption and Repurchase

General

The Pricing Supplement relating to a Series of Notes will indicate either that such Notes cannot be redeemed prior to Maturity, other than for tax reasons (as set forth below), or the terms on which the Notes will be redeemable prior to Maturity at the option of the Issuer or at the option of the Holder or at the option of either. Notice of redemption shall be provided as set forth below under "—Notices".

Capital Notes shall be undated with no fixed date for redemption.

Redemption for Tax Reasons

The Notes of any Series may be redeemed, subject to any other terms set forth in the applicable Pricing Supplement, in whole but not in part, at the option of the Issuer, upon not more than 60 days', nor less than 30 days', prior notice given as provided below under "—Notices", at a redemption price equal to 100% of the principal amount (or at the then current Amortized Face Amount, if the Note is a Discount Note or, if such Note is an Indexed Note, at the Redemption Price (as defined below) specified in the applicable Pricing Supplement) (and premium, if any, thereon) together with interest, to the date fixed for redemption, if on the next succeeding Interest Payment Date the Issuer will become obligated to pay additional amounts (as provided in the applicable Indenture for the Notes of such Series) as a result of any change in, or amendment to, the laws or regulations of a Tax Jurisdiction or any change in the application or official interpretation of such laws or regulations, which change or amendment become effective on or after the date on which the first Tranche of such Series is issued and such obligation cannot be avoided by the use of reasonable measures available to the Issuer; *provided*, that no such notice of redemption shall be given earlier than 90 days prior to the earliest date on which the Issuer would be obliged to pay such additional amounts were a payment in respect of the Notes then due. Capital Notes may be so redeemed only if permitted under applicable Icelandic rules, regulations and laws.

In the event that the Issuer elects to redeem the Notes of any Series pursuant to the provisions set forth in the preceding paragraph, the Issuer will deliver to the applicable Trustee (i) a certificate, signed by two authorized officers of the Issuer, evidencing compliance with such provisions and stating that the Issuer is entitled to redeem the Notes of any such Series pursuant to the terms of such Notes and the applicable Indenture and (ii) a written Opinion of Counsel to the Issuer to the effect that the circumstances referred to above exist.

Redemption at the Option of the Issuer

The Senior and Subordinated Notes will be redeemable at the option of the Issuer prior to the Stated Maturity if, and, only if an Initial Redemption Date ("Initial Redemption Date") is specified in the applicable Pricing Supplement. If so specified, and subject to any other terms set forth in the applicable Pricing Supplement, such Series of Senior and Subordinated Notes will be subject to redemption at the option of the Issuer on any date on and after the applicable Initial Redemption Date, in whole or from time to time in part in increments of US$100,000 or the minimum denomination specified in such Pricing Supplement (*provided* that any remaining principal amount thereof shall be at least US$100,000 or such minimum denomination), at the applicable Redemption Price on notice given not more than 60 days, if the Notes are being redeemed in whole, or 45 days, if the Notes are being redeemed in part, nor less than 30 days prior to the date of redemption and in accordance with the provisions of the respective Indenture.

"Redemption Price" with respect to a Senior or Subordinated Note, means, unless otherwise specified in the applicable Pricing Supplement, an amount equal to the sum of (i) the Initial Redemption Percentage specified in such Pricing Supplement (as adjusted by the Annual Redemption Percentage Reduction, if applicable (as specified in such Pricing Supplement)) multiplied by the unpaid principal amount or the portion to be redeemed plus (ii) accrued interest, if any, to the date of redemption. Unless otherwise specified in the applicable Pricing Supplement, the Initial

Redemption Percentage, if any, applicable to a Note shall decline at each anniversary of the Initial Redemption Date by an amount equal to the applicable Annual Redemption Percentage Reduction, if any, until the Redemption Price is equal to 100% of the unpaid principal amount thereof or the portion thereof to be redeemed.

The Capital Notes of any Series may be redeemable at the option of the Issuer if a Capital Event Redemption Event occurs or if an Initial Redemption Date ("Initial Redemption Date") is specified in the applicable Pricing Supplement. Capital Notes of a Series may be subject to redemption at the option of the Issuer on any date on and after the applicable Initial Redemption Date, if so specified, and subject to any other terms set forth in the applicable Pricing Supplement, or on any Capital Event Redemption Date, in whole but not in part at the applicable Redemption Price or Capital Event Redemption Price on notice given not more than 60 days, if the Notes are being redeemed in whole, or 45 days, if the Notes are being redeemed in part, nor less than 30 days prior to the date of redemption and in accordance with the provisions of the respective Indenture.

"Capital Event Redemption Price" and "Capital Event Redemption Date", with respect to a Capital Note, have the meanings specified in the applicable Pricing Supplement. Except as provided in "—Events of Default—Capital Notes" the Issuer shall not redeem the Capital Notes until all Converted Amounts have been reconverted and reinstated as debt in full as an obligation in respect of the Capital Notes and only if permitted under applicable Icelandic rules, regulations and laws.

Unless otherwise specified in the applicable Pricing Supplement, the Notes will not be subject to any sinking fund.

Repayment at the Option of the Holders of Senior Notes

If so specified in the applicable Pricing Supplement, Senior Notes may be repayable by the Issuer in whole or in part at the option of the Holders thereof on their respective optional repayment dates ("Optional Repayment Dates") specified in such Pricing Supplement. For the avoidance of doubt, the Subordinated Notes and the Capital Notes will not be so repayable. If no Optional Repayment Date is specified with respect to a Note, such Note will not be repayable at the option of the Holder thereof prior to the Stated Maturity. Any repayment in part will be in increments of US$100,000 or the minimum denomination specified in the applicable Pricing Supplement (provided that any remaining principal amount thereof shall be at least US$100,000 or such minimum denomination). Unless otherwise specified in the applicable Pricing Supplement, the repayment price for any Note to be repaid means an amount equal to the sum of the unpaid principal amount thereof or the portion thereof plus accrued interest to the date of repayment. Except as otherwise specified in the applicable Pricing Supplement, exercise of the repayment option is irrevocable.

Selection of Notes for Partial Redemption

In the case of any partial redemption of Notes, and subject to any other terms specified in the applicable Pricing Supplement, the Notes to be redeemed shall be selected either by the applicable Trustee individually by lot not more than 60 days prior to the Redemption Date from the outstanding Notes not previously called for redemption or in such other manner as may be agreed by the Issuer and the Holders.

Repurchase

The Issuer may (subject, in the case of Capital Notes, to the extent required, to the prior written consent of the FSA having been obtained) at any time purchase Notes at any price or prices in the open market or otherwise. Notes so purchased may be held or resold or, at the discretion of the Issuer, surrendered to the applicable Trustee for cancellation. If any applicable Pricing Supplement provides for mandatory sinking fund payments with respect to such Notes, the Indentures provide that in lieu of making all or any part of any mandatory sinking fund payment in cash, the Issuer may deliver to the applicable Trustee Notes previously purchased or otherwise acquired by the Issuer (to the extent not previously credited).

Negative Pledge

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

As used herein:

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

(i) recourse to such borrower for amounts limited to the cash flow or net cash flow (other than historic cash flow or historic net cash flow) from a Specified Asset; and/or

(ii) recourse to such borrower for the purpose only of enabling amounts to be claimed in respect of such Relevant Indebtedness in an enforcement of any encumbrance given by such borrower over a Specified Asset or the income, cash flow or other proceeds deriving therefrom (or given by a shareholder or the like in the borrower over its shares or the like in the capital of the borrower) to secure such Relevant Indebtedness, provided that (a) the extent of such recourse to such borrower is limited solely to the amount of any recoveries made on any such enforcement, and (b) such person or persons is/are not entitled, by virtue of any right or claim arising out of or in connection with such Relevant Indebtedness, to commence proceedings for the winding up or dissolution of the borrower or to appoint or procure the appointment of any receiver, trustee or similar person or officer in respect of the borrower or any of its assets (save for the assets the subject of such encumbrance); and/or

(iii) recourse of such borrower generally, or directly or indirectly to the Issuer or any Subsidiary, under any form of assurance, undertaking or support, which recourse is limited to a claim for damages (other than liquidated damages and damages required to be calculated in a specified way) for breach of an obligation (not being a payment obligation or an obligation to procure payment by another or an indemnity in respect thereof or any obligation to comply or to procure compliance by another with any financial ratios or other tests of financial condition) by the person against which such recourse is available;

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

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

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

"Specified Asset" means an asset of the Issuer or any Subsidiary over which security is given in connection with any limited recourse securitization 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.

Events of Default—Senior Notes

The following shall constitute "Events of Default" with respect to the Senior Notes:

(i) a failure to pay, or to duly provide for the payment of, any principal (including premium or final redemption amount, initial redemption amount or early redemption amount, if any, and in the case of Discount Notes, the Amortized Face Amount or other amount payable in respect thereof) of any Senior Note of the Series of Senior Notes of which such Senior Note is a part when due (whether at Maturity, upon redemption or otherwise);

(ii) a failure to pay, or to duly provide for the payment of, any interest for a period of 30 days or more, in respect of any Senior Note of the Series of Senior Notes of which such Senior Note is a part when due;

(iii) a failure to make any payment in respect of indebtedness for Borrowed Money (as defined in the Senior Indenture) (which indebtedness has an outstanding aggregate principal amount of at least the Specified Amount) of the Issuer or any Material Subsidiary on its due date (or by the expiry of any applicable grace period as originally provided) or such indebtedness becoming due and payable prior to the Stated Maturity by reason of default or the failure to honor any guarantee or indemnity of any payment in respect of indebtedness for moneys borrowed of any third party given by the Issuer or any Material Subsidiary when due and called upon (except where the aggregate liability under any such guarantees or indemnities does not exceed the Specified Amount);

(iv) a default by the Issuer in the performance or observance of any obligation, condition or provision binding on it under the Senior Notes or the Senior Indenture (other than any obligation included in the Senior Indenture solely for the benefit of Senior Notes other than the Senior Notes of any such particular Series) and, except where such default is or the effects of such default are, in the opinion of the Trustee, not capable of remedy when no such continuation and notice as is hereinafter mentioned will be required, such default continues for 30 days (or such longer period as the Senior Trustee may permit) after written notice thereof has been given by the Senior Trustee to the Issuer requiring the same to be remedied;

(v) an order is made by any competent court or an effective resolution is passed for the winding-up of the Issuer or any Material Subsidiary (except, in any such case, a winding-up or dissolution for the purpose of a reconstruction or amalgamation the terms of which have previously been approved in writing by the Senior Trustee or by the Holders of not less than a majority in aggregate principal amount of the Outstanding Senior Notes or a voluntary solvent winding-up or a transfer of all or a material part of the business, undertaking and assets of such Material Subsidiary to the Issuer or any other subsidiary of the Issuer);

(vi) The Issuer or any Material Subsidiary stops or threatens in writing to stop payment to its creditors generally or the Issuer or any Material Subsidiary ceases or threatens in writing to cease to carry on its business or substantially the whole of its business (except for the purpose of or in connection with a reconstruction or amalgamation the terms of which have previously been approved in writing by the Senior Trustee or by the Holders of not less than a majority in aggregate principal amount of the Outstanding Senior Notes or a voluntary solvent winding-up or a transfer of all or a material part of the business, undertaking and assets of such Material Subsidiary to the Issuer or any other subsidiary of the Issuer);

(vii) an encumbrancer takes possession or a receiver, administrator, administrative receiver or other similar officer is appointed of the whole or any material part of the undertaking, property and assets of the Issuer or any Material Subsidiary or a distress or execution is levied or enforced upon or sued out against the whole or any material part of the chattels or property of the Issuer or any Material Subsidiary and, in the case of any of the foregoing events, is not discharged within 30 days (or such longer period as the Senior Trustee may permit);

(viii) admission by the Issuer or any Material Subsidiary in writing that it is unable to pay its debts generally; or

(ix) any other event of default provided with respect to Senior Notes of that Series.

"Adjusted Tangible Net Worth" means the aggregate of (1) the nominal amount of the share capital of the Issuer for the time being issued and paid up or credited as paid up, (2) the amounts standing to the credit of the reserves (including any share premium account and profit and loss account) of the Issuer and its subsidiaries and (3) any amount attributable to minority interests in subsidiaries, all as shown in the latest audited consolidated balance sheet of the Issuer and its subsidiaries prepared in accordance with IFRS less (4) any amounts, determined in accordance with IFRS, representing distribution of cash or tangible assets declared, recommended or made by the Issuer or any of its subsidiaries (other than any distribution attributable to the Issuer or another subsidiary) out of profits accrued prior to the date of, and not provided for in, the latest audited consolidated balance sheet of the Issuer and its subsidiaries and less (5) any amounts shown in such latest audited consolidated balance sheet attributable to intangible assets and of any debit on the profit and loss account.

"Material Subsidiary" means at any relevant time, any Subsidiary that meets any of the following conditions:

(a) the Issuer's and its other Subsidiaries' investments in and advances to the Subsidiary exceed 10 percent of the total assets of the Issuer and its Subsidiaries consolidated as of the end of the most recently completed fiscal year; or

(b) the Issuer's and its other Subsidiaries' proportionate share of the total assets (after intercompany eliminations) of the Subsidiary exceeds 10 percent of the total assets of the Issuer and its Subsidiaries consolidated as of the end of the most recently completed fiscal year; or

(c) the Issuer and its other Subsidiaries' equity in the income from continuing operations before income taxes, extraordinary items and cumulative effect of a change in accounting principle of the Subsidiary exceeds 10 percent of such income of the Issuer and its Subsidiaries consolidated for the most recently completed fiscal year.

"Specified Amount" means the greater of (a) $10,000,000 or its equivalent in any other currency or currencies and (b) such amount in dollars as is equal to 1% of the Adjusted Tangible Net Worth.

In case an Event of Default specified in clause (v), (vi), (vii) or (viii) above shall occur, the Stated Maturity of all Senior Notes shall automatically be accelerated and the principal amount of such Notes, together with interest accrued thereon and Additional Amounts, if any, shall be immediately due and payable. In case any other Event of Default with respect to any Series of Senior Notes shall have occurred and be continuing, the Senior Trustee or the Holders of at least 25% in aggregate principal amount of the Senior Notes of that Series may declare the principal of (including premium, if any on) or (in the case of Discount Notes) such lesser amount as may be provided for with respect to such Notes, all the Senior Notes of that Series to be due and payable immediately, by a notice in writing to the Issuer (and to the Senior Trustee if given by Holders), and upon any such declaration of acceleration such principal or such lesser amount, as the case may be, including premium, if any, thereon, together with any accrued interest and all other amounts owing under such Senior Notes and under the Senior Indenture (with respect to such Series of Senior Notes), shall become immediately due and payable, without presentment, demand, protest or notice of any kind, all of which have been expressly waived by the Issuer. Upon such an acceleration, any premium and interest on the Senior Notes shall also become due and payable. At any time after such a declaration of acceleration but before a judgment or decree for payment of the money due has been obtained by the Senior Trustee or the Holders of such Outstanding Senior Notes, the Holders of a majority in aggregate principal amount of such Outstanding Senior Notes may rescind and annul such acceleration and its consequences, provided all required payments (other than as a result of such acceleration) have been made and all Events of Default with respect to such Senior Notes shall have been cured or waived.

The Holders of a majority in aggregate principal amount of the Outstanding Senior Notes of a Series may waive, on behalf of the Holders of all such Senior Notes of that Series, any past default of that series with respect to the Senior Notes of that Series and its consequences, except a default in the payment of the principal of (or premium, if any, on) or interest, if any, on any such Senior Note of that Series or a default in respect of a covenant or provision of the Senior Indenture that cannot be modified or amended without the consent of the Holders of each such Senior Note of that Series affected thereby. See "—Waivers" below.

The Issuer has also covenanted that if (i) there is a failure to pay, or to duly provide for the payment of, any interest for a period of 30 days upon any Senior Note of a Series when such interest becomes due and payable or (ii) there is a failure to pay, or to duly provide for the payment of, the principal of (or premium, if any, on) any Senior Note of a Series at its Maturity, the Issuer will, upon demand of the Senior Trustee for the Senior Notes of such Series, pay to it, for the benefit of the Holders of such Senior Notes, the whole amount then due and payable on such Senior Notes for principal (and premium, if any) and interest, if any, with interest upon the overdue principal (and premium, if any) and, to the extent that payment of such interest shall be legally enforceable, upon any overdue installments of interest at a rate per annum equal to the rate borne by such Senior Notes (or, in the case of Discount Notes, the Notes' Yield to Maturity); and, in addition thereto, such further amount as shall be sufficient to cover the costs and expenses of collection, including the reasonable compensation, expenses, disbursements and advances of the Senior Trustee, its agents and counsel.

If the Issuer fails to pay such amounts forthwith upon such demand, the Senior Trustee, in its own name and as trustee of an express trust, may institute a judicial proceeding for the collection of the sums so due and unpaid, and may prosecute such proceedings to judgment or final decree, and may enforce the same against the Issuer or any other obligor upon the Senior Notes and collect the moneys adjudged or decreed to be payable in the manner provided by law out of the property of the Issuer, or any other obligor upon the Senior Notes, wherever situated.

Holders of Senior Notes of any Series may not enforce the Senior Indenture or Senior Notes, except as described in the preceding paragraphs; provided that each Holder of Senior Notes will have the right to institute suit for the enforcement of payment of the principal of (and premium, if any, on) and interest, if any, on such Senior Notes on the respective Stated Maturities thereof. The Senior Trustee may require indemnity satisfactory to it before it enforces the Senior Indenture or Senior Note. Subject to certain limitations, Holders of a majority in aggregate principal amount of the Outstanding Senior Notes of any Series may direct the Senior Trustee in its exercise of any trust or power. The Issuer will furnish the Senior Trustee with an annual certificate of certain of its officers certifying, to the best of their knowledge, whether the Issuer is, or has been, in default and specifying the nature and status of any such default. The Senior Trustee may withhold from Holders of Senior Notes of any Series notice of any continuing default (except a default in payment) if it determines in good faith that the withholding of such notice is in the interest of such Holders.

Events of Default—Subordinated Notes

The following events or circumstances (each an "Event of Default") shall be an event of default in relation to the Subordinated Notes:

(i) the Issuer shall default in the payment of principal in respect of any Subordinated Note which has become due and payable; or

(ii) the Issuer shall default in the payment of interest or any additional amounts due on any Subordinated Note; or

(iii) a court or agency or supervisory authority in Iceland (having jurisdiction in respect of the same) shall have instituted a proceeding or entered a decree or order for the appointment of a receiver or liquidator in any insolvency, bankruptcy, rehabilitation, readjustment of debt, marshalling of assets and liabilities or similar arrangements involving the Issuer or all or substantially all of its property, and such proceedings, decree or order shall not have been vacated.

(iv) the Issuer shall file a petition to take advantage of any insolvency statute or shall voluntarily suspend payment of its obligations.

(1) If any Event of Default specified in clause (iii) or (iv) above shall occur, the Stated Maturity of all Subordinated Notes shall automatically be accelerated and the principal amounts of such Notes, together with interest accrued thereon and Additional Amounts, if any, shall be immediately due and payable. If any Event of Default set forth in (i) or (ii) above with respect to any Series of Subordinated Notes shall have occurred and shall be continuing, the Subordinated Notes Trustee or the Holders of at least 25% in aggregate principal amount of the Subordinated Notes of that Series may declare the principal amount of such series to be immediately due and payable together with interest accrued thereon and Additional Amounts, if any, shall be immediately due and payable.

(2) If a Series of Subordinated Notes has been declared due and payable under this subsection "—Events of Default Relating to Subordinated Notes", the Subordinated Notes Trustee or holders of the Subordinated Notes may claim payment in respect of such notes and therefore institute such steps, including the obtaining of a judgment against the Issuer for any amount due and payable in respect of the Subordinated Notes, as it thinks desirable with a view to enforcing its claim or to having the Issuer declared insolvent or put into bankruptcy or compulsory winding-up of its business.

(3) The Subordinated Notes Trustee or a holder of Subordinated Notes may institute such proceedings against the Issuer as it may think fit to enforce any obligation, condition, undertaking or provision binding on the Issuer under the Subordinated Notes provided that the Issuer shall not by virtue of the institution of any such proceedings be obliged to pay any sum or sums sooner than the same would otherwise have been payable by it other than as set forth in clauses (1) and (2) above.

(4) No remedy against the Issuer, other than as provided above in sub paragraphs (1), (2) and (3), or proving or claiming in the insolvency, bankruptcy or compulsory winding-up of the Issuer's business in Iceland or elsewhere, shall be available to the Subordinated Notes Trustee or a holder of Subordinated Notes, whether for the recovery of amounts owing in respect of the Subordinated Notes or in respect of any breach by the Issuer of any of its obligations or undertakings with respect to the Subordinated Notes.

Events of Default—Capital Notes

The following events or circumstances (each an "Event of Default") shall be an event of default in relation to the Capital Notes:

(i) the Issuer shall default in the payment of principal for a period of three days in respect of any Capital Note which has become due and payable; or

(ii) the Issuer shall, to the extent that it is obliged to pay interest according to "—Sufficiency of Available Distributable Funds in Respect of Capital Notes", default for a period of seven days in the payment of interest due on any Capital Note; or

(iii) a court or agency or supervisory authority in Iceland (having jurisdiction in respect of the same) shall have instituted a proceeding or entered a decree or order for the appointment of a receiver or liquidator in any insolvency, rehabilitation, readjustment of debt, marshalling of assets and liabilities or similar arrangements involving the Issuer or all or substantially all of its property, and such proceedings, decree or order shall not have been vacated or shall have remained in force undischarged or unstayed for a period of 14 days; or

(iv) the Issuer shall file a petition to take advantage of any insolvency statute or shall voluntarily suspend payment of its obligations.

(1) If any Event of Default specified in clause (iii) or (iv) above shall occur, all Capital Notes shall become immediately due and payable and if any other Event of Default with respect to any Series of Capital Notes shall have occurred and shall be continuing, the Capital Notes Trustee or the Holders of at least 25% in aggregate principal amount of the Capital Notes of that Series may declare the principal amount of such series to be immediately due and repayable (and upon such declaration the Capital Notes will become immediately due and payable) whether or not the whole or any part of any Converted Amount has been reconverted and reinstated as debt at an amount equal to the principal amount (construed as provided above) of the Capital Notes, together with interest, if any, and Additional Amounts, if any, on the principal amount accrued to, but excluding, the due date for redemption (provided that the Issuer is obliged to make such payment of interest in accordance with subsection entitled "—Sufficiency of Available Distributable Funds in Respect of Capital Notes" or would be so obliged were the due date for repayment an Interest Payment Date).

(2) If a Series of Capital Notes has been declared due and payable under this subsection "—Events of Default Relating to Capital Notes", the Capital Notes Trustee or holders of the Capital Notes may claim payment in respect of the Capital Notes only in the insolvency or voluntary or involuntary liquidation of the Issuer and may therefore institute such steps, including the obtaining of a judgment against the Issuer for any amount due in respect of the Capital Notes, as it thinks desirable with a view to having the Issuer declared insolvent or put into liquidation.

(3) The Capital Notes Trustee or a holder of Capital Notes may institute such proceedings against the Issuer as it may think fit to enforce any obligation, condition, undertaking or provision binding on the Issuer under the Capital Notes (other than, without prejudice to sub paragraphs (1) and (2) above, any obligation for the payment of any principal or interest in respect of the Capital Notes) provided that the Issuer shall not by virtue of the institution of any such proceedings be obliged to pay any sum or sums sooner than the same would otherwise have been payable by it.

(4) The Capital Notes Trustee or a provider of any Converted Amount may institute such proceedings against the Issuer as it may think fit to enforce any obligation, condition, undertaking or provision binding on the Issuer as provided under subsection "—Status and Subordination of Capital Notes" and "—Status and Subordination of Capital Notes—Utilization and Conversion of Capital Notes", provided that the Issuer shall not by virtue of the institution of such proceedings be obliged to pay any sum or sums sooner than the same would otherwise have been payable by it.

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

Judgments

Under current New York law, a state court in the State of New York rendering a judgment in respect of a Note denominated in other than U.S. dollars would be required to render such judgment in the Specified Currency, and such judgment would be converted into U.S. dollars at the Market Exchange Rate prevailing on the date of entry of such judgment. Accordingly, the Holder of such Note denominated in other than U.S. dollars would be subject to exchange rate fluctuations between the date of entry of a judgment in a currency other than U.S. dollars and the time the amount of such judgment is paid to such Holder in U.S. dollars and converted by such Holder into the Specified Currency. It is not certain, however, whether a non-New York state court would follow the same rules and procedures with respect to conversions of judgments in currency other than U.S. dollars.

The Issuer will indemnify the Trustee and the Holder of any Note against any loss incurred by such Holder and/or the Trustee as a result of any judgment or order being given or made for any amount due under such Note and such judgment or order requiring payment in a currency (the "Judgment Currency") other than the Specified Currency, and as a result of any variation between (i) the rate of exchange at which the Specified Currency amount is converted into the Judgment Currency for the purpose of such judgment or order, and (ii) the rate of exchange at which the Holder of such Note, on the date of payment of such judgment or order, is able to purchase the Specified Currency with the amount of the Judgment Currency actually received by such Holder, as the case may be.

Consolidation, Merger and Sale or Lease of Assets

So long as any Note of a Series remains Outstanding, the Issuer will not consolidate or amalgamate with or merge into any other corporation or convey, transfer or lease its properties and assets substantially as an entirety to any Person unless (i) the corporation formed by such consolidation or amalgamation or into which the Issuer is merged or the Person which acquired by conveyance or transfer, or which leases, the properties and assets of the Issuer substantially as an entirety shall be a corporation or other Person organized and validly existing under the laws of Iceland which shall expressly assume, by an amendment to the applicable Indenture that is executed and delivered to the applicable Trustee and is in form reasonably satisfactory to the applicable Trustee, the due and punctual payment of the principal of (and premium, if any, on) and interest, if any, on all of the Notes of such a Series and the performance of every covenant of the applicable Indenture (other than a covenant included in the applicable Indenture solely for the benefit of Notes other than such Notes) and of such Notes to be performed, and such assumption shall provide that such corporation or Person shall pay to the Holder of any such Notes such additional amounts as may be necessary in order that every net payment of the principal of (and premium, if any, on) and interest, if any, on such Notes will not be less than the amounts provided for in such Notes to be then due and payable and such obligations shall extend to any deduction or withholding for or on account of any present or future tax, assessment or governmental charge imposed upon such payment (it being understood that, except as aforesaid, no such corporation or Person shall be obligated to make any indemnification or payment in respect of any tax consequences to any Holder as a result of such assumption of rights and obligations if such corporation or Person would not be obligated to pay an additional amount pursuant to the applicable Indenture if such corporation or Person were the Issuer); (ii) immediately after giving effect to such transaction, no default with respect to the Subordinated Notes and no Event of Default with respect to the Senior Notes or Capital Notes Series, and in no event which after notice or lapse of time, or both, would become an Event of Default with respect to such Senior Notes or Capital Notes, shall have occurred and be continuing; and (iii) the Issuer has delivered to the applicable Trustee a certificate signed by two duly authorized officers and an Opinion of Counsel each stating that such consolidation, amalgamation, merger, conveyance, transfer or lease and such amendment to the applicable Indenture evidencing the assumption by such corporation or Person comply with the applicable Indenture and that all conditions precedent provided for in the applicable Indenture relating to such transaction have been complied with.

Upon any such consolidation, amalgamation or merger, or any such conveyance, transfer or lease, the successor corporation or Person will succeed to, and be substituted for, and may exercise every right and power of the Issuer, under the applicable Indenture with the same effect as if such successor corporation or Person has been named as the issuer thereunder, and thereafter, except in the case of a lease, the predecessor corporation shall be relieved of all obligations and covenants under the applicable Indenture and such Notes.

Satisfaction and Discharge

Except as may otherwise be set forth in the Pricing Supplement relating to the Notes of a Series, the Indentures provide that the Issuer will be discharged from its obligations under the Notes of a Series (with certain exceptions) at any time prior to the Stated Maturity, if any, or redemption of such Notes when (i) the Issuer has irrevocably deposited or caused to be deposited with or to the order of the applicable Trustee, in trust, (a) sufficient funds in the currency, currencies, currency unit or units in which such Notes are payable (without consideration of any reinvestment thereof) to pay the principal of (and premium, if any, on) and interest, on such Notes to the Stated Maturity, if any (or Redemption Date), or (b) such amount of U.S. Government Obligations (as defined below) as will, together with the predetermined and certain income to accrue thereon (without consideration of any reinvestment thereof), be sufficient to pay when due the principal of (and premium, if any, on) and interest, if any, to the Stated Maturity, if any (or Redemption Date) on such Notes, or, (c) such amount equal to the amount referred to in clause (a) or (b) in any combination of currency or currency unit of U.S. Government Obligations; (ii) the Issuer has paid all other sums payable with respect to such Notes; (iii) the Issuer has delivered to the applicable Trustee an Opinion of Counsel to the effect that (a) the Issuer has received from, or there has been published by, the U.S. Internal Revenue Service a ruling, or (b) since the date of the applicable Indenture there has been a change in applicable United States federal income tax law, in either case to the effect that, and based upon which such Opinion of Counsel shall confirm that, the Holders of such Notes will not recognize income, gain or loss for United States federal income tax purposes as a result of such discharge and will be subject to United States federal income tax on the same amount and in the same manner and at the same time as would have been the case if such discharge had not occurred; and (iv) certain other conditions are met. Upon such discharge, the Holders of the Notes of such a Series shall no longer be entitled to the benefits of the terms and conditions of the applicable Indenture and Notes, except for certain provisions including registration of transfer and exchange of such Notes and replacement of mutilated, destroyed, lost or stolen Notes of such a Series, and shall look for payment only to such deposited funds or obligations. In addition, under the requirements of the FSA at the date of this Offering Circular, any such discharge with respect to the Capital Notes of any Series would require the consent of the FSA.

"U.S. Government Obligations" means non-callable (i) direct obligations (or certificates representing an ownership interest in such obligations) of the United States for which its full faith and credit are pledged or (ii) obligations of a Person controlled or supervised by, and acting as an agency or instrumentality of, the United States, the timely payment of which is unconditionally guaranteed as a full faith and credit obligation of the United States.

Supplemental Indentures

The Indentures contain provisions permitting the Issuer and the applicable Trustee (i) without the consent of the Holders of any Notes (including the Notes of such a Series) issued under the applicable Indenture, to execute supplemental indentures for certain enumerated purposes, such as to cure any ambiguity or inconsistency or to make any change that does not have a materially adverse effect on the rights of any holder of such Notes, and (ii) with the consent of the Holders of not less than 66 2/3% in aggregate principal amount of the Outstanding Notes of each Series of Notes issued under the applicable Indenture (including the Notes of any such Series) and affected thereby, to execute supplemental indentures for the purpose of adding any provisions to or changing in any manner or eliminating any of the provisions of the applicable Indenture or of modifying in any manner the rights of holders of any such Note under the applicable Indenture; provided, that no such supplemental indenture may, without the consent of the Holder of each such Outstanding Note (including such Notes) affected thereby (a) change the Stated Maturity, if any, of the principal of or interest on any such Note, or change the terms of any Note with no stated maturity to include a Stated Maturity of the principal amount of any such Note, or reduce the principal amount of any such Note or the rate of interest thereon, if any, or any premium or principal payable upon redemption thereof, or change any obligation of the Issuer to pay additional amounts thereon, or change any Place of Payment where, or change the currency in which, any such Note or the interest, if any, thereon is payable, or impair the right to institute suit for the enforcement of any such payment on or after the Stated Maturity, if any, thereof or the date any such payment is otherwise due and payable (or, in the case of redemption, on or after the redemption date); or (b) reduce the percentage in aggregate principal amount of such Outstanding Notes of any particular Series, the consent of whose Holders is required for any such supplemental indenture, or the consent of whose Holders is required for any waiver (of compliance with certain provisions of the applicable Indenture or certain defaults thereunder and their consequences) provided for in the applicable Indenture; or (c) change any obligation of the Issuer to maintain an office or agency in the places and for the purposes specified in the applicable Indenture; or (d) modify certain of the provisions of the applicable Indenture pertaining to the waiver by Holders of such Notes of past defaults, supplemental indentures with the consent of Holders of such Notes and the waiver by Holders of such Notes of certain covenants, except to increase any specified percentage in aggregate principal amount required for any actions by Holders of Notes or to provide that certain other provisions of the applicable Indenture cannot be modified or waived without the consent of the Holder of each such Note affected thereby; or (e) in the case of the Capital Notes or Subordinated Notes, change in any manner adverse to the interests of the Holders of such Outstanding Subordinated Notes the subordination provisions of such Subordinated Notes. The provisions of the Capital Note Indenture relating to maturity, redemption, repayment, events of default and subordination of the Capital Notes shall not be capable of modification by any Supplemental Indenture other than with the prior written consent of the FSA, to the extent required, or for the purpose of correcting a manifest error.

Notes authenticated and delivered after the execution of any amendment to the Indentures or Notes may bear notation as to any matter provided by such amendment.

New Notes, so modified to conform, in the opinion of the Issuer, to any modification contained in any such amendment may be prepared by the Issuer, authenticated and delivered in exchange for the Notes then outstanding.

Waivers

The Holders of not less than 66 2/3% in aggregate principal amount of the Outstanding Notes of each Series of Notes issued under the applicable Indenture and affected thereby, may on behalf of the Holders of all such Notes waive compliance by the Issuer with certain restrictive provisions of the applicable Indenture as pertain to the corporate existence of the Issuer, the maintenance of certain agencies by the Issuer or, solely with respect to Senior Notes, as pertain to the negative pledge covenant as described under "Negative Pledge" above.

The Holders of 66 2/3% in aggregate principal amount of the Outstanding Notes of a Series issued under the applicable Indenture may waive on behalf of the Holders of all such Notes of such Series, any past default and its consequences under the applicable Indenture, except a default in the payment of the principal of (or premium, if any, on) or interest, if any, on any such Note of that Series or a default in respect of a covenant or a provision which under the applicable Indenture cannot be modified or amended without the consent of the Holder of each Outstanding Note of such a Series.

Notices

Notices to Holders of Notes in registered form will be given by mail to the addresses of such Holders as they appear in the Note Register. For so long as the Notes are listed on the Luxembourg Stock Exchange and the rules of the Luxembourg Stock Exchange so require (visit www.bourse.lu for more information), notices shall also be published in a leading newspaper of general circulation in Luxembourg (which is expected to be *d'Wort*); *provided that* for so long as the Notes are held in registered global form and if the rules of the Luxembourg Stock Exchange would so permit, notifications may be made either through DTC, Euroclear Bank S.A./N.V., as the Euroclear Operator ("Euroclear") or Clearstream Banking, société anonyme ("Clearstream, Luxembourg") or by mail to the address of such Holders as they appear in the Note Register with a copy of the Luxembourg Stock Exchange in place of publication in a newspaper as described above.

Title

The Issuer, the Trustees and any agent of the Issuer or the Trustees may treat the registered owner of any Note in registered form as the absolute owner thereof (whether or not such security shall be overdue and notwithstanding any notice to the contrary) for the purpose of making payment and for all other purposes.

Governing Law

The Indentures and the Notes will be governed by and construed in accordance with the laws of the State of New York, except that the subordination provisions of the Subordinated Indenture and Subordinated Notes and of the Capital Notes Indenture and Capital Notes will be governed by and construed in accordance with the laws of Iceland.

Consent to Service

The Issuer has designated and appointed Kaupthing Securities Inc. at 230 Park Avenue, Suite 1528, in the Borough of Manhattan, City and State of New York, 10169 as its authorized agent upon which process may be served in any suit or proceeding arising out of or relating to the applicable Notes or Indenture which may be instituted in any State or Federal court located in the Borough of Manhattan, City of New York; State of New York, and has submitted (for the purposes or any such suit or proceeding) to the jurisdiction of any such court in which any such suit or proceeding is so instituted. The Issuer has agreed, to the fullest extent that it lawfully may do so, that final judgment in any such suit, action or proceeding brought in such a court shall be conclusive and binding upon it and may be enforced in the courts of England and Wales (or any other courts to the jurisdiction of which it is subject).

Notwithstanding the foregoing, any actions arising out of or relating to the applicable Notes or Indenture may be instituted by the Issuer, the Trustees or the Holder of any Note in any competent court in England and Wales or such other competent jurisdiction, as the case may be.

Concerning the Trustees

Each of the Indentures will provide that, except during the continuance of an Event of Default, with respect to the Senior Indenture and the Capital Note Indenture, and during the continuance of any default with respect to the Subordinated Indenture, the relevant Trustee will have no obligations other than the performance of such duties as are specifically set forth in such Indenture. If any event described in the preceding sentence has occurred and is continuing, the relevant Trustee will use the same degree of care and skill in its exercise of the rights and powers vested in it by the relevant Indenture as a prudent person would exercise under the circumstances in the conduct of such person's own affairs.

Book-Entry System

DTC will act as securities depositary for the Global Notes. Unless otherwise specified, the Global Notes will be issued as fully-registered securities registered in the name of Cede & Co. (DTC's partnership nominee).

The Issuer understands that DTC is a limited-purpose trust company organized under the laws of the State of New York, a "Banking Organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Exchange Act. DTC holds securities that its participants ("Participants") deposit with DTC. DTC also facilitates the clearance and settlement among Participants of transactions in such securities through electronic book-entry changes in Participants' accounts, thereby eliminating the need for physical movement of securities certificates. Direct Participants ("Direct Participants") include securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is owned by a number of its Direct Participants and by the New York Stock Exchange, Inc., the American Stock Exchange, Inc., and the National Association of Securities Dealers, Inc. Access to DTC's system is also available to others such as securities brokers and dealers, banks and trust companies that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). The rules applicable to DTC and its Participants are on file with the Securities and Exchange Commission.

Purchases of Global Notes or Global Receipts under DTC's system must be made by or through Direct Participants, which will receive a credit for the Global Notes or Global Receipts on DTC's records. The ownership interest of each actual purchaser of each Global Note or Global Receipt is in turn to be recorded on the Direct and Indirect Participants' records. Beneficial owners will not receive written confirmation from DTC of their purchase, but beneficial owners are expected to receive written confirmations providing details of the transactions, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the beneficial owner entered into the transaction. Transfers of ownership interests in the Global Notes or Global Receipts are to be accomplished by entries made on the books of Participants acting on behalf of the beneficial owners. Beneficial owners will not receive certificates representing their ownership interests in Global Notes or Global Receipts, except in the event that use of the book-entry system for one or more Global Notes or Global Receipts is discontinued.

To facilitate subsequent transfers, all Global Notes and Global Receipts deposited by Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co. The deposit of Global Notes and Global Receipts with DTC and their registration in the name of Cede & Co. effect no change in beneficial ownership. DTC has no knowledge of the actual beneficial owners of the Global Notes or Global Receipts; DTC's records reflect only the identity of the Direct Participants to whose accounts such Global Notes or Global Receipts are credited, which may or may not be the beneficial owners. The Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to beneficial owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time.

Redemption notices shall be sent to Cede & Co. If less than all of the Notes and Global Receipts within a Series are being redeemed, DTCs current practice is to determine by lot the amount of the interest of each Direct Participant in such issue to be redeemed.

Neither DTC nor Cede & Co. will consent or vote with respect to Notes. Under its usual procedures, DTC will mail an "Omnibus Proxy" to the Issuer as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts the Notes are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Principal and interest payments on the Global Notes and Global Receipts will be made to DTC. DTC's practice is to credit Direct Participants' accounts on the payable date in accordance with their respective holdings shown on DTC's records unless DTC has reason to believe that it will not receive payment on the payable date. Payments by Participants to beneficial owners will be governed by standing instructions and customary practices, as in the case of securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC, or the Issuer, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal and interest to DTC is the responsibility of the Issuer, disbursement of such payments to Direct Participants shall be the responsibility of DTC, and disbursement of such payments to the beneficial owners shall be the responsibility of Direct and Indirect Participants.

A beneficial owner shall give notice to elect to have its Global Notes or Global Receipts purchased or tendered, through its Participant, to the applicable Trustee for a Series of Notes, and shall effect delivery of such Global Notes or Global Receipts by causing the Direct Participant to transfer the Participant's interest in the Global Notes or Global Receipts, on DTC's records, to such Trustee. The requirement for physical delivery of Global Notes or Global Receipts in connection with a demand for purchase or a mandatory purchase will be deemed satisfied when the ownership rights in the Global Notes are transferred by a Direct Participant on DTC's records.

DTC may discontinue providing its services as securities depositary with respect to the Global Notes at any time by giving reasonable notice to the Issuer and the Dealers. Under such circumstances, in the event that a successor securities depository is not obtained, Certificated Notes will be printed and delivered in exchange for the Global Notes.

The Issuer may decide to discontinue use of the system of book-entry transfers through DTC (or a successor securities depository). In that event, registered or book entry Certificated Notes will be printed and delivered in exchange for the Global Notes represented by the Global Securities held by DTC.

The information in this section concerning DTC and DTC's book-entry system has been obtained from sources that the Issuer believes to be reliable, but the Issuer takes no responsibility for the accuracy thereof.

None of the Issuer, any Trustee, any. Paying Agent, any registrar for the Notes or any Dealer will have any responsibility or liability for any aspect of the records relating to or payments made on account of beneficial ownership interests in a Global Note or for maintaining, supervising or reviewing any records relating to such beneficial ownership interests.

DTC

DTC has advised us as follows:

- DTC is:
    - a limited-purpose trust company organized under the laws of the State of New York, which is a wholly-owned subsidiary of Depository Trust and Clearing Company, owned in turn by the principal users of DTC, consisting primarily of banks, broker-dealers and other financial institutions, including the initial purchasers of the notes,
    - a member of the Federal Reserve System,
    - a "clearing corporation" within the meaning of the Uniform Commercial Code, and
    - a "clearing agency" registered pursuant to the provisions of Section 17A of the Exchange Act.
- DTC was created to hold securities for its participants and to facilitate the clearance and settlement of securities transactions, including transfers and pledges, in deposited securities between its participants through electronic book-entry changes to the accounts of its participants. This eliminates the need for physical movement of certificates.
- Participants in DTC include securities brokers and dealers, banks, trust companies and clearing corporations and may include certain other organizations. DTC is partially owned by some of these participants or their representatives.
- Indirect access to the DTC system is also available to banks, brokers, dealers and trust companies that have relationships with participants.
- The rules applicable to DTC and DTC participants are on file with the SEC.

Clearstream, Luxembourg

Clearstream, Luxembourg has advised us as follows:

- Clearstream, Luxembourg is a duly licensed bank organized as a société anonyme incorporated under the laws of Luxembourg and is subject to regulation by the Luxembourg Commission for the Supervision of the Financial Sector (Commission de Surveillance du Secteur Financier). Clearstream, Luxembourg is owned by Deutsche Boise AG. The shareholders of Deutsche Borse AG are banks, securities dealers and financial institutions.
- Clearstream, Luxembourg holds securities for its customers and facilitates the clearance and settlement of securities transactions among them. It does so through electronic book-entry changes to the accounts of its customers. This eliminates the need for physical movement of certificates.

- Clearstream, Luxembourg provides other services to its participants, including safekeeping, administration, clearance and settlement of internationally traded securities, lending and borrowing of securities and collateral management. It interfaces with the domestic markets in over 30 countries through established depositary and custodial relationships.
- Clearstream, Luxembourg's customers include worldwide securities brokers and dealers, banks, trust companies and clearing corporations and may include professional financial intermediaries. Its U.S. customers are limited to securities brokers and dealers and banks.
- Indirect access to the Clearstream, Luxembourg system is also available to others that clear through Clearstream, Luxembourg customers or that have custodial relationships with its customers, such as banks, brokers, dealers and trust companies.
- Clearstream, Luxembourg is an indirect participant in DTC.
- Clearstream, Luxembourg has established an electronic bridge with Euroclear to facilitate settlement of trades between Clearstream, Luxembourg and Euroclear.
- Distributions with respect to the notes held beneficially through Clearstream, Luxembourg will be credited to cash accounts of Clearstream, Luxembourg customers in accordance with its rules and procedures, to the extent received by Clearstream, Luxembourg.

Euroclear

Euroclear has advised us as follows:

- Euroclear is incorporated under the laws of Belgium as a bank and is subject to regulation by the Belgian Banking and Finance Commission (Commission Bancaire et Financiere) and the National Bank of Belgium (Banque Nationale de Belgique). The Euroclear system is owned by Euroclear Clearance System Public Limited Company (ECS plc) and operated through a license agreement by Euroclear.
- Securities clearance accounts and cash accounts with Euroclear are governed by the Terms and Conditions Governing Use of Euroclear and the related Operating Procedures of Euroclear, and applicable Belgian law. These terms and conditions and operating procedures govern transfer of securities and cash within Euroclear, withdrawals of securities and cash from Euroclear, and receipt of payments with respect to securities in Euroclear. Euroclear acts under these terms and conditions and operating procedures only on behalf of Euroclear participants and has no record of or relationship with persons holding through Euroclear accounts.
- Euroclear holds securities for its customers and facilitates the clearance and settlement of securities transactions among them. It does so through simultaneous electronic book-entry delivery against payment, thereby eliminating the need for physical movement of certificates.
- Euroclear provides other services to its customers, including credit custody, lending and borrowing of securities and tri-party collateral management. It interfaces with the domestic markets of several other countries.
- Euroclear customers include banks, central banks, securities brokers and dealers, trust companies and clearing corporations and may include certain other professional financial intermediaries.
- Euroclear is an indirect participant in DTC.
- Indirect access to the Euroclear system is also available to others that clear through Euroclear customers or that maintain a custodial relationship with a Euroclear participant, either directly or indirectly.
- All securities in Euroclear are held on a fungible basis. This means that specific certificates are not matched to specific securities clearance accounts.

SPECIAL PROVISIONS RELATING TO FOREIGN CURRENCY NOTES

Exchange Rates and Exchange Controls

An investment in Notes that are denominated in, or the payment of which is determined with reference to, a Specified Currency other than U.S. dollars entails significant risks that are not associated with a similar investment in a security denominated in U.S. dollars. Similarly, an investment in an Indexed Note entails significant risks that are not associated with an investment in non-Indexed Notes. Such risks include, without limitation, the possibility of significant changes in rates of exchange between U.S. dollars and the Specified Currency (or, in the case of each Indexed Note, the rate of exchange between the denominated currency and the indexed currency for such Indexed Note), including changes resulting from official redenomination with respect to such Specified Currency (or, in the case of each Indexed Note, with respect to the denominated currency or the indexed currency therefor) and the possibility of the imposition or modification of foreign exchange controls with respect to the Specified Currency. Such risks generally depend on factors over which we have no control, such as economic and political events and the supply of and demand for the relevant currencies. In recent years, rates of exchange between Specified Currencies have been highly volatile, and such volatility may continue in the future. Fluctuations in any particular exchange rate that have occurred in the past are not necessarily indicative, however, of fluctuations in the rate that may occur during the term of any Note.

Depreciation of a currency or composite currency in which a Note is denominated against the U.S. dollar would result in a decrease in the effective yield of such Note below its coupon rate, and in certain circumstances could result in loss to the investor on a U.S. dollar basis. Similarly, depreciation of the denominated currency with respect to an Indexed Note against the applicable indexed currency would result in the principal amount payable with respect to such Indexed Note at the Stated Maturity being less than the face amount of such Indexed Note which, in turn would decrease the effective yield of such Indexed Note below its applicable interest rate and could also result in a loss to the investor.

The Notes will provide that, in the event of an official redenomination of a foreign currency (including, without limitation, an official redenomination of a foreign currency that is a composite currency) the obligations of the Issuer with respect to payments on Notes denominated in such currency shall, in all cases, be deemed immediately following such redenomination to provide for the payment of that amount of redenomination currency representing the amount of such obligations immediately before such redenomination. Except as expressly provided herein or in the applicable Pricing Supplement, the Notes do not provide for any adjustment to any amount payable under the Notes as a result of (a) any change in the value of a foreign currency relative to any other currency due to fluctuations in exchange rates or (b) any redenomination of any component currency of any composite currency (unless such composite currency is itself officially redenominated).

Governments have from time to time imposed, and may in the future impose, exchange controls that could affect exchange rates as well as the availability of a foreign currency for making payments with respect to a Note denominated in such currency. There can be no assurances that exchange controls will not restrict or prohibit payments of principal or interest in any currency or composite currency. Even if there are not actual exchange controls, it is possible that, with respect to any particular Note, the currency for such Note will not be available to the Issuer to make payments of interest and principal then due because of circumstances beyond our control. In that event, the Issuer will make such payment in the manner set forth below under "—Payment Currency".

The Pricing Supplement relating to Notes denominated in a Specified Currency other than U.S. dollars or relating to Indexed Notes will contain information concerning historical exchange rates for such Specified Currency or denominate currency against the U.S. dollar or other relevant currency (including, in the case of Indexed Notes, the applicable indexed currency) and any exchange controls affecting such currency or currencies. Information concerning exchange rates is furnished as a matter of information only and should not be regarded as indicative of the range of or trend in fluctuations in currency exchange rates that may occur in the future.

Payment Currency

Except as otherwise provided herein or in the applicable Pricing Supplement, if payment on a Note is required to be made in a Specified Currency other than U.S. dollars or in any currency unit and such currency or currency unit is unavailable due to the imposition of exchange controls or other circumstances beyond our control or if such currency is no longer used by the government of the country issuing such currency or for the settlement of transactions by public institutions of or within the international banking community, then all payments in respect of such Note shall be made in U.S. dollars until such currency or currency unit is again available or so used. The amount so payable on any date in such currency or currency unit will be converted into U.S. dollars on the basis of the Market Exchange Rate for such currency, or for each Component Currency, as of the Conversion Date. See "Description of the Notes —Payment of

Principal, Premium, if any, and Interest, if any" above. Any payment made under such circumstances in U.S. dollars will not constitute an Event of Default under the Notes.

If the official unit of any Component Currency is altered by way of combination or subdivision, the number of units of that currency as a Component Currency shall be divided or multiplied in the same proportion. If two or more Component Currencies are consolidated into a single currency, the amounts of those currencies as Component Currencies shall be replaced by an amount in such single currency equal to the sum of the amounts of the consolidated Component Currencies expressed in such single currency. If any Component Currency is divided into two or more currencies, the amount of the original Component Currency shall be replaced by the amounts of such two or more currencies having an aggregate value on the date of division equal to the amount of the former Component Currency immediately before such division.

Foreign Currency Judgments

The Notes and the Indentures will be governed by and construed in accordance with the laws of the State of New York applicable to instruments made to be performed wholly within such jurisdiction, except that the subordination provisions in the Subordinated Notes and in the Subordinated Indenture will be governed by and construed in accordance with the laws of Iceland. Courts in the United States customarily have not rendered judgments for money damages denominated in any currency other than U.S. dollars. If a Note is denominated in a Specified Currency other than U.S. dollars, any judgment under New York law will be rendered in the foreign currency of the underlying obligations and converted into U.S. dollars at a rate of exchange prevailing on the date of entry of the judgment or decree.

Information Limited to U.S. Holders

The information set forth in this Offering Circular (except for certain tax information) is directed to prospective purchasers of Notes who are U.S. Holders (as defined below), and we disclaim any responsibility to advise prospective purchasers who are residents of countries other than the United States with respect to any matters that may affect the purchase or holding of, or receipt of payments of principal, premium or interest in respect of, Notes. Such persons should consult their own counsel with regard to such matters.

TAXATION

To ensure compliance with Internal Revenue Service Circular 230, we advise you that any tax discussion herein was not written and is not intended to be used and cannot be used by any taxpayer for purposes of avoiding penalties that may be imposed on the taxpayer under the Internal Revenue Code of 1986, as amended (the "Code"). Any such tax discussion was written to support the promotion or marketing of the Notes to be issued pursuant to this Offering Circular. Each taxpayer should seek advice based on the taxpayer's particular circumstances from an independent tax adviser.

Certain United States Federal Income Tax Considerations

The following summary of certain United States federal income tax consequences of the purchase, ownership and disposition of the Notes is based upon laws, regulations, rulings and decisions now in effect, all of which are subject to change (including changes in effective dates) or possible differing interpretations. It deals only with Notes held as capital assets and does not purport to deal with persons in special tax situations, such as financial institutions, insurance companies, tax-exempt entities, persons liable for alternative minimum tax, regulated investment companies, dealers in securities or currencies, traders in securities that elect to use a mark to market method of accounting, persons holding Notes as part of a hedging, integrated, conversion or constructive sale transaction, or as a position in a "straddle" for tax purposes, or persons whose functional currency is not the United States dollar. Further, this summary does not address any tax consequences applicable to holders of equity interests in a Holder of the Notes. It also does not deal with Holders other than U.S. Holders of the Notes (except where otherwise specifically noted). Any special United States federal income tax considerations relevant to a particular issue of the Notes will be provided in the applicable Pricing Supplement. If a partnership holds our Notes, the tax treatment of a partner will generally depend upon the status of the partner and the activities of the partnership. If you are a partner of a partnership holding our Notes, you should consult your tax advisers.

This summary deals only with the United States federal income tax consequences of the purchase, ownership, and disposition of Senior Notes. The United States federal income tax consequences of the purchase, ownership, and disposition of Subordinated Notes and Capital Notes will be discussed in the applicable Pricing Supplement.

Persons considering the purchase of the Notes should consult their own tax advisers concerning the application of United States federal income tax laws to their particular situations as well as any consequences of the purchase, ownership and disposition of the Notes arising under the laws of any other taxing jurisdiction.

As used herein, the term "U.S. Holder" means a beneficial owner of a Note that is for United States federal income tax purposes (i) a citizen or resident of the United States, (ii) a corporation created or organized in or under the laws of the United States, any state thereof or the District of Columbia, (iii) an estate whose income is subject to United States federal income tax regardless of its source, or (iv) a trust (A) if a court within the United States is able to exercise primary supervision over the administration of the trust and one or more United States persons have the authority to control all substantial decisions of the trust or (B) that has a valid election in effect under applicable U.S. Treasury regulations (the "Regulations") to be treated as a United States person.

This discussion is based on the Code, judicial decisions, published rulings, administrative pronouncements, and existing and proposed Regulations, all as are in effect on the date of this Offering Circular and all of which are subject to change after such date, possibly with retroactive effect.

Characterization of the Notes

We generally intend to treat Senior Notes issued under the Program as debt unless otherwise indicated in the applicable Pricing Supplement. Certain types of Notes, however, such as Indexed Notes, or Notes with very long maturities, may be treated as equity for U.S. federal income tax purposes. The tax treatment of such Notes will be discussed in the applicable Pricing Supplement.

Payments of Interest

General

The term "interest" as used in this section "Certain United States Federal Income Tax Considerations" shall include any additional amounts required to be paid under the terms of the Notes. Interest on a Note, whether payable in U.S. dollars or a currency, composite currency or basket of currencies other than U.S. dollars (each a "foreign currency"), other than interest on a "Discount Note" that is not "qualified stated interest" (each as defined below under

"Original Issue Discount—General"), will be taxable to a U.S. Holder as ordinary income at the time it is received or accrued, depending on the Holder's method of accounting for tax purposes. Interest received or accrued by a U.S. Holder on the Notes and OID, if any, accrued with respect to the Notes (as described below under "Original Issue Discount") generally will constitute income from sources outside the United States for purposes of computing the foreign tax credit limitation. For foreign tax credit limitation purposes, for tax years beginning before January 1, 2007, such income will generally constitute "passive income" or, in the case of certain Holders, "financial services income" and, for tax years beginning after December 31, 2006, such income will generally constitute "passive category income" or "general category income". The rules regarding the availability of foreign tax credits are complex and U.S. Holders may be subject to various limitations thereon.

Foreign currency denominated interest

If an interest payment is denominated in, or determined by reference to, a foreign currency, the amount of income recognized by a cash basis U.S. Holder will be the U.S. dollar value of the interest payment, based on the exchange rate in effect on the date of receipt, regardless of whether the payment is in fact converted into U.S. dollars.

An accrual basis U.S. Holder may determine the amount of income recognized with respect to an interest payment denominated in, or determined by reference to, a foreign currency in accordance with either of two methods. Under the first method, the amount of income accrued will be based on the average exchange rate in effect during the interest accrual period (or, with respect to an accrual period that spans two taxable years of a U.S. Holder, the part of the period within the taxable year).

Under the second method, the U.S. Holder may elect to determine the amount of income accrued on the basis of the exchange rate in effect on the last day of the accrual period or, in the case of an accrual period that spans two taxable years, the exchange rate in effect on the last day of the part of the period within the taxable year. Additionally, if a payment of interest is actually received within five business days of the last day of the accrual period or taxable year, an electing accrual basis U.S. Holder may instead translate the accrued interest into U.S. dollars at the exchange rate in effect on the day of actual receipt. Any such election will apply to all debt instruments held by the U.S. Holder at the beginning of the first taxable year to which the election applies or thereafter acquired by the U.S. Holder, and will be irrevocable without the consent of the Internal Revenue Service (the "IRS").

Upon receipt of the interest payment (including a payment attributable to accrued but unpaid interest upon the sale or retirement of a Note) denominated in, or determined by reference to, a foreign currency, the accrual basis U.S. Holder will recognize ordinary income or loss measured by the difference between the exchange rate used to accrue interest income pursuant to one of the two above methods and the exchange rate in effect on the date of receipt, regardless of whether the payment is in fact converted into U.S. dollars.

Original Issue Discount

General

The following is a summary of the principal United States federal income tax consequences of the ownership of Notes issued with original issue discount ("OID"). The following summary does not discuss the United States federal income tax consequences of an investment in contingent payment debt instruments. The material United States federal income tax consequences of investing in Notes that are contingent payment debt instruments may be addressed in the Pricing Supplement, if applicable.

A Note, other than a Note with a term of one year or less (a "Short-Term Note"), will be treated as issued with OID (a "Discount Note") if the excess of the Note's "stated redemption price at maturity" over its issue price is not less than a *de minimis* amount (0.25% of the Note's stated redemption price at maturity multiplied by the number of complete years to its maturity). An obligation that provides for the payment of amounts other than qualified stated interest before maturity (an "installment obligation") will be treated as a Discount Note if the excess of the Note's stated redemption price at maturity over its issue price is not less than 0.25% of the Note's stated redemption price at maturity multiplied by the weighted average maturity of the Note. A Note's weighted average maturity is the sum of the following amounts determined for each payment on a Note (other than a payment of qualified stated interest): (i) the number of complete years from the issue date until the payment is made multiplied by (ii) a fraction, the numerator of which is the amount of the payment and the denominator of which is the Note's stated redemption price at maturity. Generally, the issue price of a Note will be the first price at which a substantial amount of Notes included in the issue of which the Note is a part is sold to persons other than bond houses, brokers, or similar persons or organizations acting in the capacity of underwriters, placement agents, or wholesalers. The stated redemption price at maturity of a Note is the total of all payments provided by the Note that are not payments of "qualified stated interest". A qualified stated interest payment is generally any one of a series of stated interest payments on a Note that are unconditionally payable at least annually at a single fixed rate (with certain exceptions for lower rates paid during some periods), or a variable rate (in the circumstances described below under "Variable Interest Rate Notes"), applied to the outstanding principal amount of the Note. Solely for the purposes of determining whether a Note has OID, the Issuer will be deemed to exercise any call option that has the effect of decreasing the yield on the Note, and the U.S. Holder will be deemed to exercise any put option that has the effect of increasing the yield on the Note.

If a Note has *de minimis* OID, a U.S. Holder must include the *de minimis* amount in income (generally as capital gain) as stated principal payments are made on the Note, unless the holder makes the election described below under "Election to treat all interest as original issue discount." A U.S. Holder can determine the includible amount with respect to each such payment by multiplying the total amount of the Note's *de minimis* OID by a fraction equal to the amount of the principal payment made, divided by the stated principal amount of the Note. U.S. Holders of Discount Notes must include OID in income calculated on a constant-yield method before the receipt of cash attributable to the income, and generally will have to include in income increasingly greater amounts of OID over the life of the Discount Notes. The amount of OID includible in income by a U.S. Holder of a Discount Note is the sum of the daily portions of OID with respect to the Discount Note for each day during the taxable year or portion of the taxable year on which the U.S. Holder holds the Discount Note ("accrued OID"). The daily portion is determined by allocating to each day in any "accrual period" a pro rata portion of the OID allocable to that accrual period. Accrual periods with respect to a Note may be of any length selected by the U.S. Holder and may vary in length over the term of the Note as long as (i) no accrual period is longer than one year and (ii) each scheduled payment of interest or principal on the Note occurs on either the final or first day of an accrual period. The amount of OID allocable to an accrual period equals the excess of (a) the product of the Discount Note's adjusted issue price at the beginning of the accrual period and the Discount Note's yield to maturity (determined on the basis of compounding at the close of each accrual period and properly adjusted for the length of the accrual period) over (b) the sum of the payments of qualified stated interest on the Note allocable to the accrual period. The "adjusted issue price" of a Discount Note at the beginning of any accrual period is the issue price of the Note increased by (x) the amount of accrued OID for each prior accrual period and decreased by (y) the amount of any payments previously made on the Note that were not qualified stated interest payments.

Acquisition premium

A U.S. Holder that purchases a Discount Note for an amount less than or equal to the sum of all amounts payable on the Note after the purchase date, other than payments of qualified stated interest, but in excess of its adjusted issue price (any such excess being "acquisition premium") and that does not make the election described below under "Election to Treat All Interest as Original Issue Discount", is permitted to reduce the daily portions of OID by a fraction, the numerator of which is the excess of the U.S. Holder's adjusted basis in the Note immediately after its purchase over the Note's adjusted issue price, and the denominator of which is the excess of the sum of all amounts payable on the Note after the purchase date, other than payments of qualified stated interest, over the Note's adjusted issue price.

Market discount

A Note, other than a Short-Term Note, generally will be treated as purchased at a market discount (a "Market Discount Note") if the Note's stated redemption price at maturity or, in the case of a Discount Note, the Note's "revised issue price", exceeds the amount for which the U.S. Holder purchased the Note by at least 0.25% of the Note's stated redemption price at maturity or revised issue price, respectively, multiplied by the number of complete years to the Note's maturity (or, in the case of a Note that is an installment obligation, the Note's weighted average maturity). If this excess is not sufficient to cause the Note to be a Market Discount Note, then the excess constitutes "*de minimis* market discount". For this purpose, the "revised issue price" of a Note generally equals its issue price, increased by the amount of any OID that has accrued on the Note and decreased by the amount of any payments previously made on the Note that were not qualified stated interest payments.

Under current law, any gain recognized on the maturity or disposition of a Market Discount Note (including any payment on a Note that is not qualified stated interest) will be treated as ordinary income to the extent that the gain does not exceed the accrued market discount on the Note. Alternatively, a U.S. Holder of a Market Discount Note may elect to include market discount in income currently over the life of the Note. This election shall apply to all debt instruments with market discount acquired by the electing U.S. Holder on or after the first day of the first taxable year to which the election applies. This election may not be revoked without the consent of the IRS. A U.S. Holder of a Market Discount Note that does not elect to include market discount in income currently will generally be required to defer deductions for interest on borrowings incurred to purchase or carry a Market Discount Note that is in excess of the interest and OID on the Note includible in the U.S. Holder's income, to the extent that this excess interest expense does not exceed the portion of the market discount allocable to the days on which the Market Discount Note was held by the U.S. Holder.

Under current law, market discount will accrue on a straight-line basis unless the U.S. Holder elects to accrue the market discount on a constant-yield method. This election applies only to the Note with respect to which it is made and is irrevocable.

Election to treat all interest as original issue discount

A U.S. Holder may elect to include in gross income all interest that accrues on a Note using the constant-yield method described above under "Original Issue Discount—General" with certain modifications. For purposes of this election, interest includes stated interest, OID, *de minimis* OID, market discount, *de minimis* market discount and unstated interest, as adjusted by any amortizable bond premium (described below under "Notes Purchased at a Premium") or acquisition premium. This election will generally apply only to the Note with respect to which it is made and may not be revoked without the consent of the IRS. If the election to apply the constant-yield method to all interest on a Note is made with respect to a Market Discount Note, the electing U.S. Holder will be treated as having made the election discussed above under "Market Discount" to include market discount in income currently over the life of all debt instruments with market discount held or thereafter acquired by the U.S. Holder. U.S. Holders should consult their tax advisers concerning the propriety and consequences of this election.

Variable interest rate notes

Notes that provide for interest at variable rates ("Variable Interest Rate Notes") generally will bear interest at a "qualified floating rate" and thus will be treated as "variable rate debt instruments" under Treasury regulations governing accrual of OID. A Variable Interest Rate Note will qualify as a "variable rate debt instrument" if (a) its issue price does not exceed the total noncontingent principal payments due under the Variable Interest Rate Note by more than a specified *de minimis* amount and (b) it provides for stated interest, paid or compounded at least annually, at (i) one or more qualified floating rates, (ii) a single fixed rate and one or more qualified floating rates, (iii) a single objective rate, or (iv) a single fixed rate and a single objective rate that is a qualified inverse floating rate.

A "qualified floating rate" is any variable rate where variations in the value of the rate can reasonably be expected to measure contemporaneous variations in the cost of newly borrowed funds in the currency in which the Variable Interest Rate Note is denominated. A fixed multiple of a qualified floating rate will constitute a qualified floating rate only if the multiple is greater than 0.65 but not more than 1.35. A variable rate equal to the product of a qualified floating rate and a fixed multiple that is greater than 0.65 but not more than 1.35, increased or decreased by a fixed rate, will also constitute a qualified floating rate. In addition, two or more qualified floating rates that can reasonably be expected to have approximately the same values throughout the term of the Variable Interest Rate Note (e.g. two or more qualified floating rates with values within 25 basis points of each other as determined on the Variable Interest Rate Note's issue date) will be treated as a single qualified floating rate. Notwithstanding the foregoing, a variable rate that would otherwise constitute a qualified floating rate but which is subject to one or more restrictions such as a maximum numerical limitation (i.e. a cap) or a minimum numerical limitation (i.e. a floor) may, under certain circumstances, fail to be treated as a qualified floating rate unless the cap or floor is fixed throughout the term of the Note.

An "objective rate" is a rate that is not itself a qualified floating rate but which is determined using a single fixed formula and which is based on objective financial or economic information (e.g. one or more qualified floating rates or the yield of actively traded personal property). Other variable interest rates may be treated as objective rates if so designated by the IRS in the future. Despite the foregoing, a variable rate of interest on a Variable Interest Rate Note will not constitute an objective rate if it is reasonably expected that the average value of the rate during the first half of the Variable Interest Rate Note's term will be either significantly less than or significantly greater than the average value of the rate during the final half of the Variable Interest Rate Note's term. A "qualified inverse floating rate" is any objective rate where the rate is equal to a fixed rate minus a qualified floating rate, as long as variations in the rate can reasonably be expected to inversely reflect contemporaneous variations in the qualified floating rate. If a Variable Interest Rate Note provides for stated interest at a fixed rate for an initial period of one year or less followed by a variable rate that is either a qualified floating rate or an objective rate for a subsequent period and if the variable rate on the Variable Interest Rate Note's issue date is intended to approximate the fixed rate (e.g., the value of the variable rate on the issue date does not differ from the value of the fixed rate by more than 25 basis points), then the fixed rate and the variable rate together will constitute either a single qualified floating rate or objective rate, as the case may be.

A qualified floating rate or objective rate in effect at any time during the term of the instrument must be set at a "current value" of that rate. A "current value" of a rate is the value of the rate on any day that is no earlier than three months prior to the first day on which that value is in effect and no later than one year following that first day.

If a Variable Interest Rate Note that provides for stated interest at either a single qualified floating rate or a single objective rate throughout the term thereof qualifies as a "variable rate debt instrument", then any stated interest on the

Note which is unconditionally payable in cash or property (other than debt instruments of the Issuer) at least annually will constitute qualified stated interest and will be taxed accordingly. Thus, a Variable Interest Rate Note that provides for stated interest at either a single qualified floating rate or a single objective rate throughout the term thereof and that qualifies as a "variable rate debt instrument" will generally not be treated as having been issued with OID unless the Variable Interest Rate Note is issued at a "true" discount (i.e. at a price below the Note's stated principal amount) not less than a specified *de minimis* amount. OID on a Variable Interest Rate Note arising from "true" discount is allocated to an accrual period using the constant yield method described above by assuming that the variable rate is a fixed rate equal to (i) in the case of a qualified floating rate or qualified inverse floating rate, the value, as of the issue date, of the qualified floating rate or qualified inverse floating rate, or (ii) in the case of an objective rate (other than a qualified inverse floating rate), a fixed rate that reflects the yield that is reasonably expected for the Variable Interest Rate Note.

In general, any other Variable Interest Rate Note that qualifies as a "variable rate debt instrument" will be converted into an "equivalent" fixed rate debt instrument for purposes of determining the amount and accrual of OID and qualified stated interest on the Variable Interest Rate Note. Such a Variable Interest Rate Note must be converted into an "equivalent" fixed rate debt instrument by substituting any qualified floating rate or qualified inverse floating rate provided for under the terms of the Variable Interest Rate Note with a fixed rate equal to the value of the qualified floating rate or qualified inverse floating rate, as the case may be, as of the Variable Interest Rate Note's issue date. Any objective rate (other than a qualified inverse floating rate) provided for under the terms of the Variable Interest Rate Note is converted into a fixed rate that reflects the yield that is reasonably expected for the Variable Interest Rate Note. In the case of a Variable Interest Rate Note that qualifies as a "variable rate debt instrument" and provides for stated interest at a fixed rate in addition to either one or more qualified floating rates or a qualified inverse floating rate, the fixed rate is initially converted into a qualified floating rate (or a qualified inverse floating rate, if the Variable Interest Rate Note provides for a qualified inverse floating rate). Under these circumstances, the qualified floating rate or qualified inverse floating rate that replaces the fixed rate must be such that the fair market value of the Variable Interest Rate Note as of the Variable Interest Rate Note's issue date is approximately the same as the fair market value of an otherwise identical debt instrument that provides for either the qualified floating rate or qualified inverse floating rate rather than the fixed rate. Subsequent to converting the fixed rate into either a qualified floating rate or a qualified inverse floating rate, the Variable Interest Rate Note is converted into an "equivalent" fixed rate debt instrument in the manner described above.

Once the Variable Interest Rate Note is converted into an "equivalent" fixed rate debt instrument pursuant to the foregoing rules, the amount of OID and qualified stated interest, if any, are determined for the "equivalent" fixed rate debt instrument by applying the general OID rules to the "equivalent" fixed rate debt instrument and a U.S. Holder of the Variable Interest Rate Note will account for the OID and qualified stated interest as if the U.S. Holder held the "equivalent" fixed rate debt instrument. In each accrual period, appropriate adjustments will be made to the amount of qualified stated interest or OID assumed to have been accrued or paid with respect to the "equivalent" fixed rate debt instrument in the event that these amounts differ from the actual amount of interest accrued or paid on the Variable Interest Rate Note during the accrual period.

Short-term notes

In general, a cash basis U.S. Holder of a short-term Note is not required to accrue OID (as specially defined below for the purposes of this paragraph) for United States federal income tax purposes unless it elects to do so (but may be required to include any stated interest in income as the interest is received). Accrual basis U.S. Holders and certain other U.S. Holders are required to accrue OID on Short-Term Notes on a straight-line basis or, if the U.S. Holder so elects, under the constant-yield method (based on daily compounding). In the case of a U.S. Holder not required and not electing to include OID in income currently, any gain realized on the sale or retirement of the Short-Term Note will be ordinary income to the extent of the OID accrued on a straight-line basis (unless an election is made to accrue the OID under the constant-yield method) through the date of sale or retirement. U.S. Holders who are not required and do not elect to accrue OID on Short-Term Notes will be required to defer deductions for interest on borrowings allocable to Short-Term Notes in an amount not exceeding the deferred income until the deferred income is realized.

For purposes of determining the amount of OID subject to these rules, all interest payments on a Short-Term Note are included in the Short-Term Note's stated redemption price at maturity. A U.S. Holder may elect to determine OID on a Short-Term Note as if the Short-Term Note had been originally issued to the U.S. Holder at the U.S. Holder's purchase price for the Short-Term Note. This election shall apply to all obligations with a maturity of one year or less acquired by the U.S. Holder on or after the first day of the first taxable year to which the election applies, and may not be revoked without the consent of the IRS.

Foreign currency notes

OID for any accrual period on a Discount Note that is denominated in, or determined by reference to, a foreign currency will be determined in the foreign currency and then translated into U.S. dollars in the same manner as stated interest accrued by an accrual basis U.S. Holder, as described above under "Payments of Interest". Upon receipt of an amount attributable to OID (whether in connection with a payment of interest or the sale or retirement of a Note), a U.S. Holder may recognize exchange gain or loss, which will be ordinary gain or loss measured by the difference between the amount received (translated into U.S. dollars at the exchange rate on the date of receipt) and the amount previously accrued.

Market Discount on a Note that is denominated in, or determined by reference to, a foreign currency will be accrued by a U.S. Holder in the foreign currency. If the U.S. Holder elects to include market discount in income currently, the accrued market discount will be translated into U.S. dollars at the average exchange rate for the accrual period (or portion thereof within the U.S. Holder's taxable year). Upon the receipt of an amount attributable to accrued market discount, the U.S. Holder will recognize ordinary gain or loss measured in the same manner as for accrued qualified stated interest or OID. A U.S. Holder that does not make this election will recognize, upon the disposition or maturity of the Note, the U.S. dollar value of the amount accrued, calculated at the exchange rate in effect on that date, and no part of this accrued market discount will be treated as exchange gain or loss.

Notes Purchased at a Premium

A U.S. Holder that purchases a Note for an amount in excess of its principal amount, or for a Discount Note, its stated redemption price at maturity, may elect to treat the excess as "amortizable bond premium", in which case the amount required to be included in the U.S. Holder's income each year with respect to interest on the Note will be reduced by the amount of amortizable bond premium allocable (based on the Note's yield to maturity) to that year. In the case of a Note that is denominated in, or determined by reference to, a foreign currency, bond premium will be computed in units of foreign currency, and amortizable bond premium will reduce interest income in units of the foreign currency. At the time amortized bond premium offsets interest income, exchange gain or loss (taxable as ordinary income or loss) is realized measured by the difference between exchange rates at that time and at the time of the acquisition of the Notes. Any election to amortize bond premium shall apply to all bonds (other than bonds the interest on which is excludable from gross income for U.S. federal income tax purposes) held by the U.S. Holder at the beginning of the first taxable year to which the election applies or thereafter acquired by the U.S. Holder, and is irrevocable without the consent of the IRS. See also "Original Issue Discount—Election to Treat All Interest as Original Issue Discount".

Purchase, Sale and Retirement of Notes

A U.S. Holder's tax basis in a Note will generally be its U.S. dollar cost (as defined below) increased by the amount of any OID or market discount included in the U.S. Holder's income with respect to the Note and the amount, if any, of income attributable to *de minimis* OID and *de minimis* market discount included in the U.S. Holder's income with respect to the Note, and reduced by (i) the amount of any payments that are not qualified stated interest payments, and (ii) the amount of any amortizable bond premium applied to reduce interest on the Note. The U.S. dollar cost of a Note purchased with a foreign currency will generally be the U.S. dollar value of the purchase price on the date of purchase or, in the case of Notes traded on an established securities market, as defined in the applicable Treasury Regulations, that are purchased by a cash basis U.S. Holder (or an accrual basis U.S. Holder that so elects), on the settlement date for the purchase.

A U.S. Holder will generally recognize gain or loss on the sale or retirement of a Note equal to the difference between the amount realized on the sale or retirement and the tax basis of the Note. The amount realized on a sale or retirement for an amount in foreign currency will be the U.S. dollar value of this amount on the date of sale or retirement or, in the case of Notes traded on an established securities market, as defined in the applicable Treasury Regulations, sold by a cash basis U.S. Holder (or an accrual basis U.S. Holder that so elects), on the settlement date for the sale. Such an election by an accrual basis U.S. Holder must be applied consistently from year to year and cannot be revoked without the consent of the IRS. Except to the extent described above under "Original Issue Discount—Market Discount" or "Original Issue Discount—Short-Term Notes" or attributable to accrued but unpaid interest or changes in exchange rates, gain or loss recognized on the sale or retirement of a Note will be capital gain or loss and will be long-term capital gain or loss if the U.S. Holder's holding period in the Notes exceeds one year. Long-term capital gain is currently taxable at a reduced rate for individuals, trusts and estates. The deductibility of capital losses is subject to significant limitations.

Gain or loss recognized by a U.S. Holder on the sale or retirement of a Note that is attributable to changes in exchange rates will be treated as ordinary income or loss and is taken into account only to the extent of total gain or loss realized on the transaction.

Gain or loss realized by a U.S. Holder on the sale or retirement of a Note generally will be U.S. source.

Exchange of Amounts in other than U.S. Dollars

Foreign currency received as interest on a Note or on the sale or retirement of a Note will have a tax basis equal to its U.S. dollar value at the time the interest is received or at the time of the sale or retirement. Foreign currency that is purchased will generally have a tax basis equal to the U.S. dollar value of the foreign currency on the date of purchase. Any gain or loss recognized on a sale or other disposition of a foreign currency (including its use to purchase Notes or an exchange for U.S. dollars) will be ordinary income or loss.

Backup Withholding and Information Reporting

In general, payments of interest and accrued OID on, and the proceeds of a sale, redemption or other disposition of, the Notes, payable to a U.S. Holder by a U.S. paying agent or other U.S. intermediary will be reported to the IRS and to the U.S. Holder as may be required under applicable regulations. Backup withholding will apply to these payments and to accruals of OID if the U.S. Holder fails to provide an accurate taxpayer identification number or certification of exempt status or fails to report all interest and dividends required to be shown on its U.S. federal income tax returns. Certain U.S. Holders (including, among others, corporations) are not subject to backup withholding. U.S. Holders should consult their tax advisers as to their qualification for exemption from backup withholding and the procedure for obtaining an exemption.

Icelandic Taxation

The comments below are of a general nature based upon our understanding of current law and practice in Iceland. They should not be construed as providing specific advice as to Icelandic taxation and are subject to changes as to the applicable rules in the future. They relate only to the position of persons who are the absolute beneficial owners of the Notes. They may not apply to certain classes of persons, such as dealers. Prospective holders of the Notes who are in any doubt as to their personal tax position or who may be subject to tax in any other jurisdiction should consult their professional advisers.

Non-Icelandic Tax Residents

As for individuals or a legal entities that are not resident, domiciled (or registered in the case of a 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 Notes.

We are not required to withhold any taxes in respect of such amounts provided that the Director of Internal Revenue's confirmation of the relevant Dealer's and the Paying Agent's status as a non-Icelandic tax-residents has been obtained (either by the Dealer and Paying Agent in question or us on their behalf). In the event we are required to withhold tax, we will pay such additional amounts as shall be necessary in order that the net amounts received by the Holders of the Notes after such withholding shall equal the respective amounts of principal and interest which would otherwise have been receivable in respect of the Notes, in the absence of such withholding, as described above under "Description of the Notes—Payment of Additional Amounts".

There are no estate or inheritance taxes, succession duties, gift taxes or capital gains taxes imposed by Iceland or any authority of, or in, Iceland in respect of the Notes if, at the time of the death of the Holder or the transfer of the Notes, such Holder or transferor is not a tax resident of Iceland.

Icelandic Tax Residents

Beneficial owners of the Notes that are resident in Iceland for tax purposes are subject to income tax in Iceland on their interest income in accordance with Icelandic tax law. The rate depends on their tax status.

Subject to certain exemptions applicable to, for example, most banks and pension funds, we are required to withhold a 10% tax on the interest paid to the Holders of the Notes which is considered a preliminary tax payment but does not necessarily constitute the final tax liability of the Holder.

EU Savings Directive

Under EC Council Directive 2003/48/EC on the taxation of savings income, Member States are required, from July 1, 2005, to provide to the tax authorities of another Member State details of payments of interest (or similar income) paid by a person within its jurisdiction to an individual resident in that other Member State. However, for a transitional period, Austria, Belgium and Luxembourg 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-E.U. countries and territories including Switzerland have agreed to adopt similar measures (a withholding system in the case of Switzerland) with effect from the same date.

Luxembourg Taxation

The following summary is of a general nature and is included herein solely for information purposes. It is based on the laws presently 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 Notes 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.

Please be aware that the residence concept used under the respective headings below applies for Luxembourg income tax assessment purposes only. Any reference in the present section to a tax, duty, levy, impost or other charge or withholding of a similar nature refers to Luxembourg tax law and/or concepts only. Also, please note that a reference to Luxembourg income tax encompasses corporate income tax (*impôt sur le revenu des collectivités*), municipal business tax (*impôt commercial communal*), a solidarity surcharge (*contribution au fonds de chômage*) as well as personal income tax (*impôt sur le revenu*) generally. Investors may further be subject to net wealth tax (*impôt sur la fortune*) as well as other duties, levies or taxes. Corporate income tax, municipal business tax as well as the solidarity surcharge invariably apply to most corporate taxpayers resident in Luxembourg for tax purposes. Individual taxpayers are generally subject to personal income tax and the solidarity surcharge. Under certain circumstances, where an individual taxpayer acts in the course of the management of a professional or business undertaking, municipal business tax may apply as well.

Taxation of the Holders of the Notes

Withholding tax

Non-resident Holders of Notes

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 Notes, nor on accrued but unpaid interest in respect of the Notes, nor is any Luxembourg withholding tax payable upon redemption or repurchase of the Notes held by non-resident Holders of Notes.

Under the Laws implementing the 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 are 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% during the first three-year period starting July 1, 2005, at a rate of 20% for the subsequent three-year period and at a rate of 35% thereafter. Responsibility for the withholding of the tax will be assumed by the Luxembourg paying agent. Payments of interest under the Notes coming within the scope of the Laws would at present be subject to withholding tax of 15%.

Resident Holders of Notes

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 Notes, nor on accrued but unpaid interest in respect of Notes, nor is any Luxembourg withholding tax payable upon redemption or repurchase of Notes held by Luxembourg resident Holders of Notes.

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 resident in Luxembourg will be subject to a withholding tax of 10%. 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 Notes coming within the scope of the Law would be subject to withholding tax of 10%.

Income taxation

Non-resident Holders of Notes

A non-resident corporate Holder of Notes or an individual Holder of Notes acting in the course of the management of a professional or business undertaking, who has a permanent establishment or permanent representative in Luxembourg to which such Notes are attributable, is subject to Luxembourg income tax on interest accrued or received, redemption premiums or issue discounts, under the Notes and on any gains realised upon the sale or disposal, in any form whatsoever, of the Notes.

Resident Holders of Notes

A corporate Holder of Notes must include any interest accrued or received, any redemption premium or issue discount, as well as any gain realised on the sale or disposal, in any form whatsoever, of the Notes, in its taxable income for Luxembourg income tax assessment purposes. The same inclusion applies to an individual Holder of Notes, acting in the course of the management of a professional or business undertaking.

A Holder of Notes that is governed by the law of July 31, 1929, on pure holding companies, as amended, or by the laws of March 30, 1988 and December 20, 2002 on undertakings for collective investment, as amended, is neither subject to Luxembourg income tax in respect of interest accrued or received, any redemption premium or issue discount, nor on gains realised on the sale or disposal, in any form whatsoever, of the Notes.

An individual Holder of Notes, acting in the course of the management of his/her private wealth, is subject to Luxembourg income tax in respect of interest received, redemption premiums or issue discounts, under the Notes, except if withholding tax has been levied on such payments in accordance with the Law. A gain realised by an individual Holder of Notes, acting in the course of the management of his/her private wealth, upon the sale or disposal, in any form whatsoever, of Notes is not subject to Luxembourg income tax, provided this sale or disposal took place more than six months after the Notes were acquired. However, any portion of such gain corresponding to accrued but unpaid interest income is subject to Luxembourg income tax.

Net Wealth Taxation

A corporate Holder of Notes, whether it is resident in Luxembourg for tax purposes or, if not, it maintains a permanent establishment or a permanent representative in Luxembourg to which such Notes are attributable, is subject to Luxembourg wealth tax on such Notes, except if the Holder of Notes is governed by the law of July 31, 1929 on pure holding companies, as amended, or by the laws of March 30, 1988 and December 20, 2002 on undertakings for collective investment, as amended, or is a securitisation company governed by the law of March 22, 2004 on securitisation, or a capital company governed by the law of June 15, 2004 on venture capital vehicles.

An individual Holder of Notes, whether he/she is resident in Luxembourg or not, is not subject to Luxembourg wealth tax on such Notes.

Other Taxes

Neither the issuance nor the transfer of Notes will give rise to any Luxembourg stamp duty, value added tax, issuance tax, registration tax, transfer tax or similar tax or duty.

Where a Holder of Notes is resident in Luxembourg for tax purposes at the time of his/her death, the Notes are included in his/her taxable estate for inheritance tax assessment purposes.

Gift tax may be due on a gift or donation of Notes if embodied in a Luxembourg deed or recorded in Luxembourg.

PLAN OF DISTRIBUTION

The Notes are being offered on a continuous basis for sale by us to or through, Citigroup Global Markets Inc., Banc of America Securities LLC, Credit Suisse Securities (USA) LLC, Deutsche Bank Securities Inc., Lehman Brothers Inc., Merrill Lynch, Pierce, Fenner & Smith Incorporated and Morgan Stanley & Co. Incorporated, together with such other Dealer as may be appointed by us with respect to a particular tranche of Notes (the "Dealers"). One or more Dealers may purchase Notes, as principal, from us from time to time for resale to investors and other purchasers at varying prices relating to prevailing market prices at the time of resale as determined by any Dealer, or, if so specified in the applicable Pricing Supplement, for resale at a fixed offering price. If we and a Dealer agree, a Dealer may also utilize its reasonable efforts on an agency basis to solicit offers to purchase the Notes.

Unless otherwise specified in the applicable Pricing Supplement, any Note sold to one or more Dealers as principal will be purchased by such Dealers at a price equal to 100% of the principal amount thereof or such other price as may be set forth in the applicable Pricing Supplement less a percentage of the principal amount equal to a commission as agreed upon by the relevant Dealers and the Issuer. A Dealer may sell Notes it has purchased from the Issuer as principal to certain dealers less a concession equal to all or any portion of the discount received in connection with such purchase. Such Dealer may allow, and such dealers may reallow, a discount to certain other dealers. After the initial offering of Notes, the offering price (in the case of Notes to be resold at a fixed offering price), the concession and the reallowance may be changed.

We may withdraw, cancel or modify the offering contemplated hereby without notice and may reject offers to purchase Notes in whole or in part. Each Dealer shall have the right, in its discretion reasonably exercised, without notice to us, to reject in whole or in part any offer to purchase Notes received by it on an agency basis.

In connection with this offering, the Dealers, acting directly or through subsidiaries, may over-allot or effect transactions that stabilize, maintain or otherwise affect the market price of the Notes with a view to supporting the market price of the Notes at a level higher than that which might otherwise prevail for a limited period. However, there may be no obligation on the Dealers or any agent to do this. Such stabilization, if commenced, may be discontinued at any time and must be brought to an end after a limited period. Such stabilizing, if any, shall be in compliance with all relevant laws and regulations. These transactions may include stabilizing transactions pursuant to which the Dealers, acting directly or through subsidiaries, may bid for or purchase Notes in the open market or otherwise for the purpose of stabilizing the market price of the Notes. Each of the Dealers, acting directly or through subsidiaries, may also create a short position for its account by selling more Notes in connection with the offering than it is committed to purchase from the Issuer, and in such case may purchase Notes in the open market following completion of the offering to cover all or a portion of such short position.

Neither we nor any of the Dealers makes any representation or prediction as to the direction or magnitude of any effect that the transactions described in the immediately preceding paragraph may have on the price of Notes. In addition, neither we nor the Dealers makes any representation that the Dealers will engage in any such transactions or that such transactions, once commenced, will not be discontinued without notice.

We have agreed to indemnify the Dealers against certain liabilities (including liabilities under the Securities Act) or to contribute to payments the Dealers may be required to make in respect thereof. We also have agreed to reimburse the Dealers for certain other expenses.

In the ordinary course of business, the Dealers and their affiliates may have engaged in and may in the future engage in investment and/or commercial banking transactions with us or our affiliates.

TRANSFER RESTRICTIONS

Offers and Sales by the Dealers

The Notes have not been, and will not be, registered under the Securities Act or any other applicable securities laws and may not be offered or sold in the United States except pursuant to an effective registration statement or in accordance with an applicable exemption from the registration requirements of the Securities Act and such other securities laws. Accordingly, the Notes are being offered and sold only (l)(i) to qualified institutional buyers ("QIBs"), as defined in Rule 144A, (ii) if specified in the applicable Pricing Supplement to institutional investors that qualify as accredited investors ("Institutional Accredited Investors"), as defined in Rule 501(a)(l), (2), (3) or (7) under the Securities Act, purchasing for their own account or as fiduciary or agent for others (which others also must be Institutional Accredited Investors unless the purchaser is a bank acting in its fiduciary capacity) for investment purposes and not for distribution in violation of the Securities Act (iii) in offers and sales that occur outside the United States to persons other than U.S. persons in offshore transactions meeting the requirements of Rule 903 of Regulation S under the Securities Act or (iv) in other transactions exempt from the registration under the Securities Act and (2) in compliance with any other applicable securities laws.

Purchasers' Representations and Restrictions on Resale

Each purchaser of Notes (other than a Dealer in connection with the initial issuance and sale of Notes by the Issuer) and each owner of any beneficial interest therein, will be deemed, by its acceptance or purchase thereof, to have represented to and agreed with us and any Dealer as follows:

1. It is purchasing the Notes for its own account or an account with respect to which it exercises sole investment discretion and it and any such account is either (A) a QIB, and is aware that the sale to it is being made in reliance on Rule 144A or (B) if permitted in the applicable Pricing Supplement, an Institutional Accredited Investor acquiring the Notes for investment purposes and not for distribution in violation of the Securities Act or (C) a foreign purchaser that is outside the United States (or a foreign purchaser that is a dealer or other fiduciary as referred to above).

2. It acknowledges that the Notes have not been registered under the Securities Act or with any securities regulatory authority of any jurisdiction and may not be offered or sold within the United States or to, or for the account or benefit of U.S. persons, except as set forth below.

3. It understands and agrees that Notes initially offered in the United States to QIBs will be represented by U.S. Global Notes, that any Notes initially offered to Institutional Accredited Investors will be represented by physical registered certificates and that Notes offered outside the United States in reliance on Regulation S will be represented by International Global Notes.

4. It shall not resell or otherwise transfer any of such Notes except (A) to us or a Dealer or by, through, or in a transaction approved by a Dealer, (B) within the United States to a QIB in a transaction complying with Rule 144A, (C) if permitted in the applicable Pricing Supplement, within the United States to an Institutional Accredited Investor acquiring the Notes for investment purposes and not for distribution in violation of the Securities Act, (D) outside the United States, in compliance with Rule 903 or 904 under the Securities Act, (E) pursuant to the exemption from registration provided by Rule 144 under the Securities Act (if available), or (F) pursuant to an effective registration statement under the Securities Act.

5. It agrees that it will give to each person to whom it transfers the Notes notice of any restrictions on transfer of such Notes.

6. It acknowledges that prior to any proposed transfer of Notes (other than pursuant to an effective registration statement) the Holder of such Notes may be required to provide certifications relating to the manner of such transfer as provided in the applicable Indenture.

7. It acknowledges that the Trustee for the Notes will not be required to accept for registration the transfer of any Notes acquired by it, except upon presentation of evidence satisfactory to us and such Trustee that the restrictions set forth herein have been complied with.

8. It acknowledges that neither we nor the Dealers nor any person representing us or the Dealers have made any representations to it with respect to us or the offering or sale of any Notes, other than the information contained in this Offering Circular, which Offering Circular has been delivered to it and upon which it is

relying in making its investment decision with respect to the Notes. Accordingly, it acknowledges that no representation or warranty is made by the Dealers as to the accuracy or completeness of such material.

9. It acknowledges that we, the Dealers and others will rely upon the truth and accuracy of the foregoing acknowledgments, representations and agreements and agrees that if any of the acknowledgments, representations or agreements deemed to have been made by its purchase of the Notes are no longer accurate, it shall promptly notify us and the Dealers. If it is acquiring the Notes as a fiduciary or agent for one or more investor accounts, it represents that it has sole investment discretion with respect to each such account and it has full power to make the foregoing acknowledgments, representations, and agreements on behalf of each account.

Set forth below is a form of legend which will appear on the face of Notes, other than International Global Notes, and which will be used to notify transferees of the foregoing restrictions on transfer. Additional copies of such notice may be obtained from the Trustee.

"THIS NOTE HAS NOT BEEN REGISTERED UNDER THE U.S. SECURITIES ACT OF 1933, AS AMENDED (THE "U.S. SECURITIES ACT") OR ANY OTHER SECURITIES LAWS. THE HOLDER HEREOF, BY PURCHASING THIS NOTE, AGREES FOR THE BENEFIT OF KAUPTHING BANK HF. (THE "ISSUER") THAT THIS NOTE MAY BE OFFERED, RESOLD, PLEDGED OR OTHERWISE TRANSFERRED ONLY (1) TO THE ISSUER OR A DEALER OR BY, THROUGH OR IN A TRANSACTION APPROVED BY A DEALER, (2) SO LONG AS THIS SECURITY IS ELIGIBLE FOR RESALE PURSUANT TO RULE 144A UNDER THE U.S. SECURITIES ACT ("RULE 144A"), TO A PERSON WHO THE SELLER REASONABLY BELIEVES IS A QUALIFIED INSTITUTIONAL BUYER (AS DEFINED IN RULE 144A) IN ACCORDANCE WITH RULE 144A, (3) IN AN OFFSHORE TRANSACTION IN ACCORDANCE WITH RULE 903 OR 904 OF REGULATION S UNDER THE U.S. SECURITIES ACT, (4) IF PERMITTED IN THE APPLICABLE PRICING SUPPLEMENT TO AN "ACCREDITED INVESTOR" WITHIN THE MEANING OF RULE 501(a)(l), (2), (3) OR (7) UNDER THE U.S. SECURITIES ACT ACQUIRING THE NOTES FOR INVESTMENT PURPOSES AND NOT FOR DISTRIBUTION IN VIOLATION OF SUCH ACT, (5) PURSUANT TO AN EXEMPTION FROM REGISTRATION UNDER THE U.S. SECURITIES ACT PROVIDED BY RULE 144 UNDER THE U.S. SECURITIES ACT (IF AVAILABLE) OR (6) PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT UNDER THE U.S. SECURITIES ACT, AND IN EACH OF SUCH CASES IN ACCORDANCE WITH ANY APPLICABLE SECURITIES LAWS OF ANY STATE OF THE UNITED STATES OR ANY OTHER APPLICABLE JURISDICTION. THE HOLDER HEREOF, BY PURCHASING THIS NOTE, REPRESENTS AND AGREES FOR THE BENEFIT OF THE ISSUER THAT IT WILL NOTIFY ANY PURCHASER OF THIS SECURITY FROM IT OF THE RESALE RESTRICTIONS REFERRED TO ABOVE".

For further discussion of the requirements (including the presentation of transfer certificates) under the Indenture to effect exchanges or transfers of interest in Global Notes and Certificated Notes, see "Description of the Notes—Form, Transfer, Exchange and Denomination".

Selling Restrictions

United Kingdom

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

(i) in relation to any Notes having a maturity of less than one year of the date of their issue, (a) it is a person whose ordinary activities involve it in acquiring, holding, managing or disposing of investments (as principal or agent) for the purposes of its business and (b) it has not offered or sold and will not offer or sell any Notes other than to persons whose ordinary activities involve them in acquiring, holding, managing or disposing of investments (as principal or as agent) for the purposes of their businesses or who it is reasonable to expect will acquire, hold, manage or dispose of investments (as principal or agent) for the purposes of their businesses where the issue of the Notes would otherwise constitute a contravention of Section 19 of the Financial Services and Markets Act 2000 (the "FSMA") by the Issuer;

(ii) it has only communicated or caused to be communicated and will only communicate or cause to be communicated any 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 of any Notes in circumstances in which Section 21(1) of the FSMA does not apply to the Issuer; and

(iii) it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to any Notes in, from or otherwise involving the United Kingdom.

Japan

The Notes have not been and will not be registered under the Securities and Exchange Law of Japan (the "Securities and Exchange Law") and each Dealer has agreed and each further Dealer appointed under the Programme will be required to agree that it will not offer or sell any Notes, directly or indirectly, in Japan or to, or for the benefit of, any resident of Japan (which term as used herein means any person resident in Japan, including any corporation or other entity organized under the laws of Japan), or to others for re-offering or resale, directly or indirectly, in Japan or to a resident of Japan except pursuant to an exemption from the registration requirements of, and otherwise in compliance with, the Securities and Exchange Law and any other applicable laws, regulations and ministerial guidelines of Japan.

France

Each of the Dealers and the Issuer has represented and agreed that:

(i) it has only made and will only make an offer of Notes to the public (*appel public à l'épargne*) in France in the period beginning (i) when a prospectus in relation to those Notes has been approved by the *Autorité des marchés financiers* ("AMF"), on the date of such publication or, (ii) when a prospectus has been approved in another Member State of the European Economic Area which has implemented the EU Prospectus Directive 2003/71/EC, on the date of notification of such approval to the AMF, all in accordance with articles L.412-1 and L.621-8 of the French *Code monétaire et financier* and the *Règlement général* of the AMF, and ending at the latest on the date which is 12 months after the date of such publication; or

(ii) it has only made and will only make an offer of Notes to the public in France (*appel public à l'épargne*) and/or it has only required and will only require the admission to trading on Euronext Paris S.A. in circumstances which do not require the publication by the offeror of a prospectus pursuant to articles L.411-2 and L.412-1 of the French *Code monétaire et financier*; and

(iii) otherwise, it has not offered or sold and will not offer or sell, directly or indirectly, Notes to the public in France, and has not distributed or caused to be distributed and will not distribute or cause to be distributed to the public in France, the Offering Circular or any other offering material relating to the Notes, and that such offers, sales and distributions have been and shall only be made in France to (i) providers of investment services relating to portfolio management for the account of third parties, and/or (ii) qualified investors (*investisseurs qualifiés*), all as defined in, and in accordance with, articles L.411-1, L.411-2 and D.411-1 of the French *Code monétaire et financier*.

Iceland

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

European Economic Area

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

a) in (or in Germany, where the offer starts within) the period beginning on the date of publication of a prospectus in relation to those Notes which has been approved by the competent authority in that Relevant Member State or, where appropriate, approved in another Relevant Member State and notified to the competent authority in that Relevant Member State, all in accordance with the Prospectus Directive and ending on the date which is 12 months after the date of such publication;

b) at any time to legal entities which are authorised or regulated to operate in the financial markets or, if not so authorised or regulated, whose corporate purpose is solely to invest in securities;

c) at any time to any legal entity which has two or more of (1) an average of at least 250 employees during the last financial year; (2) a total balance sheet of more than €43,000,000 and (3) an annual net turnover of more than €50,000,000, as shown in its last annual or consolidated accounts; or

d) at any time in any other circumstances which do not require the publication by the Issuer of a prospectus pursuant to Article 3 of the Prospectus Directive.

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

Hong Kong

Each Dealer has represented, warranted and agreed that it has not offered or sold and will not offer or sell the Notes in Hong Kong SAR by means of this Offering Circular or any other document, other than to persons whose ordinary business involves buying or selling shares or debentures, whether as principal or agent or in circumstances which do not constitute an offer to the public within the meaning of the Companies Ordinance (Cap. 31 of the Laws of Hong Kong SAR), and (2) unless it is a person who is permitted to do so under the securities laws of Hong Kong SAR, it has not issued or held for the purpose of issues in Hong Kong and will not issue or hold or the purpose of issue in Hong Kong SAR this Offering Circular, any other offering material or any advertisement, invitation or document relating to the Notes, otherwise than with respect to Notes intended to be disposed of to persons outside Hong Kong SAR or only to persons whose business involves the acquisition, disposal, or holding of securities whether as principal or as agent.

Singapore

Each Dealer has represented, warranted and agreed that this Offering Circular has not been registered as a prospectus with the Monetary Authority of Singapore. Accordingly, this Offering Circular or any other document or material in connection with the offer or sale, or invitation for subscription or purchase, of the Notes, may not be circulated or distributed, nor may the Notes be offered or sold, or be made the subject of an invitation for subscription or purchase, whether directly or indirectly to the public or any member of the public in Singapore other than (1) to an institutional investor or other person specified in Section 274 or the Securities and Futures Act, Chapter 289 of Singapore (the "SFA"), (2) to a sophisticated investor, and in accordance with the conditions, specified in Section 275 of the SFA or (3) otherwise pursuant to, and in accordance with the conditions of, any other applicable provision of the SFA.

General

No action has been or will be taken by any Dealer or by the Issuer that would permit the offer or sale of any Notes or any interest therein or possession or distribution of the Offering Circular or any other offering material relating to any Notes in any jurisdiction where action for that purpose is required.

Without prejudice to the above paragraphs, each Dealer has represented and agreed that it has not and will not directly or indirectly offer, sell or deliver any Notes or distribute the Offering Circular or any other offering material relating to any Notes in or from any jurisdiction except under circumstances that to the best of such Dealer's knowledge or belief will result in compliance with the applicable laws and regulations thereof and will not impose any obligations on the Issuer.

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

SETTLEMENT

Unless otherwise specified in the applicable Pricing Supplement, payment of the purchase price of the Notes will be required to be made in immediately available funds in the applicable Specified Currency in New York City three Business Days after the trade date.

WHERE YOU CAN FIND MORE INFORMATION

Our annual consolidated IFRS financial statements as at and for the years ended December 31, 2006 and as at and for the years ended December 31, 2005 appear on pages F-1 through F-129. Those consolidated financial statements have been audited by our independent auditors, in accordance with International Standards on Auditing and generally accepted auditing standards in Iceland, respectively, and have been reported upon without qualification. Copies of our subsequent audited consolidated financial statements and unaudited semi-annual financial statements, if any, will be attached hereto and incorporated herein by reference. Such financial statements will not be distributed to Holders of outstanding Notes, but will be available to such Holders upon request. Requests for copies of such financial statements should be directed to the Group Treasury, Kaupthing Bank hf., Borgartún 19, 105 Reykjavík, Iceland (fax +354 444 6119).

We are a bank validly existing as a public institution in the Republic of Iceland. At the date of this Offering Circular, we do not file reports and other information with the SEC under the Exchange Act. In order to preserve the exemption for resales and other transfers under Rule 144A, we have agreed to furnish the information required to be delivered pursuant to Rule 144A(d)(4) under the Securities Act if a Noteholder or prospective purchaser specified by a registered Holder requests such information. We will continue to provide such reports for so long as it is neither subject to the reporting requirements of Section 13 or l5(d) of the Exchange Act nor exempt from such reporting requirements pursuant to Rule 12g3-2(b) of the Exchange Act.

The address of our internet website is www.kaupthing.net. The information on our website is not part of this Offering Circular and is not incorporated by reference into this Offering Circular.

INDEPENDENT AUDITORS

Our consolidated financial statements included in this Offering Circular have been audited by KPMG hf., an independent registered public accounting firm, as stated in their report appearing herein.

LEGAL MATTERS

The validity of the Notes will be passed upon for us by Allen & Overy LLP and for the Dealers by Milbank, Tweed, Hadley & McCloy LLP.

LISTING AND GENERAL INFORMATION

Listing

Application for approval has been made to the Luxembourg Stock Exchange to approve this document as an Offering Circular and, if a Series of Notes are to be listed on the Luxembourg Stock Exchange, application will be made for Notes issued under the Program to be admitted to trading on the Euro MTF Market of the Luxembourg Stock Exchange. The Euro MTF Market of the Luxembourg Stock Exchange is an unregulated market for the purposes of Directive 2004/39/EC. The Luxembourg Stock Exchange has allocated the number 13320 to the Program for listing purposes.

In March 2003, the European Commission published a proposal for a Directive of the European Parliament and of the Council on the harmonization of transparency requirements with regard to information about issuers whose securities are admitted to trading on a regulated market in the European Union ((2003/0045(COD)), known as the "Transparency Directive". While the Euro MTF market of the Luxembourg Stock Exchange is not a regulated market, the Transparency Directive may become effective in a form such that it becomes unduly burdensome for the Issuer to maintain a listing on the Euro MTF market of the Luxembourg Stock Exchange. In particular, the Issuer may be required to publish financial information either more regularly than it otherwise would be required to or according to accounting principles which are materially different from the accounting principles which the Issuer would otherwise use to prepare its published financial information. In such circumstances, the Issuer may seek an alternative admission to listing, trading and/or quotation for the Notes by another listing authority, stock exchange and/or quotation system outside the European Union, or, alternatively, the Issuer may opt not to have the Notes listed, traded and/or quoted by any listing authority, stock exchange and/or quotation system.

Authorization

The Program has been established and Notes will be issued thereunder pursuant to authority granted by our board of directors on February 22, 2006, as such authority may be supplemented from time to time.

Significant Change

Except as disclosed herein, as of the date of this Offering Circular there has been no significant change in the financial position or results of operations of the Issuer or the Issuer and its subsidiaries, taken as a whole, since December 31, 2006 and, as of the date of this Offering Circular, there has been no material adverse change in the prospects of the Issuer or the Issuer and its subsidiaries, taken as a whole.

Litigation

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

Clearing Systems

The Notes will be accepted for clearance through the DTC, Euroclear and Clearstream, Luxembourg systems. The appropriate DTC CUSIP number, Common Code and ISIN for each tranche allocated by DTC, Euroclear and Clearstream, Luxembourg, as applicable, and details of any other agreed clearing system will be contained in the applicable Pricing Supplement. Transactions normally will be effected for settlement not earlier than three days after the date of the transaction.

Documents Available for Collection and Inspection

For the period of 12 months following the date of this Offering Circular, copies of the following documents will, when published, be available from the registered office of the Issuer and from the specified office of each of the Issuing and Principal Paying Agent and the Paying Agent for the time being in Luxembourg:

(i) the Articles of Association of the Issuer;

(ii) the audited financial statements of the Issuer in respect of the financial years ended December 31, 2006 and 2005 and in respect of the financial years ended December 31, 2005 and 2004, in each case together with the audit reports prepared in connection therewith;

(iii) the Senior Indenture, the Subordinated Indenture, the Capital Notes Indenture, the Luxembourg Paying Agency Agreement, the forms of the Global Notes and the forms of the Notes in definitive form;

(iv) a copy of this Offering Circular;

(v) any future Offering Circulars, prospectuses, information memoranda and supplements including Pricing Supplements (except that a Pricing Supplement relating to a Note 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 Prospectus Directive will only be available for inspection by a Holder of such Note and such Holder must produce evidence satisfactory to the Issuer and the Paying Agent as to its holding of Notes and identity) to this Offering Circular and any other documents incorporated herein or therein by reference;

(vi) any Officer's Certificate supplied by the Issuer in connection with the Program; and

(vii) in the case of each issue of Notes admitted to trading on the Luxembourg Stock Exchange's Euro MTF market and subscribed pursuant to a subscription agreement, the subscription agreement (or equivalent document).

Post-issuance Information

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

Subsidiaries

Set forth in the table below is certain information regarding our principal consolidated subsidiaries.

Company:	Country	Business Group(1)	Share Capital in millions	Equity interest accum. %
Arion Custody Service hf.	Iceland	OD	115	99.9
Eik fasteignafelag hf	Iceland	OD	707	100.0
FI-Holding A/S (FIH)	Denmark	IB, Tr, Ba	842	100.0
Kaupthing Bank Luxembourg S.A.	Luxembourg	CM, Tr, Ba, AM & PB	7,936	100.0
Kaupthing Bank Oyj	Finland	IB, CM, Tr, Ba, AM & PB	1,670	100.0
Kaupthing Føroyar Virdisbrævameklarafelag P/F	Faeroe Islands	IB, CM, AM & PB	112	100.0
Kaupthing Holding UK Ltd. (Singer & Friedlander)	UK	IB, CM, Tr, Ba, AM & PB	28,847	100.0
Kaupthing New York Inc. (Kaupthing Securities Inc.)	USA	CM	260	100.0
Kaupthing Norge AS	Norway	IB, CM, AM & PB	1,433	100.0
Kaupthing Sverige AB	Sweden	IB, CM, Tr, Ba, AM & PB	2,807	93.5
Kaupthing UK Ltd.	UK	IB, CM, Tr, Ba, AM & PB	364	100.0
KB-Líf hf.	Iceland	Ba	17	100.0
Kirna ehf.	Iceland	IB, Tr	31,770	100.0
Norvestia Oyj	Finland	CM	4,455	30.6
Rekstrarfelag Kaupthings banka hf.	Iceland	AM & PB	44	100.0
Vidjar ehf.	Iceland	Ba	1	100.0
Sparisjodur Kaupthings hf.	Iceland	Ba	100	100.0

(1) IB: Investment Banking, CM: Capital Markets, Tr: Treasury, Ba: Banking, AM & PB: Asset Management and Private Banking, OD: Other Divisions.

INDEX TO FINANCIAL INFORMATION

Amounts in the financial statements and notes thereto in pages F-2 to F-129 are in ISK millions unless otherwise indicated.

INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Shareholders of Kaupthing Bank hf.

Report on the Consolidated Financial Statements

We have audited the accompanying Consolidated Financial Statements of Kaupthing Bank hf. and its subsidiaries ("the Bank"), which comprise the Consolidated Balance Sheet as at 31 December 2006, and the Consolidated Income Statement, Consolidated Statement of changes in Equity and Consolidated Cash Flow Statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Managements Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these Consolidated Financial Statements in accordance with International Financial Reporting Standards as adopted by EU. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of Financial Statements that are free from material misstatements, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditors' Responsibility

Our responsibility is to express an opinion on these Consolidated Financial Statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance whether the Financial Statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the Financial Statements. The procedures selected depend on our judgement, including the assessment of the risks of material misstatement of the Financial Statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the Financial Statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the Financial Statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Opinion

In our opinion, the Consolidated Financial Statements give a true and fair view of the consolidated financial position of Kaupthing Bank hf. as at 31 December 2006, and of its consolidated financial performance and its Consolidated Cash Flows for the year then ended in accordance with International Financial Reporting Standards as adopted by EU.

Reykjavik, 29 January 2007

KPMG hf.

Saemundur Valdimarsson

Reynir Stefan Gylfason

CONSOLIDATED INCOME STATEMENT FOR THE YEAR 2006

	2006	2005	Notes
Interest income	187,451	100,009	
Interest expense	(135,089)	(67,299)	
Net interest income	**52,362**	**32,710**	42
Fee and commission income	40,904	23,508	
Fee and commission expense	(3,620)	(1,080)	
Net fee and commission income	**37,284**	**22,428**	43
Net financial income	60,157	37,282	44-49
Share of profit of associates	1,194	1,396	69
Other operating income	16,219	8,382	50
Operating income	**167,216**	**102,198**	
Salaries and related expenses	(33,570)	(20,317)	52-53
Administration expenses	(19,800)	(11,594)	
Depreciation and amortisation	(5,976)	(2,818)	75
Other operating expenses	(660)	(796)	
Impairment on loans	(4,857)	(2,450)	55
Impairment on other assets	(1,270)	(1,939)	55
Earnings before income tax	**101,083**	**62,284**	
Income tax expense	(14,636)	(11,228)	56
Net earnings	**86,447**	**51,056**	
Attributable to.			
Shareholders of Kaupthing Bank hf.	85,302	49,260	
Minority interest	1,145	1,796	
Net earnings	**86,447**	**51,056**	
Earnings per share			
Basic earnings per share	1271	752	57
Diluted earnings per share	1234	739	57

CONSOLIDATED BALANCE SHEET AS AT 31 DECEMBER 2006

	2006	2005	Notes
Assets			
Cash and balances with central banks	106,961	34,877	58
Loans to credit institutions	485,334	195,594	59
Loans to customers	2,538,609	1,543,700	60-64
Bonds and debt instruments	318,264	390,575	65
Shares and equity instruments	159,020	114,355	65
Derivatives	65,454	21,047	65,93
Derivatives used for hedging	6,453	4,459	65,93
Securities used for hedging	115,938	82,098	65
Investments in associates	5,304	13,888	69
Intangible assets	68,301	54,943	70-71
Investment property	31,584	24,156	72-73
Property and equipment	30,466	22,433	74-77
Tax assets	5,834	5,004	84
Other assets	**117,874**	**33,682**	78
Total Assets	**4,055,396**	**2,540,811**	
Liabilities			
Due to credit institutions and central banks	110,456	69,643	
Deposits	750,658	486,175	
Borrowings	2,399,939	1,556,567	79
Subordinated loans	216,030	102,688	80
Financial liabilities measured at fair value	71,264	60,273	81-83
Tax liabilities	23,209	18,458	84
Other liabilities	148,948	44,495	87-88
Total Liabilities	**3,720,504**	**2,338,299**	
Equity			
Share capital	7,321	6,638	
Share premium	164,028	114,606	
Reserves	17,220	(1,540)	
Retained earnings	134,941	74,479	
Total Shareholders' Equity	**323,510**	**194,183**	89-91
Minority interest	11,382	8,329	
Total Equity	**334,892**	**202,512**	
Total Liabilities and Equity	**4,055,396**	**2,540,811**	

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR 2006

	Share capital and premium	Reserves	Retained earnings	Total Share-holders' equity	Minority interest	Total equity
2006						
Equity 1 January 2006	121,244	(1,540)	74,479	194,183	8,329	202,512
Translation difference		18,289		18,289	2,176	20,465
Fair value changes in AFS financial assets		(9)		(9)		(9)
Deferred pension reserve		480		480		480
Net earnings recognised directly in equity		18,760		18,760	2,176	20,936
Net earnings according to the Income Statement			85,302	85,302	1,145	86,447
Total recognised earnings for the year		18,760	85,302	104,062	3,321	107,383
Dividends paid to equity holders, ISK 37.6 per share			(24,814)	(24,814)		(24,814)
Issued new share capital	55,558			55,558		55,558
Purchases and sales of treasury stock	(6,024)			(6,024)		(6,024)
Exercised stock options	571			571		571
Other changes			(26)	(26)	(268)	(294)
Equity 31 December 2006	**171,349**	**17,220**	**134,941**	**323,510**	**11,382**	**334,892**
2005						
Equity 1 January 2005	117,080	(670)	32,960	149,370	9,539	158,909
Translation difference		(388)		(388)	(77)	(465)
Fair value changes in AFS financial assets		(2)		(2)		(2)
Deferred pension reserve		(480)		(480)		(480)
Net earnings recognised directly in equity		(870)		(870)	(77)	(947)
Net earnings according to the Income Statement			49,260	49,260	1,796	51,056
Total recognised earnings for the year		**(870)**	**49,260**	**48,390**	**1,719**	**50,109**
Dividends paid to equity holders, ISK 10 per share			(3,298)	(3,298)		(3,298)
Issued new share capital	416			416		416
Restating the initial investments in shares			(4,886)	(4,886)		(4,886)
Purchases and sales of treasury stock	3,706			3,706		3,706
Exercised stock options	42			42		42
Other changes			443	443	(2,929)	(2,486)
Equity 31 December 2005	**121,244**	**(1,540)**	**74,479**	**194,183**	**8,329**	**202,512**

CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR 2006

	2006	2005
Cash flows from operating activities:		
Earnings before income tax	101,083	62,284
Adjustments to reconcile Net earnings to cash flow (used in) from operating activities		
Non-cash items included in Net earnings and other adjustments	1,481	4,936
Operating assets and liabilities, changes	(144,389)	23,234
Income taxes paid	(8,115)	(1,455)
Net cash (used in) from operating activities	**(49,940)**	**88,999**
Cash flows from investing activities:		
Investment in associated companies	(5,400)	(1,805)
Disposal of associated companies	20,266	6,111
Dividend received from subsidiaries	4,103	102
Payment for acquisition of subsidiaries (less cash acquired)	0	(60,356)
Purchase of Intangible assets	(1,810)	(2,884)
Purchase of Investment property	(3,475)	(4,839)
Proceeds from sale of Investment property	5,367	208
Purchase of Property and equipment	(13,818)	(4,965)
Proceeds from sale of Property and equipment	3,283	1,452
Other changes	221	(4,855)
Net cash from (used in) investing activities	**8,737**	**(71,831)**
Cash flows from financing activities:		
Subordinated loan capital issued	111,336	42,731
Subordinated loan capital repaid	(2,601)	(3,524)
(Purchases) sales of own shares to meet share awards and share option awards	(5,800)	3,706
Proceeds from the issue of shares	55,558	0
Dividends paid	(24,814)	(3,298)
Net cash from financing activities	**133,679**	**39,615**
Net increase in cash and cash equivalents	92,476	56,783
Cash and cash equivalents at beginning of the year	81,758	26,985
Effect of exchange rate changes on cash held	28,555	(2,010)
Cash and cash equivalents at year end	**202,789**	**81,758**
Additional information:		
Paid and total purchase price of subsidiaries	0	63,708
Received and total sale price of subsidiaries	0	6,111

CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR 2006 - NOTES

	2006	2005
Non-cash items in the Income Statement and other adjustments		
Impairment on loans	4,857	2,450
Depreciation and amortisation	5,976	2,818
Impairment on other assets	1,270	1,939
Net earnings of associated companies	(1,194)	(1,396)
Investment property, fair value change	(96)	(365)
Net gain on disposal of Investment property	(3,020)	0
Indexation and exchange rate difference	2,689	2,458
Net gain on disposal on Property and equipment	(303)	(248)
Net gain on a disposal of a subsidiary	0	(3,093)
Net gain on a disposal of associated companies	(8,398)	0
Share based payment expenses	571	42
Changes in other non-cash items	(871)	331
	1,481	**4,936**
Changes in operating assets and liabilities		
Loans, change	(1,253,947)	(394,644)
Financial assets measured at fair value, change	(51,147)	(68,042)
Financial assets available for sale, change	(2,016)	(118,012)
Tax assets, change	(3,060)	(1,276)
Other assets, change	(82,894)	(10,096)
Deposits, change	301,998	233,892
Borrowings, change	834,270	421,593
Financial liabilities, measured at fair value, change	10,872	(14,988)
Provisions, change	1,378	3,271
Tax liabilities, change	(1,788)	(1,422)
Other liabilities, change	101,945	(27,042)
	(144,389)	**23,234**
Cash and cash equivalents at year end		
Cash in hand and demand deposits	95,828	16,828
Due from credit institutions	106,961	64,930
Cash and cash equivalents at year end	**202,789**	**81,758**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

GENERAL INFORMATION

1. Reporting entity

Kaupthing Bank hf. is a company incorporated and domiciled in Iceland. The address of the Bank's registered office is Borgartún 19, Reykjavik. The Consolidated Financial Statements for the year 2006 comprise Kaupthing Bank hf. (the Parent Company) and its subsidiaries (together referred to as "the Bank"). The Bank offers integrated financial services to companies, institutional investors and individuals. These services include corporate banking, investment banking, retail banking, capital markets services, asset management and comprehensive wealth management for private banking clients.

2. Basis of preparation

a) Statement of compliance

The Consolidated Financial Statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU.

Certain comparative information have been restated.

The Financial Statements were approved and authorised for issue by the Board of Directors of Kaupthing Bank hf. on 29 January 2007.

b) Basis of measurement

The Consolidated Financial Statements are prepared on the historical cost basis except the following assets and liabilities that are stated at their fair value: derivative financial instruments, financial instruments held for trading, financial instruments designated at fair value through profit and loss, financial instruments classified as available-for-sale and investment properties.

Non-current assets and disposal groups held for sale are stated at the lower of carrying amount and fair value less costs to sell, unless IFRS 5 requires that another measurement basis shall be used.

c) Functional and presentation currency

The Consolidated Financial Statements are presented in Icelandic krona (ISK), which is the Bank's functional currency. Except as indicated, financial information presented in ISK has been rounded to the nearest million.

d) Use of estimates and judgements

The preparation of the Consolidated Financial Statements in conformity with IFRS requires management to make judgements, estimates and assumptions. These judgements, estimates and assumptions affect the application of accounting policies and the reported amounts of assets and liabilities as well as, income and expenses in the Consolidated Financial Statement presented. Actual results may differ from the estimates and the assumptions made.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

Judgements made by management in the application of IFRS that have significant effect on the Consolidated Financial Statements and estimates with a significant risk of material adjustment in the next year are discussed in note 37.

SIGNIFICANT ACCOUNTING POLICIES

The accounting policies set out below have been applied consistently to all periods presented in these Consolidated Financial Statements, and have been applied consistently by Bank's entities.

3. Basis of consolidation

a) Subsidiaries

Subsidiaries are entities controlled by the Bank. Control exists when the Bank has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Control usually exists when the

Bank holds more than the 50% of the voting power of the subsidiary. In assessing control, potential voting rights that are currently exercisable or convertible are taken into account. The Financial Statements of subsidiaries are included in the Consolidated Financial Statements from the date that control commences until the date that control ceases.

The purchase method of accounting is used to account for the acquisition of subsidiaries by the Bank. The cost of an acquisition is measured as the fair value, at the date of exchange, of the assets given, liabilities incurred or assumed and equity instruments issued, plus cost directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Bank's share of the net identifiable assets acquired is recorded as Goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the Income Statement.

b) Special purpose entities

Special purpose entities are entities that are created to accomplish a narrow and well-defined objective such as the securitisation of particular assets, or the execution of a specific borrowing or lending transaction. The Financial Statements of special purpose entities are included in the Bank's Consolidated Financial Statements where the substance of the relationship is that the Bank controls the special purpose entity.

c) Funds management

The Bank manages and administers assets held in unit trusts and other investment vehicles on behalf of investors. The Financial Statements of these entities are not included in these Consolidated Financial Statements except when the Bank controls the entity. Information about the Bank's securitisation is set out in note 67.

d) Transactions eliminated on consolidation

Intragroup balances, unrealised income and expenses arising from intragroup transactions, are eliminated in preparing the Consolidated Financial Statements. Unrealised gains arising from transactions with associates and jointly controlled entities are eliminated to the extent of the Bank's interest in the entity. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

4. Associates

Associates are those entities over which the Bank has significant influence, i.e. the power to participate in the financial and operating policy decisions of the associates but not control or joint control over those policies. Significant influence generally exists when the Bank holds between 20% and 50% of the voting power, including potential voting rights. Investments in associates are initially recognised at cost. The carrying amount of investments in associates includes goodwill and accumulated impairment loss.

Investments in associates held as venture capital in Investment Banking are not accounted for on an equity basis but are designated upon initial recognition as financial assets at fair value through profit or loss and accounted for in accordance with IAS 39 Financial Instruments Recognition and Measurement.

The Consolidated Financial Statements include the Bank's share of the total recognised income and expenses of associates on an equity accounted investees, from the date that significant influence commences until the date that significant influence ceases. When the Bank's share of losses exceeds its interest in an equity accounted associate, the Bank's carrying amount is reduced to nil and recognition of further losses is discontinued except to the extent that the Bank has incurred legal or constructive obligations or made payments on behalf of the associate. If the associate subsequently reports profits, the investor resumes recognising its share of those profits only after its share of the profits equals the share of losses not recognised.

If an investment in an associate is classified as held for sale, the equity method is no longer applied and the investment is accounted for as non-current assets held for sale.

5. Foreign currency

a) Functional currencies

Items included in the Financial Statements of each of the Bank's entities are measured using the functional currency of the respective entity.

b) Foreign currency transactions

Transactions in foreign currencies are translated to the respective functional currencies of Bank entities at exchange rates at the dates of transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated to the functional currency at the exchange rate at that date. The foreign currency gain or loss on monetary items is the difference between amortised cost in the functional currency at the beginning of the period, adjusted for effective interest and payments during the period, and the amortised cost in foreign currency translated at the exchange rate at the end of the period. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated to the functional currency at the exchange rate at the date that the fair value was determined. Foreign currency differences arising on retranslation are recognised in profit or loss, except for differences arising on the retranslation of available-for-sale equity instruments or a financial liability designated as a hedge of the net investment in a foreign operation.

c) Foreign operations

The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on acquisition, are translated to Icelandic krona, at exchange rates at the reporting date. The income and expenses of foreign operations are translated to Icelandic krona at average exchange rates approximating the exchange rates current at the dates of the transactions.

Foreign exchange difference arising on translation are recognised directly in Equity. Since 1 January 2004, the Bank's date of transition to IFRSs, such differences have been recognised in the Translation reserve. When a foreign operation is disposed, in part or in full, the relevant amount in the Translation reserve is transferred to the Income Statement.

d) Hedges of net investment in foreign operations

See accounting policy 10d.

6. Income and expense

a) Interest income and expense

Interest income and expense are recognised in the Income Statement as it accrues, taking into account the effective yield of the asset or an applicable floating rate. Interest income and expense includes the amortisation of any discount or premium or other differences between the initial carrying amount of an interest bearing instrument and its amount at maturity calculated on an effective interest rate basis.

The effective interest rate method is a method of calculating the amortised cost of a financial asset or a financial liability (or group of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Bank estimates cash flows, considering all contractual terms of the financial instrument, but does not consider future credit losses. The calculation generally includes all fees and amounts paid or received between parties to the contract that are an integral part of the effective interest rate, as well as transaction costs and all other premiums or discounts.

Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised at the rate of interest used to discount the impairment loss. Interest income on financial assets which have been written down as a result of impairment is calculated based on the net amount of the financial asset taking the write-down into consideration.

b) Fee and commission

The Bank provides various services to its clients and earns income there from, such as income from Investment Banking, Corporate Banking, Capital Markets, Asset Management and Retail. Banking. Fees earned from services that are provided over a certain period of time are recognised as the services are provided. Fees earned from transaction-type services are recognised when the service has been completed. Fees that are performance-linked are recognised when the performance criteria are fulfilled.

c) Net financial income

Net financial income comprises of Dividend income, Net trading income and Net income from other financial instruments at fair value.

Dividend income is recognised in the Income Statement on the date the dividend is declared.

Net trading income comprises gains less losses related to trading assets and liabilities, and includes all realised and unrealised fair value changes, interest, dividends and foreign exchange differences.

Net income from other financial instruments at fair value relates to non-qualifying derivatives held for risk management purposes and financial assets and liabilities designated at fair value through profit or loss, and includes all realised and unrealised fair value changes, interest, dividends and foreign exchange differences.

d) Lease payments made

Payments made under operating leases are recognised in profit or loss on a straight-line basis over the term of the lease. Lease incentives received are recognised as an integral part of the total lease expense, over the term of the lease.

Minimum lease payments made under finance leases are apportioned between the finance expense and the reduction of the outstanding liability. The finance expense is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of liability. Contingent lease payments are accounted for by revising the minimum lease payments over the remaining term of the lease when the lease adjustment is confirmed.

e) Income tax

Income tax comprises current and deferred tax. Income tax is recognised in the Income Statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

The deferred income tax asset/liability has been calculated and entered in the Balance Sheet. The calculation is based on the difference between Balance Sheet items as presented in the tax return on the one hand, and in the Financial Statements on the other, taking into consideration a carry-forward tax loss. This difference is due to the fact that tax assessments are based on premises that differ from those governing the Financial Statements, mostly because revenues, especially of financial assets, are recognised earlier in the Financial Statements than in the tax return. A calculated tax asset is only offset against income tax liability if they are due to tax assessment from the same tax authorities.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reviewed at each reporting date and reduced to the extent that it is no longer probable that the related tax benefit will be realised.

7. Impairment of financial assets

At each reporting date, the Bank assesses whether there is objective evidence that financial assets not carried at fair value through profit or loss are impaired. Financial assets are impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the assets, and that the loss event has an impact on the future cash flows on the asset that can be estimated reliably.

An impairment loss is recognised whenever the carrying amount of a financial asset exceeds its recoverable amount. Impairment losses are recognised as described below.

a) Impairment on loans

The Bank recognises losses for impaired loans promptly where there is objective evidence that impairment of a loan or portfolio of loans has occurred. This is done on a consistent basis in accordance with the Bank's guidelines.

There are two basic methods of calculating impairment losses, those calculated on individual loans and those losses assessed on a collective basis. Losses expected as a result of future events, no matter how likely, are not recognised.

Objective evidence of impairment includes observable data about the following loss events:

i) significant financial difficulty of the borrower;

ii) a breach of contract, such as a default on installments or on interest or principal payments;

iii) the Bank granting to the borrower, for economic or legal reasons relating to the borrower's financial difficulty, a refinancing concession, that the lender would not otherwise consider;

iv) it becomes probable that the borrower will enter bankruptcy or undergo other financial reorganisation;

v) the disappearance of an active market for that financial asset because of financial difficulties; or

vi) observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of loans since the initial recognition of those assets, even if the decrease cannot yet be identified with the individual financial assets in the Bank, including:

- adverse changes in the payment status of borrowers in the Bank; or
- general national or local economic conditions connected with the assets in the Bank.

Individually assessed loans

Impairment losses on individually assessed accounts are determined by an evaluation of the exposures on a case-by-case basis. The Bank assesses at each reporting date whether there is any objective evidence that a loan is impaired. This procedure is applied to all accounts that are considered individually significant. In determining such impairment losses on individually assessed accounts, the following factors are considered:

- the Bank's aggregate exposure to the customer;
- the amount and timing of expected receipts and recoveries;
- the likely dividend available on liquidation or bankruptcy;
- the complexity of determining the aggregate amount and ranking of all creditor claims and the extent to which legal and insurance uncertainties are evident;
- the realisable value of security (or other credit mitigates) and likelihood of successful repossession; and
- the likely deduction of any costs involved in recovery of amounts outstanding.

Impairment loss is calculated by comparing the present value of the expected future cash flows, discounted at the original effective interest rate of the loan, with its current carrying value and the amount of any loss is charged in the Income Statement. The carrying amount of impaired loans is reduced through the use of an allowanceaccount. In the case of a loan at variable interest rates, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract.

Collectively assessed loans

Where loans have been individually assessed and no evidence of loss has been identified, these loans are grouped together on the basis of similar credit risk characteristics for the purpose of calculating a collective impairment loss. This loss covers loans that are impaired at the reporting date but which will not be individually identified as such until some time in the future.

The collective impairment loss is determined after taking into account:

- future cash flows in a group of loans evaluated for impairment are estimated on the basis of the contractual cash flows of the assets;
- historical loss experience in portfolios of similar risk characteristics (for example, by industry sector, loan grade or product);
- the estimated period between a loss occurring and that loss being identified and evidenced by the establishment of an allowance against the loss on an individual loan;
- future cash flows in a group of loans evaluated for impairment are estimated on the basis of the contractual cash; and
- management's experienced judgement as to whether the current economic and credit conditions are such that the actual level of inherent losses is likely to be greater or less than that suggested by historical experience.

The estimated period between a loss occurring and its identification is determined for each identified portfolio.

Estimates of changes in future cash flows for groups of assets should be consistent with changes in observable data from period to period (for example, changes in property prices, payment status, or other factors indicative of changes in the probability of losses on the group and their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Bank to minimise any differences between loss estimates and actual losses.

Loan write-offs

Loans (and the related impairment allowance accounts) are normally written off, either partially or in full, when there is no realistic prospect of recovery of these amounts and, for collateralised loans, when the proceeds from the realisation of security have been received.

Reversals of impairment

If, in a subsequent period, the amount of an impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed. The amount of any reversal is recognised in the Income Statement.

Assets acquired in exchange for loans

Non-financial assets acquired in exchange for loans in order to achieve an orderly realisation are recorded as assets held for sale and reported in the Balance Sheet. The assets acquired are recorded at the lower of its fair value less costs to sell and the carrying amount of the loan, net of impairment allowance amounts, at the date of exchange. No depreciation is provided in respect of assets held for sale. Any subsequent write-down of the acquired assets to fair value less costs to sell is recorded as an impairment loss and included in the Income Statement. Any subsequent increase in the fair value less costs to sell, to the extent this does not exceed the cumulative impairment loss, is recognised in the Income Statement.

b) Impairment of financial assets available-for-sale

The Bank determines that available-for-sale equity investments are impaired when there has been a significant or prolonged decline in the fair value below its cost. This determination of what is significant or prolonged requires judgement. In making this judgement, the Bank evaluates, among other factors, the normal volatility in share price. In addition, impairment may be appropriate when there is evidence of deterioration in the financial strength of the investee, industry and sector performance, changes in technology, and operational and financing cash flows. The amount of impairment loss is recognised in the Income Statement. Impairment losses are subsequently reversed if the reasons for the impairment loss charged no longer apply.

c) Calculation of recoverable amount

The recoverable amount of the Bank's investments in financial assets carried at amortised cost is calculated as the present value of estimated future cash flows, discounted at the original effective interest rate (i.e. the effective interest rate computed at initial recognition of these financial assets).

d) Reversals of impairment

An impairment loss in respect of financial assets carried at amortised cost is reversed if the subsequent increase in recoverable amount can be related objectively to an event occurring after the impairment loss was recognised.

An impairment loss in respect of an investment in an equity instrument classified as available-for-sale is not reversed through profit or loss. If the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in the Income Statement, the impairment loss shall be reversed, with the amount of the reversal recognised in the Income Statement.

However, any subsequent recovery in the fair value of an impaired available-for-sale equity security is recognised directly in equity. Changes in impairment provisions attributable to time value are reflected as a component of interest income.

8. Impairment of non-financial assets

The carrying amounts of the Bank's non-financial assets, other than investment property and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists then the asset's recoverable amount is estimated. The recoverable amount of goodwill is estimated at each reporting date.

An impairment loss is recognised if the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. A cash-generating unit is the smallest identifiable asset group that generates cash flows that largely are independent from other assets and groups. Impairment losses are recognised in profit or loss. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of the other assets in the unit (group of units) on a pro rata basis.

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less cost to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

An impairment loss in respect of goodwill is not reversed. In respect of other assets, impairment losses recognised in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

9. Derivatives

A derivative is a financial instrument or other contract, the value of which changes in response to a change in an underlying variable (such as share, commodity or bond prices, an index value or an exchange or interest rate), which requires no initial net investment or initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors and which is settled at a future date.

The Bank uses derivatives for trading purposes and to hedge its exposure to market price risk, foreign exchange and interest rate risk arising from operating, financing and investing activities.

Derivatives are recognised at fair value. Fair value changes are recognised in the Income Statement, except in the case of derivatives that are designated and are effective hedging instruments, whose fair value changes are recognised in accordance with the accounting policies in note 10. Changes in fair values of derivatives are split into i) interest income, ii) foreign exchange differences and other gains and losses. Interest income is recognised on accrual basis. Derivatives with positive fair values are recognised as trading assets and derivatives with negative fair values are recognised as trading liabilities.

The fair value of derivatives is determined in accordance with the accounting policy presented in note 13.

10. Hedging

Due to the Bank's risk positions and funding structure, its risk management policies require that the Bank should minimise its exposure to changes in foreign currency rates and manage interest rate risk, credit risk and market price risk exposure within certain guidelines (see also separate section on risk management). The Bank uses both derivative and non-derivative financial instruments to manage the potential earnings impact of these risks.

Several types of derivatives are used for this purpose, including interest rate swaps and currency swaps, options, financial futures, forward contracts and other derivatives. The purpose of the Bank's hedging activities is to protect the Bank from the risk that the net cash inflows will be adversely affected by changes in interest or exchange rates, credit ratings or market prices. The Bank enters into transactions to ensure that it is economically hedged in accordance with risk management policies. For qualifying hedge relationships, the Bank uses hedge accounting.

Each qualifying hedge relationship is evidenced and driven by management's approach to risk management and the decision to hedge the particular risk. Where hedge accounting is applied the Bank assesses, both at the inception of the hedge and each time the Bank prepares its annual or interim Financial Statements, whether the derivatives used as hedges are highly effective in offsetting the changes in value or cash flows associated with the hedged items. A hedge is normally regarded as highly effective if the changes in fair value or cash flows of the hedged item are expected to almost fully offset the changes in fair value or cash flows of the hedging instrument. Actual effectiveness results must be within a range of 80 to 125 per cent on a cumulative basis. The designation and effectiveness measurement follows the methodologies that management has in place for risk identification and measurement. The ineffective portion of any gain or loss on a hedging instrument is recognised in the Income Statement.

The Bank's risk management activities concentrates on hedging the Bank's net exposure based on its asset and liability positions. Therefore the Bank monitors its interest rate risk exposures by reviewing the net asset or liability gaps within repricing bands. For hedge accounting purposes, the Bank designates the benchmark interest rate exposure of a portion of the underlying gross exposure as the hedged item and the hedge relationship is viewed at a micro level, considering only the relationship between the hedged item and the hedging instrument.

Where the Bank hedges a portfolio of loans in respect of interest rate risk it groups the loans into homogenous layers, each with specific maturities.

The Bank designates hedge relationships only for fair value hedge accounting and net investments in foreign operations.

The treatment of changes in fair value depends on their classification into the following categories:

a) Fair value hedges

Fair value hedges seek to eliminate risks of changes in the fair value of a recognised asset or liability or firm commitment that will give rise to a gain or loss that will be recognised in the Income Statement.

When a derivative hedges the changes in fair value of recognised assets or liabilities or an identified portion of such assets or liabilities, any gain or loss on the hedging instrument is recognised in the Income Statement. The hedged items are also stated at fair value in respect of the risk being hedged, with any gain or loss being recognised in the Income Statement. The gains and losses on the hedging instruments and hedge items are presented together in the Income Statement as Net financial income.

If the derivative expires or is sold, terminated or exercised, it no longer meets the criteria for fair value hedge accounting, or the designation is revoked, hedge accounting is discontinued. Any adjustment up to that point, to a hedged item for which the effective interest method is used, is amortised to profit or loss as part of the recalculated effective interest rate of the item over its remaining life.

b) Other non-trading derivatives

When a derivative is not held for trading, and is not designated in a qualifying hedge relationship, all changes in its fair value are recognised immediately in profit or loss as a component of Net financial income.

c) Embedded derivatives

Derivatives may be embedded in another contractual arrangement (a host contract). The Bank accounts for embedded derivatives separately from the host contract when the host contract is not itself carried at fair value through profit or loss, and the characteristics of the embedded derivatives are not clearly and closely related to the host contract. Separated embedded derivatives are accounted for depending on their classification, and are presented in the Balance Sheet together with the host contract.

d) Hedges of net investments in foreign operations

Hedges of net investments in foreign operations seek to eliminate the exposure to foreign currency risks of the net investments.

Exchange differences arising from the translation of the net investment in foreign operations and of related hedges are taken to Translations reserve in equity. The portion of the gain or loss on an instrument used to hedge a net investment in a foreign operation that is determined to be an effective hedge is recognised directly in equity. The ineffective portion is recognised immediately in the Income Statement. They are recycled and recognised in Income Statement upon disposal of the operation. In respect of all foreign operations, any differences that have arisen before 1 January 2004, the date of transition to IFRS, are presented as retained earnings in the equity statement.

11. Cash and cash equivalents

Cash and cash equivalents in the Consolidated Statement of Cash Flows consist of cash, demand deposits with the central banks and demand deposits with other credit institutions.

12. Loans

Loans are non-derivative financial instruments with fixed or determinable payments that are not quoted in an active market and that the Bank does not intend to sell immediately or in the near term. Loans include loans provided by the Bank to credit institutions and to its customers, participation in loans from other lenders and purchased loans.

When the Bank is the lessor in a lease agreement that transfers substantially all of the risks and rewards incidental to ownership of an asset to the lessee, the arrangement is presented within loans.

When the Bank purchases a financial asset and simultaneously enters into an agreement to resell the asset (or a substantially similar asset) at a fixed price on a future date (reverse repo or stock borrowing), the arrangement is accounted for as a loan, and the underlying asset is not recognised in the Bank's Financial Statements.

Loans are initially measured at fair value plus incremental direct transaction costs, and subsequently measured at their amortised cost using the effective interest method, except when the Bank chooses to carry the loans at fair value through profit or loss as described in accounting policy 13 b). Accrued Interest income is included in the carrying amount of loans.

13. Financial assets measured at fair value through profit and loss

a) Trading assets

Trading assets are financial instruments acquired principally for the purpose of generating profits from short-term price fluctuations or from a dealer's margin.

b) Financial assets designated at fair value through profit or loss

The Bank classifies certain financial assets upon their initial recognition as financial assets held at fair value with fair value changes recognised in the Income Statement as Net financial income if doing so results in more relevant information because:

i) the assets are managed, evaluated and reported internally on a fair value basis;
ii) the designation eliminates or significantly reduces an accounting mismatch which would otherwise arise; or
iii) the assets contain an embedded derivative that significantly modifies the cash flows that would otherwise be required under the contract.

The assets classified according to the above-mentioned conditions consist of:

i) fixed interest rate loans originated by the Bank whose fixed interest has been changed into floating by entering into corresponding interest rate swaps;
ii) equity and debt instruments which are acquired by the Bank with a view to profiting from their total return and which are managed and evaluated on a fair value basis, including equity instruments held by the venture capital organisation of the Bank which give the Bank significant influence over the issuer but not control;
iii) structured products that contain embedded derivatives; or
iv) mortgage loans originated by the Bank's subsidiary in Denmark. These are financial assets that are granted by the Bank by providing money directly to a debtor. They are initially recorded at fair value, which is the cash given to originate the loan and are subsequently measured at fair value. The fair value of mortgage loans is based on the fair value of the underlying mortgage bonds.

Interest and dividend income that arises from these assets are included in Interest income and Net financial income, respectively. Interest income on debt instruments is recognised on an accrual basis.

14. Financial assets available-for-sale

Financial assets available-for-sale consists of unlisted equity instruments held for long time investment purposes.

Financial assets available-for-sale are recognised at fair value. Unrealised gains or losses on available-for-sale investments are recognised in equity, net of income taxes, until such investments are disposed of or until they are determined to be impaired. On disposal of an available-for-sale investment, the accumulated unrealised gain or loss included in equity is transferred to the Income Statement and recognised as Other operating income. Gains and losses on disposal are determined using the average cost method.

Dividend income on available-for-sale financial assets is included in Dividend income in the Income Statement. Exchange rate differences arising on equity instruments are recognised in equity.

15. Determination of fair value

The determination of fair value of financial assets and financial liabilities that are quoted in an active market is based on quoted prices. A market is considered active if quoted prices are readily and regularly available and those prices represent actual and regularly occurring market transactions on an arm's length basis. For all other financial instruments fair value is determined by using valuation techniques. Valuation techniques include net present value techniques, the discounted cash flow method, comparison to similar instruments for which market observable prices exist, and valuation models. The Bank uses widely recognised valuation models for determining the fair value of common and more simple financial instruments like options and interest rate and currency swaps. For these financial instruments, inputs into models are market observable.

For more complex instruments, the Bank uses proprietary models, which usually are developed from recognised valuation models. Some or all of the inputs into these models may not be market observable, and are derived from market prices or rates or are estimated based on assumptions. When entering into a transaction, the financial instrument is recognised initially at the transaction price, which is the best indicator of fair value, although the value obtained from the valuation model may differ from the transaction price. This initial difference in fair value, usually an increase, indicated by valuation techniques is recognised in the Income Statement depending upon the individual facts and circumstances of each transaction and not later than when the market data becomes observable.

The value produced by a model or other valuation technique is adjusted to allow for a number of factors as appropriate, because valuation techniques cannot appropriately reflect all factors market participants take into account when entering into a transaction. Valuation adjustments are recorded to allow for model risks, bid-ask spreads, liquidity risks, as well as other factors. Management believes that these valuation adjustments are necessary and appropriate to fairly state financial instruments carried at fair value on the Balance Sheet.

16. Recognition and derecognition of financial assets and financial liabilities

Purchases and sales of financial assets are recognised using trade date accounting, i.e. they are recognised on the date on which the Bank commits to purchase or sell the asset, except for loans which are recognised when cash is advanced to the borrowers.

Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the Bank has transferred substantially all risks and rewards of ownership.

Financial liabilities are recognised when the Bank becomes a party to the contractual provisions of the liability instrument. Financial liabilities are derecognised when the obligation of the Bank specified in the contract is discharged or cancelled or expires.

17. Offsetting financial assets and financial liabilities

Financial assets and liabilities are set off and the net amount reported in the Balance Sheet when, and only when, the Bank has a legal right to offset the recognised amounts and intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

Income and expenses are presented on a net basis only when permitted by the accounting standards, or for gains or losses arising from a group of similar transactions such as in the Bank's trading activity.

18. Amortised cost measurement of financial assets and financial liabilities

The amortised cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between the initial amount recognised and the maturity amount, minus any reduction for impairment.

19. Repurchase agreements

A repurchase agreement involves the sale of securities subject to the simultaneous agreement to repurchase the same securities at a certain later date and at an agreed price. In repurchase agreements, the cash received, including accrued interest is recognised in the Balance Sheet. The proceeds from the legal sale of these securities are reported as borrowings.

The control of the securities remains with the Bank throughout the entire term of the transaction and the securities continue to be reported in the Bank's Balance Sheet as Bonds and debt instruments, as appropriate. Interest incurred is recognized as Interest expense over the life of each agreement.

20. Leases - lessor

The Bank classifies leases based on the extent of the transfer of risks and rewards incidental to ownership of leased assets. A lease is classified as a finance lease if the lessor transfers substantially all the risks and rewards incidental to ownership. A lease is classified as an operating lease if the lessor does not transfer substantially all the risks and rewards incidental to ownership.

Operating leases - lessee

Property and equipment which the Bank leases to third parties under operating leases are classified in the Balance Sheet as Investment property or Property and equipment on a property-by-property basis. Lease payments under operating leases where the Bank is the lessee are recognised as an expense on a straight-line basis over the lease term.

21. Intangible assets

a) Goodwill

Goodwill arises on the acquisition of subsidiaries.

Acquisitions prior to 1 January 2004

In respect of acquisitions prior to 1 January 2004, goodwill is included on the basis of its deemed cost, which represents the amount recognised under previous GAAP.

Acquisitions on or after 1 January 2004

All business combinations after 1 January 2004 are accounted for by applying the purchase method. Goodwill has been recognised on the acquisition of subsidiaries and associates. In respect of business acquisitions that have occurred since 1 January 2004, goodwill represents the difference between the cost of the acquisition and the net fair value of the net identifiable assets, liabilities and contingent liabilities of the acquiree.

Acquisitions of minority interests

Goodwill arising on the acquisition of a minority interest in a subsidiary represents the excess of the cost of the additional investment over the carrying amount of the net assets acquired at the date of exchange.

Subsequent measurement

Goodwill is measured at cost less any accumulated impairment losses.

b) Other intangible assets

Intangible assets other than Goodwill that are acquired by the Bank are stated at cost less accumulated amortisation and impairment losses. Software and customer base are examples of other intangible assets.

c) Subsequent expenditure

Subsequent expenditure on capitalised Intangible assets is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred.

d) Amortisation

Amortisation is recognised in the Income Statement on a straight-line basis over the estimated useful lives of Intangible assets. Goodwill is systematically tested for impairment at each reporting date. Other Intangible assets are amortised from the date they are available for use. The estimated useful lives are as follows:

Software	5 years
Customer base	10 years.

22. Investment property

An investment property is a property which is held either to earn rental income or for capital appreciation or for both. Investment property are stated at fair value. The Bank uses internal real estate experts who determine the fair value of investment property by applying recognised valuation techniques. In cases where prices of recent market transactions of comparable properties are available, fair value is determined by reference to these transactions. The fair values are based on market values, being the estimated amount for which a property could be exchanged on the date of valuation between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion.

23. Property and equipment

a) Owned assets

Items of Property and equipment are measured at cost less accumulated depreciation and impairment losses.

When parts of an item of Property and equipment have different useful lives, they are accounted for as separate items of Property and equipment.

b) Subsequent costs

The cost of replacing part of an item of Property and equipment is recognised in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Bank and its cost can be measured reliably. All other costs are recognised in the Income Statement as an expense as incurred.

c) Depreciation

The depreciable amount of Property and equipment is determined after deducting its residual value. Depreciation is charged to the Income Statement on a straight-line basis over the estimated useful lives of each part of an item of Property and equipment. The estimated useful lives are as follows:

Real estate	25-50 years
Machinery and equipment	3-5 years
Operating lease	3-10 years

The residual value is reassessed annually.

24. Non-current assets and disposal groups held for sale

Immediately before classification as held for sale, the measurement of the qualifying assets and all assets and liabilities in a disposal group is brought up-to-date in accordance with applicable IFRS. Then, on initial classification as held for sale, non-current assets and disposal groups are recognised at the lower of carrying amount and fair value less costs to sell. Investment Property held for sale is carried at fair value. Impairment losses on initial classification as held for sale are included in the Income Statement, even when there is a revaluation. The same applies to gains and losses on subsequent remeasurement.

Non-current assets and disposal groups held for sale are mainly mortgages foreclosed and disposal entities. Disposal entities are consolidated.

25. Deposits

Deposits are initially measured at fair value plus transaction costs, and subsequently measured at their amortised cost using the effective interest method, except where the Bank chooses to carry the liabilities at fair value through profit or loss.

26. Borrowings

Some of the Borrowings of the Bank are classified as other financial liabilities and are initially recognised at fair value less attributable transaction costs. Subsequent to initial recognition, borrowings are measured at amortised cost with any difference between cost and redemption amount being recognised in the Income Statement over the period of the Borrowings on an effective interest basis. Accrued interest is included in the carrying amount of the Borrowings.

27. Subordinated loans

Subordinated loans are classified as other financial liabilities and consist of liabilities in the form of subordinated capital which, in case of the Bank's voluntary or compulsory winding-up, will not be repaid until after the claims of ordinary creditors have been met. In the calculation of the capital ratio, the bonds are included within Tier I and Tier II, as shown in note 80. On the one hand, there are Subordinated loans with no maturity date that the Bank may not retire until 2011 and 2014, and then only with the permission of the Financial Supervisory Authority. These liabilities qualify as Tier I capital in the calculation of the equity ratio. On the other hand, there are Subordinated loans with various dates of maturity over the next 25 years.

Subordinated loans are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, Subordinated loans are stated at amortised cost with any difference between cost and redemption value being recognised in the Income Statement over the period of the Subordinated loans on an effective interest basis.

28. Financial liabilities measured at fair value

a) Trading liabilities

Trading liabilities primarily consist of derivatives with negative fair values and delivery obligations for short sales of securities. Hedging derivatives such as those used for internal risk control but not qualifying for hedge accounting under IAS 39 are also disclosed under this item.

Trading liabilities are measured at fair value gains and losses realised on disposal or redemption and unrealised gains and losses from changes in the fair value of trading liabilities are reported as Net gain on financial assets/liabilities measured at fair value. Interest expenses on trading liabilities are included in Interest expenses.

b) Financial liabilities designated at fair value through profit or loss

The Bank classifies certain financial liabilities upon their initial recognition as financial liabilities at fair value with fair value changes recognised in profit or loss if doing so results in more relevant information because:

i) it eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different base; or

ii) financial assets and/or financial liabilities are managed and their performance is evaluated on a fair value basis, in accordance with the Bank's risk management or investment strategy, and information about it is provided internally on that basis to the Bank's key management personnel.

If the Bank becomes a party to instruments containing embedded derivatives which meet specific conditions, the Bank classifies the instruments into this category in order to avoid the complexity of applying the rules on separation and accounting for the embedded derivatives.

The liabilities classified according to the above-mentioned conditions consist of:

- Mortgage bonds issued by the Bank are Financial liabilities that are created by the Bank by issuing bonds that correspond to the terms of the underlying mortgage loans;
- Transaction costs related to financial liabilities designated at fair value through profit and loss are included in the Income Statement as Interest expense;
- Mortgage funding is recognised when cash is advanced to the Bank from issuing bonds. They are initially recorded at fair value, which is the cash received and are subsequently measured at fair value. Fair value of issued mortgage bonds is the current market price. Liquid mortgage bonds will be carried at a value calculated by discounting cash flows; and
- Financial liabilities designated at fair value through profit or loss are measured at fair value and changes in their fair value are recognised in the Income Statement as Net financial income. Interest expenses that arise from these liabilities is recognised on an accrual basis in Interest expense.

29. Provisions

A Provision is recognised in the Balance Sheet when the Bank has a present legal or constructive obligation as a result of a past event and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

30. Other assets and Other liabilities

Other assets and Other liabilities are stated at cost.

31. Financial guarantees

Financial guarantees are contracts that require the Bank to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument.

Financial guarantee liabilities are initially recognised at their fair value, and initial fair value is amortised over the life of the financial guarantee. The guarantee liability is subsequently carried at the higher of this amortised amount and the present value of any expected payment (when a payment under the guarantee has become probable). Financial guarantees are included within Other liabilities.

32. Employee benefits

a) Defined contribution plans

Obligations for contributions to defined contribution pension plans are recognised as an expense in the Income Statement when they are due.

b) Share-based payment transactions

The grant date fair value of options granted to employees is recognised as an employee expense, with a corresponding increase in equity, over the period in which the employees become unconditionally entitled to the options. The amount recognised as an expense is adjusted to reflect the actual number of share options that vast.

The fair value of share appreciation rights is measured using the Black-Scholes formula. Measurement inputs include share price on measurement date, exercise price of the instrument, expected volatility (based on weighted average historic volatility adjusted for changes expected due to publicly available information), weighted average expected life of the instruments (based on historical experience and general option holder behaviour), expected dividends, and the risk-free interest rate (based on government bonds). Service and non-market performance conditions attached to the transactions are not taken into account in determining fair value.

33. Share capital

a) Treasury shares

Acquired own shares and other equity instruments (treasury shares) are deducted from Equity. No gain or loss is recognised in Income Statement on the purchase, sale, issue or cancellation of treasury shares. Consideration paid or received is recognised directly in Equity.

Incremental transaction costs of treasury share transaction are accounted for as a deduction from Equity.

When classifying a financial instrument (or component of it) in the Consolidated Financial Statements, all terms and conditions agreed between members of the Bank and the holders of the instrument are considered. To the extent there is an obligation that would give rise to a financial liability, the instrument is classified as financial liability, rather than an equity instrument.

b) Dividend on shares

Dividends on shares are recognised in Equity in the period in which they are approved by the Bank's shareholders.

34. Earnings per share

The Bank presents basic and diluted earnings per share data for its ordinary shares.

Earnings per share are calculated by dividing the net earnings attributable to equity holders of the Bank by the weighted average number of ordinary shares outstanding during the year.

Diluted earnings per share are calculated by adjusting the weighted average number of ordinary shares outstanding to assume conversion of all dilutive potential ordinary shares. The Bank calculates dilutive potential ordinary shares by determining the number of shares that could have been acquired at fair value (determined as the average annual market share price of the Bank's shares) based on the monetary value of the subscription rights attached to outstanding share options. The number of shares calculated as above is compared with the number of shares that would have been issued assuming the exercise of the share options.

35. New standards and interpretations not yet adopted

A number of new standards, amendments to standards and interpretations are not yet effective for the year ended 31 December 2006, and have not been applied in preparing these Consolidated Financial Statements. The Bank will apply the following new standards, amendments and interpretations when effective:

- IFRS 7 Financial Instruments Disclosures requires entities to provide disclosures in their Financial Statements that enable users to evaluate the significance of financial instruments for the entity's financial position and performance, and the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the reporting date, and how the entity manages those risks. IFRS 7, which becomes mandatory for the Bank's 2007 Financial Statements, is expected to have impact on additional disclosures.
- IFRIC 7 Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies addresses the application of IAS 29 when an economy first becomes hyperinflationary and in particular the accounting for deferred tax. IFRIC 7, which becomes mandatory for the Bank's 2007 Financial Statements, is not expected to have impact on the Consolidated Financial Statements. The main impact will be on additional disclosures.
- IFRIC 8 Scope of IFRS 2 Share-based Payment addresses the accounting for share-based payment transactions in which some or all of goods or services received cannot be specifically identified. IFRIC 8 will become mandatory for the Bank's 2007 Financial Statements, with retrospective application required. The Bank has not yet determined the potential effect of the interpretation.
- IFRIC 9 Reassessment of Embedded Derivatives requires that a reassessment of whether embedded derivatives should be separated from the underlying host contract or should be made only when there are changes to the contract. IFRIC 9, which becomes mandatory for the Bank's 2007 Financial Statements, is not expected to have any impact on the Consolidated Financial Statements.
- IFRIC 10 Interim Financial Reporting and Impairment prohibits the reversal of an impairment loss recognised in a previous interim period in respect of goodwill, an investment in an equity instrument or a financial asset carried at cost. IFRIC 10 will become mandatory for the Bank's 2007 Financial Statements, and will apply to goodwill, investments in equity instruments, and financial assets carried at cost prospectively from the date that the Bank first applied the measurement criteria of IAS 36 and IAS 39 respectively (i.e., 1 January 2004).

36. Business segment is a distinguishable component of the Bank that is engaged either in providing products or services (business segment) which is subject to risks and rewards that are different from those of other segments. The Bank's primary format for segment reporting is based on business segments.

37. Critical accounting estimates and judgements in applying accounting policies.

The Bank makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

a) Impairment losses on loans

The Bank reviews its loan portfolios to assess impairment at least on a quarterly basis. In determining whether an impairment loss should be recorded in the Income Statement, the Bank makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

b) Fair value of derivatives

The fair value of financial instruments that are not quoted in active markets are determined by using valuation techniques. Where valuation techniques (for example, models) are used to determine fair values, they are validated and periodically reviewed by qualified personnel independent of the area that created them. All models are certified before they are used, and models are calibrated to ensure that outputs reflect actual data and comparative market prices. To the extent practical, models use only observable data, however areas such as credit risk (both own and counterparty), volatilities and correlations require management to make estimates. Changes in assumptions about these factors could affect reported fair value of financial instruments.

c) Qualifying hedge relationships

In designating financial instruments as qualifying hedge relationships, the Bank has determined that it expects the hedge to be highly effective over the life of the hedging instrument.

d) Securitisations

In applying its policies on securitised financial assets, the Bank has considered both the degree of transfer of risk and rewards on assets transferred to another entity and the degree of control exercised by the Bank over the other entity:

i) When the Bank, in substance, controls the entity to which financial assets have been transferred, the entity is included in these Consolidated Financial Statements and the transferred assets are recognised in the Bank's Balance Sheet.

ii) When the Bank has transferred financial assets to another entity, but has not transferred substantially all of the risk and rewards relating to the transferred assets, the assets are recognised in the Bank's Balance Sheet.

iii) When the Bank has transferred substantially all the risk and rewards relating to the transferred assets to an entity that it does not control, the assets have been derecognised from the Bank's Balance Sheet.

SEGMENT REPORTING

38. Segment information is presented in respect of the Bank's business and geographical segments. The primary format, business segments, is based on the Bank's management and internal reporting structure.

Inter-segment pricing is determined on an arm's length basis. Business segments pay and receive interest to and from Treasury on an arm's length basis to reflect the allocation of capital and funding cost.

Segment capital expenditure is the total cost incurred during the year to acquire property and equipment and intangible assets other than goodwill.

Business segments

The Bank comprises the following main business segments:

- Capital Markets is divided into two parts - Capital Markets and Proprietary Trading. Capital Markets handles securities brokerage for the Bank's clients. Proprietary Trading handles transactions for the Bank's own account in all major markets, as well as undertaking the Bank's market making for stocks and bonds.
- Investment Banking provides various services to corporate clients through its four main products areas: M&A advisory, capital market transactions, acquisition and leverage finance and principle investment.
- Treasury is responsible for inter-bank trading, the Bank's funding, derivatives and foreign exchange trading and brokerage.
- Banking provides general banking services to retail customers in Iceland and services such as advice and assistance in financing to medium-sized and large companies, particularly in Iceland, Sweden, the UK and Denmark.
- Asset Management and Private Banking manage financial assets for institutional, corporate and private clients. Asset Management is organised into three units - Alternative and Mutual Fund Management, Asset Management for Institutional Investors and Services for Institutional Investors. Private Banking consists of two units - Customer Relations and Portfolio Management.
- Cost centers are: Overhead, Back office, Risk Management, Finance, Legal department, Information Technology, Human Resources and Sales and Marketing.

Geographical segments

The Bank operates in four main geographical regions, being Iceland, Scandinavia, United Kingdom (UK) and Luxembourg.

39. Summary of the Bank's business segments

	Capital Markets	Investment Banking	Treasury	Banking	Asset Management and Private Banking	Elimination and cost centers	Total
2006							
Net interest income	(1,513)	(3,349)	11,492	45,903	817	(988)	52,362
Net fee and commission income	7,396	9,577	2,927	5,744	11,231	409	37,284
Net financial income	7,913	42,984	8,411	750	531	(432)	60,157
Other income	(1)	44	26	6,631	962	9,751	17,413
Operating income	13,795	49,256	22,856	59,028	13,541	8,740	167,216
Operating expense	(6,205)	(3,636)	(3,078)	(14,969)	(7,380)	(24,738)	(60,006)
Impairment	(123)	1	(5)	(4,851)	(1,138)	(11)	(6,127)
Total expense	**(6,328)**	**(3,635)**	**(3,083)**	**(19,820)**	**(8,518)**	**(24,749)**	**(66,133)**
Earnings before cost allocation	**7,467**	**45,621**	**19,773**	**39,208**	**5,023**	**(16,009)**	**101,083**
Allocated cost	(3,206)	(888)	(2,015)	(8,744)	(3,426)	18,279	0
Earnings before income tax	**4,261**	**44,733**	**17,758**	**30,464**	**1,597**	**2,270**	**101,083**
Net segment revenue from external customers	20,697	53,425	(52,166)	135,108	9,516	636	167,216
Net segment revenue from other segments	(6,902)	(4,169)	75,022	(76,080)	4,025	8,104	0
Operating income	**13,795**	**49,256**	**22,856**	**59,028**	**13,541**	**8,740**	**167,216**
Depreciation and amortisation	9	8	11	3,512	21	2,415	5,976
Total assets	**214,433**	**108,946**	**1,649,940**	**2,597,032**	**12,386**	**(527,341)**	**4,055,396**
Total liabilities	183,637	47,998	1,600,859	2,421,953	4,171	(538,114)	3,720,504
Allocated equity	30,796	60,948	49,081	175,079	8,215	10,773	334,892
Total liabilities and equity	**214,433**	**108,946**	**1,649,940**	**2,597,032**	**12,386**	**(527,341)**	**4,055,396**
Capital expenditure	259	38	285	6,957	705	7,384	15,628

	Capital Markets	Investment Banking	Treasury	Banking	Asset Management and Private Banking	Elimination and cost centres	Total
2005							
Net interest income	(1,120)	(2,322)	4,733	32,076	632	(1,289)	32,710
Net fee and commission income	4,730	7,592	1,364	3,165	5,256	321	22,428
Net financial income	16,008	18,416	2,637	232	100	(111)	37,282
Other income	35	163	0	3,419	0	6,161	9,778
Operating income	**19,653**	**23,849**	**8,734**	**38,892**	**5,988**	**5,082**	**102,198**
Operating expense	(3,113)	(1,808)	(1,481)	(10,580)	(4,186)	(14,357)	(35,525)
Impairment	0	(22)	6	(2,395)	0	(1,978)	(4,389)
Total expense	**(3,113)**	**(1,830)**	**(1,475)**	**(12,975)**	**(4,186)**	**(16,335)**	**(39,914)**
Earnings before cost allocation	**16,540**	**22,019**	**7,259**	**25,917**	**1,802**	**(11,253)**	**62,284**
Allocated cost	(1,751)	(706)	(877)	(5,356)	(1,758)	10,448	0
Earnings before income tax	14,789	21,313	6,382	20,561	44	(805)	62,284
Net segment revenue from external customers	22,830	25,620	(33,915)	78,481	4,482	4,700	102,198
Net segment revenue from other segments	(3,177)	(1,771)	42,649	(39,589)	1,506	382	0
Operating Income	**19,653**	**23,849**	**8,734**	**38,892**	**5,988**	**5,082**	**102,198**
Depreciation and amortisation	19	22	4	1,475	15	1,283	2,818

Geographic analysis

40. Operating income specified by location of its markets and customers

The geographical analysis of operating income is provided in order to comply with IFRS and does not reflect the way the Bank is managed.

	Iceland	Scandinavia	UK	Luxembourg	Other	Total
2006						
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	0	19	17,413
Operating income.....................	**78,544**	**41,420**	**32,785**	**11,079**	**3,388**	**167,216**

Financial gains relating to the sale of Exista hf., amounting to ISK 26,084 million, is included in Net financial income in Iceland. Financial gains relating to the sale of VIS hf., amounting to ISK 7,421 million, is included in Other income in Iceland.

	Iceland	Scandinavia	UK	Luxembourg	Other	Total
2005						
Net interest income	10,224	10,642	7,698	3,715	431	32,710
Net fee and commission income	8,859	3,814	6,364	2,896	495	22,428
Net financial income	6,217	10,218	18,015	1,907	925	37,282
Other income.............................	6,048	1,742	1,986	2	0	9,778
Operating income.....................	**31,348**	**26,416**	**34,063**	**8,520**	**1,851**	**102,198**

41. Assets specified by location of its markets and customers

	Iceland	Scandinavia	UK	Luxembourg	Other	Total
2006						
Cash and cash balances with central banks	964	40,616	65,007	42	332	106,961
Loans to credit institutions.........	88,421	126,909	139,308	50,414	80,282	485,334
Loans to customers.....................	573,238	1,085,119	506,626	271,469	102,157	2,538,609
Financial assets measured at fair value..	332,744	261,918	30,621	36,426	3,420	665,129
Other assets	76,149	111,685	66,316	4,899	314	259,363
Assets..	**1,071,516**	**1,626,247**	**807,878**	**363,250**	**186,505**	**4,055,396**
2005						
Cash and cash balances with central banks	811	32,078	59	1,929	0	34,877
Loans to credit institutions and customers	531,743	776,470	297,642	70,693	62,746	1,739,294
Financial assets measured at fair value..	247,761	185,399	160,956	5,492	12,926	612,534
Other assets	69,362	36,809	45,389	2,165	381	154,106
Assets..	**849,677**	**1,030,756**	**504,046**	**80,279**	**76,053**	**2,540,811**

NOTES TO THE INCOME STATEMENT

Net interest income

42. Interest income and expense is specified as follows:

	Interest income	Interest expense	Net interest income
2006			
Cash and balances with central banks	911	0	911
Loans, receivables and deposits	150,405	(43,470)	106,935
Borrowings	0	(77,613)	(77,613)
Subordinated loans	0	(10,665)	(10,665)
Securities	28,191	(2,372)	25,819
Financial lease	5,359	0	5,359
Other	2,585	(969)	1,616
Interest income and expense	**187,451**	**(135,089)**	**52,362**

	Interest income	Interest expense	Net interest income
2005			
Cash and balances with central banks	367	0	367
Loans, receivables and deposits	79,297	(18,855)	60,442
Borrowings	0	(37,776)	(37,776)
Subordinated loans	0	(3,646)	(3,646)
Securities	15,356	(6,862)	8,494
Financial lease	3,375	(94)	3,281
Other	1,614	(66)	1,548
Interest income and expense	**100,009**	**(67,299)**	**32,710**

Net tee and commission income	**2006**	**2005**
43. Fee and commission income and expense is specified as follows:		
Fee and commission income		
Securities trading	11,413	8,263
Derivatives	3,582	1,680
Lending	2,901	1,665
Other fee and commission income	23,008	11,900
Fee and commission income	**40,904**	**23,508**
Fee and commission expense		
Received guarantees	(139)	(61)
Securities trading	(2,052)	(937)
Other fee and commission expense	(1,429)	(82)
Fee and commission expense	**(3,620)**	**(1,080)**

Net fee and commission income	**37,284**	**22,428**

Net financial income

44. Net financial income is specified as follows:

Dividend income	5,074	1,808
Net gain on financial assets and liabilities not at fair value	142	147
Net gain on financial assets and liabilities at fair value	52,023	33,920
Net foreign exchange gain	2,918	1,407
Net financial income	**60,157**	**37,282**

Dividend income	**2006**	**2005**

45. Dividend income is specified as follows:

Dividend income on available-for-sale financial assets	54	50
Dividend income on trading assets	3,703	1,723
Dividend income on assets at fair value through profit and loss	1,317	35
Dividend income	**5,074**	**1,808**

Net gain on financial assets and liabilities not at fair value

46. Net gain on financial assets and liabilities not at fair value are specified as follows:

Net realised gain on loans and finance leases	103	3
Net realised gain on available-for-sale assets......................................	32	138
Net realised gain on financial liabilities measured at amortised cost...	0	6
Other net realised gain	7	0
Net gain on financial assets and liabilities not at fair value............	**142**	**147**

Net gain on financial assets and liabilities at fair value

47. Net gain on financial assets and liabilities at fair value are specified as follows:

Net gain on trading portfolio	12,997	14,223
Net gain on assets designated at fair value through profit and loss	38,668	19,226
Fair value adjustments on hedge accounting	358	471
Net gain on financial assets and liabilities at fair value....................	**52,023**	**33,920**

48. Net gain on trading portfolio are specified as follows:

Loss on interest rate instruments and related derivatives......................	(3,643)	(1,720)
Gain on equity instruments and related derivatives	11,226	12,961
Gain on foreign exchange trading...	463	751
Gain on other derivatives	4,951	2,231
Net gain on trading portfolio	**12,997**	**14,223**

49. Net gain on assets designated at fair value through profit and loss are specified as follows:

(Loss) gain on interest rate instruments designated at fair value...........	(2,623)	13
Gain on equity instruments designated at fair value	41,291	19,213
Net gain on assets designated at fair value through profit and loss	**38,668**	**19,226**

Other operating income	**2006**	**2005**
50. Other operating income is specified as follows:		
Gain on disposals of assets other than held for sale	8,784	3,896
Income from operating lease	4,128	769
Fair value adjustments on investment properties	513	400
Realised gain on investment properties	216	67
Net income (loss) from assets held for sale	7	(13)
Other income	2,571	3,263
Other operating income	**16,219**	**8,382**

Personnel

51. The Bank's total number of employees is as follows:

Average number of full time equivalent positions during the year	2,630	2,318
Full time equivalent positions at the end of the year	2,719	2,368

52. Salaries and related expenses are specified as follows:

Salaries	16,388	11,041
Bonus payments	11,606	5,407
Salary related expenses	5,576	3,869
Salaries and related expense	**33,570**	**20,317**

A subsidiary of the Bank, Kaupthing Singer & Friedlander, has a defined benefit pension scheme. All accrued cost in respect of the plan has been entered into the Financial Statements. Based on actuarial calculation, the total liability is ISK 3,140 million at year end 2006.

53. Salaries to the executives of the Bank, their stock options and shares owned at year end are specified as follows:

	Salaries	**Benefits**	**Bonuses**	**Pension fund payment**	**Stock options shares**	**Shares at year end**
CEO:						
Hreidar Mar Sigurdsson	69.5	2.1	69.5	27.8	1.6	6.4
***Directors*:**						
Sigurdur Einarsson, Chairman	69.5	30.5	69.5	27.8	1.6	7.4
Ásgeir Thoroddsen	4.6					-
Bjarnfredur Ólafsson	5.3					-
Brynja Halldórsdóttir	4.6					-
Finnur Ingólfsson	4.6					-
Gunnar Páll Pálsson	4.6					-
Hjorleifur Thor Jakobsson	4.6					-
Niels de Coninck-Smith	3.5					-
Tommy Persson	4.6					-
María Solbergsdóttir	1.2					

	Salaries	**Benefits**	**Bonuses**	**Pension fund payment**	**Stock options shares**	**Shares at year end**
CEO in Iceland and Denmark:						
Ingolfur Helgason	30.0	2.0	40.0		0.5	3.3
Lars Johansen	57.0	3.2	25.4			-
Five Group Managing Directors	**99.9**	**9.0**	**97.0**	**3.5**	**1.6**	**4.6**

The remuneration of the Chairman of the Board and the other Directors of the Board is decided by the annual general meeting of shareholders. In addition, Board members receive remuneration for work in committees of the Board, such as audit, compensation and credit committees.

Remuneration to the Chairman of the Board, CEO and other members of "senior management" consist of base salary, variable salary/bonus, other benefits, extra pension contributions and stock-based compensation. The other members of senior management comprise the 5 persons who together with the CEO make up senior management. For the Chairman of the Board and CEO, the bonus is maximised at 100% of base salary For the other members of senior management bonus is generally maximized at 100% of the base salary. Bonus to the Chairman of the Board, CEO and other senior management is based on the bank's 15% minimum return on equity. Pension contributions and remuneration in the form of stock-based compensation and other benefits to the CEO and other members of senior management are part of the total remuneration package.

Remuneration to the CEO and the Chairman of the Board for the financial year 2006 was decided by the Board based on the recommendation from the compensation committee. Remuneration to other members of Group management was decided by the CEO.

Pension fund payments are extra pension contributions to the senior management and the Chairman of the Board. The Bank pays as well pension contributions to Board members and senior management based on Icelandic law. There are no pension liabilities related to Board members or senior management.

Bjarnfredur Olafsson, a Board member of the Bank, is a partner in the law firm Logos. The firm has provided the Bank legal services. Total fees paid to the firm was ISK 31.7 million for the year 2006.

The CEO and the Chairman of the Board exercised in 2006 stock options that were granted 2003. The difference in exercise price and market price were ISK 674 million for each of them.

Should the Chairman of the Board resign, he shall receive salary payments for 12 months onwards, but otherwise his salary payments shall continue for 48 months from the date of the termination of employment. The CEO's term of notice is 12 months but, should his employment terminate due to other reasons, his salary payments shall continue for 48 months.

Additional information on stock options can be found in note 99.

Auditors' fee

54. Auditors' fee is specified as follows:

	2006	2005
Audit of the Financial Statements	262	140
Other related audit service	33	33
Review of the Interim Financial Statements	36	42
Other service	121	71
Auditors' fee	452	286
Fee to others than the Parent Company's auditors, included in the above total	366	237

Impairment

55. Impairment is specified as follows:

	2006	2005
Impairment on loans	4,857	2,450
Impairment on goodwill	451	1,522
Impairment on intangible assets	819	417
Impairment on other assets	1,270	1,939
Impairment on assets	6,127	4,389

Income tax expense

56. Tax assets and tax liabilities recognised in the Income Statement are specified as follows:

Current tax expense		
Current year	10,154	8,115
Deferred tax expense		
Changes in temporary differences	4,482	3,113
Income tax expense	**14,636**	**11,228**

Reconciliation of effective tax rate		**2006**		**2005**
Earnings before income tax		101,083		62,284
Income tax using the domestic corporation tax rate	18.0%	18,195	18.0%	11,211
Effect of tax rates in foreign jurisdictions	(0.3%)	(290)	0.8%	526
Non-deductible expense	1.4%	1,394	0.4%	252
Tax exempt revenues	(2.8%)	(2,786)	(0.2%)	(145)
Tax incentives not recognised in the Income Statement	0.2%	171	(0.9%)	(532)
Other changes	(2.0%)	(2,048)	(01%)	(84)
Effective tax rate	**14.5%**	**14,636**	**180%**	**11,228**

Earnings per share

57. Earnings per share are specified as follows:

	2006	**2005**
Net earnings attributable to the shareholders of Kaupthing Bank hf.	85,302	49,260
Weighted average Share capital		
Weighted average of outstanding shares for the year	671.0	655.2
Effects of stock options	20.3	10.9
Weighted average of Share capital for the year	**691.3**	**666.1**
Basic earnings per share	127.1	75.2
Diluted earnings per share	123.4	73.9
Number of outstanding shares at the end of the year, million	732.1	663.8
Number of total shares at the end of the year, million	752.4	674.8
Average number of own shares, million	8.4	5.7
Number of own shares at the end of the year, million	8.4	0.7

NOTES TO THE BALANCE SHEET

Cash and balances with central banks

58. Cash and balances with central banks are specified as follows:

	2006	**2005**
Cash and cash balances	10,537	16,869
Cash equivalent	96,424	18,008
Cash and balances with central banks	**106,961**	**34,877**

Loans to credit institutions

59. Loans to credit institutions specified by types of loans:

Money market loans	242,284	97,544
Bank accounts	95,828	46,881
Overdrafts	7,902	1,733
Repos	50,753	0

Other loans	88,567	49,436
Loans to credit institutions	**485,334**	**195,594**

Loans to customers

	2006	2005
60. Loans to customers specified by types of loans:		
Overdrafts	113,354	101,452
Finance lease	93,006	51,212
Subordinated loans	7,369	7,647
Other loans	2,341,462	1,396,342
Provision for loans	(16,582)	(12,953)
Loans to customers	**2,538,609**	**1,543,700**
61. Loans to customers specified by sectors:		
Individuals	16.6%	173%
Holding companies	13.5%	9.8%
Industry	24.3%	19.1%
Real estate	15.6%	12.7%
Service	19.9%	27.0%
Trade	8.5%	12.4%
Transportation	1.6%	1.7%
Loans to customers	**100.0%**	**100.0%**
62. Specification of subordinated loans:		
Loans to customers	4,907	5,796
Bonds and other fixed income securities	2,462	1,851
Subordinated loans	**7,369**	**7,647**
63. Provisions on loans are specified as follows:		
Specific provision	13,404	9,155
Collective assessment	3,178	3,798
Provision on loans	**16,582**	**12,953**
64. Changes in the provision on loans are specified as follows:		
Balance at the beginning of the year	12,953	12,294
Acquisition through business combination	0	1,765
Impairment on loans during the year	4,857	2,450
Exchange rate difference on translation	1,786	(518)
Write-offs during the year	(3,203)	(3,212)
Payment of loans previously written-off	189	174
Provision on loans	**16,582**	**12,953**

Included within interest income is ISK 642 million (2005 ISK 552 million) with respect of interest income accrued on impairment on financial assets and ISK 161 million (2005 ISK 112 million) with respect to the unwind of the impairment provision discount.

Non-performing loans are classified as aggregated exposures of customers for which the Bank has made specific provisions in part or in full. Non-performing loans amounted at year end 2006 to ISK 25,506 million (2005 ISK 15,078 million), 1.00% of total loans to customers (2005: 0.98%).

Financial assets

65. Financial assets are specified as follows:

2006	Trading assets	Fin assets designated at fair value	Fin assets available for sale	Derivatives used for hedging	Total
Bonds and debt instruments					
Listed	26,208	246,620	0	0	272,828
Unlisted	3,559	31,369	0	0	34,928
Mortgage loans	0	10,508	0	0	10,508
Bonds and debt instruments	**29,767**	**288,497**	**0**	**0**	**318,264**
Shares and equity instruments					
Listed	78,463	35,353	0	0	113,816
Unlisted	10,481	34,559	164	0	45,204
Shares and equity instruments	**88,944**	**69,912**	**164**	**0**	**159,020**
Derivatives					
OTC derivatives	50,011	0	0	0	50,011
Futures	15	0	0	0	15
Other trading derivatives	15,428	0	0	0	15,428
Derivatives	**65,454**	**0**	**0**	**0**	**65,454**
Derivatives used for hedging					
Fair value hedge	0	0	0	2,953	2,953
Portfolio hedge of interest rate risk	0	0	0	3,500	3,500
Derivatives used for hedging	**0**	**0**	**0**	**6,453**	**6,453**
Securities used for hedging					
Bonds and debt instruments	66,732	0	0	0	66,732
Shares and equity instruments	47,011	2,195	0	0	49,206
Securities used for hedging	**113,743**	**2,195**	**0**	**0**	**115,938**
Financial assets	**297,908**	**360,604**	**164**	**6,453**	**665,129**

2005	Trading assets	Fin assets designated at fair value	Fin assets available for sale	Derivatives used for hedging	Total
Bonds and debt instruments					
Listed	169,714	78,730	0	0	248,444
Unlisted	0	130,098	0	0	130,098
Mortgage loans	0	12,033	0	0	12,033
Bonds and debt instruments	**169,714**	**220,861**	**0**	**0**	**390,575**
Shares and equity instruments					
Listed	54,273	18,323	0	0	72,596
Unlisted	10,025	31,567	167	0	41,759
Shares and equity instruments	**64,298**	**49,890**	**167**	**0**	**114,355**
Derivatives					
OTC derivatives	12,644	0	0	0	12,644
Futures	18	0	0	0	18
Other trading derivatives	8,385	0	0	0	8,385
Derivatives	**21,047**	**0**	**0**	**0**	**21,047**
Derivatives used for hedging					
Fair value hedge	0	0	0	982	982
Portfolio hedge of interest rate risk	0	0	0	3,477	3,477
Derivatives used for hedging	**0**	**0**	**0**	**4,459**	**4,459**

2005	Trading assets	Fin assets designated at fair value	Fin assets available for sale	Derivatives used for hedging	Total
Securities used for hedging					
Bonds and debt instruments	28,710	0	0	0	28,710
Shares and equity instruments	53,388	0	0	0	53,388
Securities used for hedging	**82,098**	**0**	**0**	**0**	**82,098**
Financial assets	**337,157**	**270,751**	**167**	**4,459**	**612,534**

66. Bonds and debt instruments designated at fair value specified by issuer:

	2006	2007
Financial institutes	270,879	117,982
Government	1,032	81,666
Corporates	16,586	21,213
Bonds and debt instruments designated at fair value	**288,497**	**220,861**

Pledged assets

67. Pledged assets are specified as follows:

	2006	2005
Mortgage loans in Kaupthing Mortgage fund	84,165	0

In the ordinary course of business, the Bank enters into transactions that result in the transfer of financial assets to third parties or special entity. The Bank has transferred retail mortgage loans to the Kaupthing Mortgage Fund, but has retained substantially all of the credit risk associated with the transferred assets, and continues to recognise these assets within loans to customers.

The Bank has entered into repurchase agreements that are conducted under terms usual and customary to standard lending, and stock borrowing and lending activities. Pledged assets according to these agreements amounted to ISK 121 billion at year end 2006 (2005 ISK 48 billion).

68. The Bank sold equity instruments during the year with a fair value of EUR 450 million for cash that has been included as a cash flow from operating activities. The Bank has continuing on and off Balance Sheet exposure to the market price of the equity shares with a maximum potential exposure of EUR 360 million against which the Bank has placed EUR 81 million cash collateral, subject to a requirement for additional collateral based on changes in the market price of the equity shares. The Bank has maximum potential exposure of EUR 360 million, although the Bank has the right to increase the exposure to EUR 400 million.

Investment in associates

69. Investment in associates are specified as follows:

	2006	2005
Carrying amount at the beginning of the year	13,888	3,649
Additions	5,400	1,805
Sold during the year	(11,868)	(42)
Transfers	0	7,671
Profit share	1,194	1,396
Dividend received	(4,103)	(102)
Foreign currency translation	793	(489)
Carrying amount at the end of the year	**5,304**	**13,888**

Main associates are specified as follows:

	Currency	Total assets	Total liabilities	Ownership	Profit share	Nominal value	Book value
Drake Management LLC, USA	USD	11,578	7,329	20.0%	604	10	2,082
Greidslumidlun hf., Iceland	ISK	30,173	28,007	39.5%	165	84	1,757
Mezzanin Kapital A/S, Denmark	DKK	5,696	3,313	22.7%	(1)	159	542

	Currency	Total assets	Total liabilities	Ownership	Profit share	Nominal value	Book value
FMS Holding af 2004 A/S, Denmark ...	DKK	633	302	25.0%	2	113	265
Reikmstofa Bankanna, Iceland	ISK	1,717	199	17.3%	0	0	263
JHM Holsted Holding A/S, Denmark...	DKK	1,545	761	25.0%	0	197	197
Eighteen other associates.....................					424	20	198
					1,194		**5,304**

Intangible assets

70. The Bank performed impairment tests on the carrying amount of goodwill as at 31 December 2006. Impairment tests are performed in the 4th quarter each year, based on the budgets and business plans approved by the Board of Directors and other assumptions.

Goodwill is distributed among cash-generating units (CGU) in keeping with the main emphasis of monitoring and managing activities. The emphasis of the Bank has been shifting such that the subsidiaries are less considered as the core of operations. Instead, operations are tending more towards placing emphasis on the Bank's operational segments. The integration of these changes in emphasis into the Bank's organization has begun and a number of organisational changes have already been made, all with the aim of uniting the Bank and increasing its transparency.

The Bank has now defined the five independent CGU of the Bank's operation which are the business segments, each devising its own budget and responsible for its own results. Furthermore, the costs of the ancillary units are distributed proportionally among the CGU. The CGU are as follows: 1) Capital Markets, 2) Investment Banking, 3) Asset Management & Private Banking, 4) Treasury, and 5) Banking. With regard to this operational restructuring and planning within the Group, goodwill in the Bank's accounts has been distributed among the CGU according to its origin. As part of the apportioning of the Bank's Goodwill, the recoverable amount is measured by value in use.

Each CGU is assessed on its own, in which expectations for return on equity, payout ratio, equity and yield are the main variables in the assessment of each CGU. An independent operating budget acts as the basis for results for the first year of the scheme, after which the next three years are based on the return objectives for each CGU and after that it is based on long-term yield of comparable units. The Bank aims to achieve consolidated 15% return on equity over the next four years. Return objectives are different within each CGU. In the budget for 2006, return on equity is expected to be higher than the Bank's objective. In the assessment, future return on equity is expected to be similar to the average of group of comparable units to each CGU.

2006	**Goodwill**	**Discount Est rate**	**Net earnings CAGR [1], year 1-4**
Capital Markets	5,815	12.7%	<2%
Investment Banking	8,596	12.7%	<2%
Treasury	5,001	12.7%	<2%
Asset Management and Private Banking........................	5,454	10.6%	18.0%
Banking	38,252	9.6%	<2%
Goodwill	**63,118**		
2005			
Capital Markets	4,618	10.9%	<2%
Investment Banking	6,826	10.9%	<2%
Treasury	3,971	10.9%	<2%
Asset Management and Private Banking........................	4,689	9.0%	>100%
Banking	30,377	8.2%	<2%
Goodwill	**50,481**		

The management assesses that likely changes in the key parameters discussed will not cause the carrying amount

[1] 1: GAGR Compound Annual Growth Rate.

of goodwill to exceed the recoverable amount.

71. Intangible assets are specified as follows:	Goodwill	Other intangible assets	Total
2006			
Balance at the beginning of the year	50,481	4,462	54,943
Exchange rate difference	13,088	792	13,880
Additions during the year	0	1,810	1,810
Impairment	(451)	(819)	(1,270)
Amortisation	0	(1,062)	(1,062)
Intangible assets	**63,118**	**5,183**	**68,301**
2005			
Balance at the beginning of the year	34,011	1,087	35,098
Acquisition through business combination	394	942	1,336
Exchange rate difference	(1,178)	(69)	(1,247)
Additions during the year	18,775	2,883	21,658
Impairment	(1,521)	0	(1,521)
Amortisation	0	(381)	(381)
Intangible assets	**50,481**	**4,462**	**54,943**

In 2006 Kaupthing Singer & Friedlander closed its Investment Management business in Leeds. -Impairment testing was undertaken on these balances as at 30 September 2006 based on the most recent information available. The results of the impairment testing suggested a full write-off of Intangible assets amounting to ISK819 million and Goodwill amounting to ISK 451 million or total ISK 1,270 million.

Investment property

72. Investment property is specified as follows	2006	2005
Balance at the beginning of the year	24,156	19,155
Exchange rate difference	3,426	5
Additions during the year	3,475	4,839
Disposals during the year	(2,347)	(208)
Revaluation during the year	96	365
Transfers	2,778	0
Investment property	**31,584**	**24,156**

The Bank's Investment property was revalued at 31 December 2006 by independent professionally qualified valuers which have recent experience in the location and category of the Investment property being valued. Valuations were based on current prices in an active market for all properties except for the properties located in Iceland where the Bank used discounted cash flow projections.

73. Leases as lessor

The Bank leases investment property as operating leases (see note 20). The future minimum lease payments under non-cancellable leases are as follows:

	2006	2005
Less than one year	1,682	917
Over 1 year and up to 5 years	4,391	3,768
Over 5 years	21,682	15,263
Minimum lease payments under non-cancellable leases	**27,755**	**19,948**

During the year 2006 ISK 2,274 million (2005 ISK 1,530 million) was recognised as rental income in the Income Statement and ISK 20 million (2005 ISK 2 million) in respect of repairs and maintenance was recognised as an expense in the Income Statement relating to investment property.

In the Income Statement, direct operating expenses include ISK 32 million relating to investment property that was unlet compared to ISK 5 million for the year before.

Property and equipment

74. Property and equipment are specified as follows:

	Real estate	Machinery and equip.	Operating lease	Total 2006	Total 2005
Balance at the beginning of the year	8,276	7,998	19,368	35,642	10,781
Acquisitions through business combination	0	0	0	0	22,884
Exchange rate difference	467	1,362	6,019	7,848	(411)
Additions during the year	4,571	3,643	5,604	13,818	4,965
Disposals during the year	(1,996)	(1,301)	(1,330)	(4,627)	(2,159)
Transfers	(2,234)	0	(579)	(2,813)	0
Impairment	0	0	0	0	(418)
Gross carrying amount at the end of the year	**9,084**	**11,702**	**29,082**	**49,868**	**35,642**
Previously depreciated	1,665	5,476	6,068	13,209	4,689
Acquisitions through business combination	0	0	0	0	7,274
Exchange rate difference	(289)	1,279	1,971	2,961	(236)
Depreciation during the year	301	1,436	3,177	4,914	2,437
Transfers	445	0	(480)	(35)	0
Disposals during the year	(78)	(668)	(901)	(1,647)	(955)
Total depreciation at the end of the year	**2,044**	**7,523**	**9,835**	**19,402**	**13,209**
Property and equipment	**7,040**	**4,179**	**19,247**	**30,466**	**22,433**

75. Depreciation and amortisation in the Income Statement is specified as follows:

	2006	2005
Depreciation of property and equipment..	4,914	2,437
Amortisation of intangible assets	1,062	381
Depreciation and amortisation	**5,976**	**2,818**

76. Property under construction

During the year ended 31 December 2006, the Bank's construction cost of a new building for future use as headquarters, incurred up to ISK 1,212 million including the acquisition cost of the land in the year 2005.

77. Leases as lessor

The Bank leases out property and equipment under operating leases (see note 20). The future minimum lease payments under non-cancellable leases are as follows:

	2006	2005
Less than one year	851	3
Over 1 year and up to 5 years	3,322	19
Over 5 years	4,414	102
Minimum lease payments under non-cancellable leases	**8,587**	**124**

During the year ended 31 December 2006, ISK 2,033 million was recognised as rental income in the Income Statement and ISK 8 million in respect of repairs and maintenance was recognised as an expense in the Income Statement relating to property and equipment. Comparative amounts for the year 2005 amounted to ISK 1,530 million and ISK 2 million, respectively.

Other assets

78. Other assets are specified as follows

	2006	2005
Unsettled securities trading	90,427	16,091
Accounts receivables	8,617	6,997
Accrued income	8,004	4,868
Prepaid expenses	2,846	2,887
Non-current assets and disposal groups classified as held for sale	2,334	2,302
Sundry assets	5,646	537
Other assets	**117,874**	**33,682**

Unsettled securities trading was settled in less than three days from the reporting.

Borrowings

79. Borrowings are specified as follows:

Bonds issued	1,762,483	1,158,806
Bills issued	156,203	164,910
Money market loans	373,285	200,581
Other loans	107,968	32,270
Borrowings	**2,399,939**	**1,556,567**

Included are Repurchase agreements with banks amounting to ISK 94,913 million at the end of December compared to ISK 14,376 million at year end 2005.

Subordinated loans

80. Subordinated loans are specified as follows:

	Currency	Original interest	Interest change	Interest after change	Maturity date	2006 Book value	2005 Book value
Loans that qualify as Tier I capital							
Issued in 2001	ISK	8.7%	2011		No maturity date	1,310	1,232
Issued in 2004	EUR	5.9%	2014	3 m Reibor + 245bp	No maturity date	15,095	12,545
Issued in 2005	EUR	6.3%	2010	6.3%	No maturity date	16,685	13,517
Issued in 2005	ISK	3 m Reibor + 1.4%			No maturity date	3,353	3,352
Issued in 2005	USD	5.1%			No maturity date	11,798	10,555
Issued in 2006	ISK	3 m Reibor + 1.4%			No maturity date	3,576	0
						51,817	**41,201**
Loans that qualify as Tier II capital							
Issued in 1996	DKK	0.0%			2007	228	370
Issued in 1999	EUR	6.4%			2009	3,067	2,545
Issued in 1999	JPY	0.0%			2032	3,513	3,057
Issued in 1999	USD	4.8%			2032	3,948	3,660
Issued in 2000	ISK	7.0%	2007	9.0%	2012	2,135	1,974
Issued in 2000	ISK	6.0%	2005	7.5%	2010	0	1,216
Issued in 2001	ISK	6.0%	2006	7.5%	2011	122	129
Issued in 2001	ISK	8.0%	2006	10.0%	2011	0	1,223
Issued in 2002	ISK	6.0%	2007	7.5%	2012	1,021	948

Issued in 2002	ISK	7.5%	2009	10.0%	2014	1,429	1,334
Issued in 2002	ISK	8.0%			2026	264	247
Issued in 2002	EUR	3 m Euribor +115bp	2007	3 m Euribor +365bp	2012	474	374
Issued in 2003	GBP	7.5%			2019	6,976	5,646
Issued in 2004	ISK	5.4%	2009	7.4%	2014	1,666	1,557
Issued in 2004	EUR	3 m Euribor +6.5bp	2009	3 m Euribor + 165bp	2014	28,281	22,284
Issued in 2004 Issued in 2005 ..	DKK USD	3.0% 7.5%	2010	4x(CMS 10y/2y) 10%/3 5%	2008 2045	142 5,512	112 4,835
Issued in 2005	EUR	6 5%	2010	4x(CMS 10y/2y) 9%/3%	2045	7,903	6,227
Issued in 2005	EUR	3 m Euribor +40bp	2012	3 m Euribor + 140bp	2017	4,758	3,749
Issued in 2006..........................	USD	7.1%			2016	92,774	0
						164,213	**61,487**
Subordinated loans.................						**216,030**	**102,688**

Financial liabilities measured at fair value

	2006	**2005**
81. Financial liabilities measured at fair value are specified as follows:		
Trading liabilities	51,095	32,003
Derivatives used for hedging - portfolio hedge of interest rate risk	8,768	13,276
Mortgage funding measured at fair value	11,401	14,994
Financial liabilities measured at fair value	**71,264**	**60,273**
82. Trading liabilities are specified as follows:		
Short position in equity instruments held for trading	2,122	3,765
Derivatives held for trading	48,788	27,942
Other liabilities held for trading	185	296
Trading liabilities	**51,095**	**32,003**
83. Derivatives used for hedging are specified as follows:		
Fair value hedge	1,070	0
Portfolio hedge of interest rate risk	7,698	13,276
Derivatives used for hedging	8,768	13,276

Tax assets and tax liabilities

84. Tax assets and liabilities are specified as follows:

	Assets	**Liabilities**
Current tax	26	10,179
Deferred tax	5,808	13,030
Tax assets and liabilities	**5,834**	**23,209**

85. Deferred tax assets and liabilities are specified as follows:

	Assets	**Liabilities**	**Net**
2006			
Balance at the beginning of the year	5,004	10,343	(5,339)
Exchange rate difference on translation	234	689	(455)
Other changes..	0	(581)	581
Calculated income tax for the year...................................	596	15,232	(14,636)
Income tax recognised in equity.......................................	0	(2,474)	2,474
Income tax to be paid in next year....................................	(26)	(10,179)	10,155

Net tax assets and (liabilities)	**5,808**	**13,030**	**(7,222)**
2005			
Balance at the beginning of the year	1,092	4,408	(3,316)
Acquisition through business combination	3,987	4,333	(346)
Disposals during the year	0	(474)	474
Exchange rate difference on translation	(150)	(932)	782
Calculated income tax for the year	75	11,303	(11,228)
Income tax to be paid in next year	0	(8,295)	8,295
Net tax assets and (liabilities)	**5,004**	**10,343**	**(5,339)**

86. Changes in deferred tax assets and liabilities are specified as follows:

	At Jan 1	Exchange rate and other adjustments	Business combination and disposal	Recognised in profit or loss	Recognised in equity	At Dec 31
2006						
Shares in other companies	1,516	190	0	1,326	0	3,032
Currency linked assets and liabilities	502	65	0	3,447	(2,474)	1,540
Loans	5,643	724	0	(942)	0	5,425
Derivatives	(841)	(183)	0	1,121	0	97
Investment property and property and equipment	455	104	0	888	0	1,447
Other assets and liabilities	(667)	(734)	0	(1,303)	0	(2,704)
Carry forward taxable loss	(1,269)	(291)	0	(55)	0	(1,615)
Change in deferred tax	**5,339**	**(125)**	**0**	**4,482**	**(2,474)**	**7,222**
2005						
Shares in other companies	575	(57)	(22)	1,020	0	1,516
Currency linked assets and liabilities	346	(38)	(12)	206	0	502
Loans	3,639	(480)	(141)	2,625	0	5,643
Derivatives	(153)	16	6	(710)	0	(841)
Investment property and property and equipment	356	(31)	(14)	144	0	455
Other assets and liabilities	65	(7)	(3)	(722)	0	(667)
Carry forward taxable loss	(1,512)	(185)	58	370	0	(1,269)
Change in deferred tax	**3,316**	**(782)**	**(128)**	**2,933**	**0**	**5,339**

Other liabilities

87. Other liabilities are specified as follows:

	2006	2005
Unsettled securities trading	91,661	8,476
Provisions	4,666	3,271
Accounts payable	4,410	3,573
Sundry liabilities	48,211	29,173
Other liabilities	**148,948**	**44,495**

Unsettled securities trading was settled in less than three days from the reporting date.

88. Provisions are specified as follows:

Provision for pensions	**3,679**	**2,815**
Provision for losses on guarantees	263	0
Other provisions	724	456
Provisions	**4,666**	**3,271**

Shareholders' equity

89. According to the Parent Company's Articles of Association, total Share capital amounts to ISK 7,405 million. At year end 2006, own shares amounted to ISK 84 million and Share capital, according to the Balance Sheet, amounted to ISK 7,321 million. One share has a nominal value of ISK 10. The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at meetings of the Bank.

	2006		2005	
Increase in Share capital during the year is broken down as follows	Share capital	Market value	Share capital	Market value
Shares outstanding at 1 January	6,638	495,195	6,521	293,732
Issued new shares	759	55,558	39	416
Purchases and sales of treasury stock	(76)	(5,730)	78	3,706
Changes in market value	0	70,673	0	197,340
Shares outstanding at 31 December	**7,321**	**615,696**	**6,638**	**495,194**
Own shares	84	7,064	7	485

90. Movement in Share capital during the year segregates as follows:

	Share capital	Share premium	Stock options	Total
2006				
Balance at 1 January 2006	6,638	114,437	169	121,244
Issued new shares	759	54,799	0	55,558
Purchases and sales of treasury stock	(76)	(5,948)	0	(6,024)
Exercised stock options	0	224	(224)	0
Stock option expense	0	0	571	571
Balance 31 December 2006	**7,321**	**163,512**	**516**	**171,349**
2005				
Balance at 1 January 2005	6,521	110,402	157	117,080
Issued new shares	39	377	0	416
Purchases and sales of treasury stock	78	3,628	0	3,706
Exercised stock options	0	30	(30)	0
Stock option expense	0	0	42	42
Balance 31 December 2005	**6,638**	**114,437**	**169**	**121,244**

The cost of issuing new shares in 2006, amounting to ISK 1,939 million, has been deducted from share premium.

Reserves

91. Movement in reserves were as follows:

	Pension reserve	Fair value reserve	Translation reserve	Total
2006				
Balance at 1 January	(480)	(2)	(1,058)	(1,540)
Translation difference	0	0	18,289	18,289
Changes in fair value of available-for-sale financial assets	0	(9)	0	(9)
Deferred pension reserve	480	0	0	480
Balance 31 December	**0**	**(11)**	**17,231**	**17,220**
2005				
Balance at 1 January	0	0	(670)	(670)

Translation difference	0	0	(388)	(388)
Changes in fair value of available-for-sale financial assets	0	(2)	0	(2)
Deferred pension reserve	(480)	0	0	(480)
Balance 31 December	**(480)**	**(2)**	**(1,058)**	**(1,540)**

Fair value reserve

The fair value reserve includes the cumulative portion of the cumulative net change in fair value of available-for-sale investments until the investment is derecognised.

Translation reserve

The translation reserve compromise all foreign exchange differences arising from the translation of the Financial Statements of foreign operations that are not integral to the operations of the Bank, as well as from the translation liabilities that hedge the Bank's net investment in foreign subsidiaries.

Pension reserve

The pension reserve includes the changes in the pension obligation.

Equity ratio

92. Equity at the end of the year amounts to ISK 334,892 million. The equity ratio, calculated in accordance with Article 84 of the Act on Financial Undertakings, was 15.0%. According to the law the ratio may not be lower than 8.0%

	2006		2005	
The ratio is calculated as follows:	Book value	Weighted value	Book value	Weighted value
Risk base				
Assets recorded in the Financial Statements	4,055,396	2,875,539	2,540,811	1,841,833
Assets deducted from equity		(66,922)		(62,590)
Guarantees and other items not included in the Balance Sheet		259,023		166,028
		3,067,640		**1,945,271**
Equity				
Tier I capital:				
Equity		334,892		202,512
Intangible assets		(65,276)		(54,943)
Assets deducted from equity		0		(6,742)
Subordinated loans		51,817		41,201
Tier II capital:				
Subordinated loans		160,717		61,285
Investment in credit institutions		(21,324)		(6,451)
		460,826		**236,862**
Equity ratio		15.0%		12.2%
Thereof Tier I ratio		10.5%		9.4%

Derivatives

93. Derivatives remaining maturity date of principal and book value are specified as follows:

	Principal			Book value		
	Up to 3 months	Over 3 months and up to a year	Over 1 year	Total	Assets	Liabilities
2006						

Currency and interests rate derivatives, agreements unlisted						
Forward exchange rate agreements................	1,428,174	137,042	4,879	1,570,095	13,178	12,575
Interest rate and exchange rate agreements.....	117,595	364,708	1,942,931	2,425,234	37,976	30,529
Options - purchased agreements.....................	53,139	22,730	62,242	138,111	2,870	63
Options - sold agreements	48,438	24,876	40,738	114,052	93	2,452
	1,647,346	**549,356**	**2,050,790**	**4,247,492**	**54,117**	**45,619**
Equity derivatives						
Equity swaps, agreements unlisted	35,888	9,076	4,886	49,850	8,430	3,369
Equity options, purchased unlisted agreements...	4,308	0	2,700	7,008	90	73
Equity options, sold unlisted agreements........	338	0	2,700	3,038	151	10
Futures, agreements listed	1,527	0	0	1,527	15	0
Contracts for differences	3,959	0	0	3,959	32	0
	46,020	**9,076**	**10,286**	**65,382**	**8,718**	**3,452**
Credit derivative contracts						
Credit default swaps	4,257	0	212,928	217,185	36	8
Total rate of return swaps	0	0	45,999	45,999	0	1,733
	4,257	0	258,927	263,184	36	1,741
Bond derivatives						
Bond swaps, agreements unlisted	22,360	2,939	25,471	50,770	2,307	102
Options - purchased agreements.....................	0	401	13,931	14,332	6,729	0
Options - sold agreements	0	401	13,931	14,332	0	6,717
	22,360	**3,741**	**53,333**	**79,434**	**9,036**	**6,819**
Derivatives	**1,719,983**	**562,173**	**2,373,336**	**4,655,492**	**71,907**	**57,631**
2005						
Currency and interests rate derivatives, agreements unlisted						
Forward exchange rate agreements................	519,031	44,442	595	564,068	5,820	4,264
Interest rate and exchange rate agreements.....	78,372	167,328	777,591	1,023,291	14,558	40,044
Options - purchased agreements.....................	2,399	4,395	25,945	32,739	861	0
Options - sold agreements	7,310	6,401	21,504	35,215	143	432
	607,112	**222,566**	**825,635**	**1,655,313**	**21,382**	**44,740**
Equity derivatives						
Equity swaps, agreements unlisted	60,252	17,987	0	78,239	2,517	4,729
Equity options, purchased unlisted agreements...	5,501	0	2,000	7,501	56	0
Equity options, sold unlisted agreements........	2,357	0	2,000	4,357	0	144
Futures, agreements listed	920	0	0	920	0	2
	69,030	**17,987**	**4,000**	**91,017**	**2,573**	**4,875**
Credit derivative contracts						
Credit default swaps	2,545	2,638	173,309	178,492	75	1
Bond derivatives						
Bond swaps, agreements unlisted	6,343	4,218	25,155	35,716	71	1,154
Derivatives	**685,030**	**247,409**	**1,028,099**	**1,960,538**	**24,101**	**50,770**

The objective of the above-mentioned agreements is to control currency and interest rate risk of the Bank. The credit risk is valued at ISK 30,575 million when calculating the equity ratio of the Bank at 31 December 2006 and ISK 27.158 million at 31 December 2005.

OFF BALANCE SHEET INFORMATION

Obligations

94. The Bank has granted its customers guarantees, overdraft permissions and loan commitments. These items are specified as follows:

	2006	**2005**

Guarantees	324,929	196,793
Credit default swaps, investment grade	217,186	179,147
Unused overdrafts	50,927	42,558
Loan commitments	317,689	165,066

The credit risk is valued at ISK 226 billion (2005 ISK 141 billion) for Guarantees, Credit default swaps, Unused overdrafts and Loan commitments when calculating the equity ratio of the Bank.

Operating lease commitments

95. At 31 December 2006, the Bank was obligated under a number of non-cancellable operating leases for premises and equipment.

The significant premises' leases usually include renewal options and escalation clauses in line with general office rental market conditions as well as rent adjustments based on price indices. However, the lease agreements do not contain contingent rent payment clauses and purchase options.

96. The Bank has concluded lease agreements regarding the real estate it uses for its operations. The lease agreement is for a period of up to 18 years and the Bank has priority right of purchase or right to extend the lease agreement at the end of that period.

Future minimum lease payments	6,714

ADDITIONAL INFORMATION

Assets under management and custody

97. Assets under management and assets under custody are specified as follows:

	2006	2005
Assets under management	1,403,376	1,073,651
Assets under custody	1,952,813	1,426,448

The Bank provides asset custody, asset management, investment management and advisory services to its clients. These services require the Bank to make decisions on the treatment, acquisition or disposal of financial instruments. Assets in the Bank's custody are not reported in its accounts.

Related parties

98. The Bank has a related party relationship with its subsidiaries, associates, the Board of Directors of the Parent Company, the Managing Directors of the Bank, the Managing Directors of the largest subsidiaries, close family members of individuals referred to above and entities with significant influence as the largest shareholders of the Bank which are Exista (23.0%) and Kjalar Invest B V (9.7%). Information regarding related parties are as follows:

Loans to significant related companies	2006	2005
Balance at the beginning of the year	36,888	26,889
Additions	91,274	28,382
Reductions	(18,606)	(18,383)
Balance at the end of the year	**109,556**	**36,888**

Comparison figures in this note have been changed because of a change in the definition of related parties. Balance at the end of year 2005 is ISK 33,823 million higher than in the Financial Statement for the year 2005.

Lysing, which is a financial institution, supervised by FSA in Iceland, had ISK 39,380 million of the total loans to related parties at the end of year 2006.

The Bank has granted loans to the Board members and its key management. The outstanding balance of loans to the Board members, management and close family members amounted to ISK 17,716 million at 31 December 2006 and ISK 7,545 million at 31 December 2005. The terms and conditions are similar for the Board members and key management as loans granted to other customers of the Bank. The aforementioned amounts do not include loans related to the business activities of the Board members and key management.

No unusual transactions took place with related parties in the year 2006. Transactions with related parties have been conducted on arm's length basis.

Stock options

99. During the year 2006, the Board of Directors of Kaupthing Bank hf. have decided on the basis of the Bank's stock option scheme to grant 564 employees in the Bank stock options to buy shares in the Bank. Stock option holders are entitled to exercise one third of their total stock option every year for three years between 20 January and 20 February, and the first period in which options can be exercised is from 20 January to 20 February 2008. The option has an exercise price of ISK 840 per share. The Board of Directors granted options on a total of 636 thousand shares.

At the same time as granting stock options to all employees, the Board of Directors of the Bank has also granted 455 employees stock options to buy 21.7 million shares over a three-year period, during which they can exercise one third of the stock option each year. The period in which options can be exercised is also from 20 January to 20 February each year, with the first exercise period in 2010. The option has an exercise price of ISK 830 per share during the first exercise period, ISK 872 per share during the 2011 exercise period and ISK 916 per share during the 2012 exercise period. The exercise of the options can be postponed each time until last exercise date but the strike price will increase to the price indicated by the relevant exercise date.

The terms and conditions of the grants are as follows, whereby all options are settled by physical delivery of shares.

Grant date / employees entitled	Number of sharps in thousands	Vesting conditions	Contractual life of options	Exercise price
October 2002	180	Five years of service. The stock option is excercisable 2007	5 years	120
March 2004	3,248	Four years of service. The stock option is exercisable 2007-2008	4 years	303
December 2002	887	Six years of service One third of total stockoption is exercisable each year 2007-2008	6 years	6522
November 2005	3,593	Three years of service One third of total stock option is exercisable each year 2007-2009	3 years	600
November 2005	7,815	Three years of service One third of total stock option is exercisable each year 2007-2009	3 years	600/630/660
December 2006	636	Three years of service One third of total stock option is exercisable each year 2008-2010	3 years	840
December 2006	21,675	Five years of service One third of total stock option is exercisable each year 2010-2012	5 years	830/872/916
Total share options	**38,034**			

The number and weighted average exercise prices of share options is as follows.

	2006		2005	
	Weighted average exercise price	Number of options	Weighted average exercise price	Number of options
Outstanding at the beginning of the year	494	20,811	209	12,630
Forfeited during the year	521	(1,447)	112	(376)
Exercised during the year	278	(3,641)	108	(4,085)
Granted during the year	871	22,311	641	12,642

Outstanding at the end of the year...	735	494	38,034	20,811

The options outstanding at 31 December 2006 have an exercise price in the range of 65,22 to 916 and a weighted average contractual life of 3.9 years.

The fair value of services received in return for share options granted is measured by reference to the fair value of share options granted. The estimate of the fair value of the services received is measured based on the Black-Scholes model. The contractual life of the option is used as an input into this model. Expectations of early exercise are not incorporated into the Black-Scholes model.

The fair value of options granted during the year determined using the Black-Scholes valuations model was ISK 3,449 millions which will be amortised over contractual life of options. The significant inputs into the model were share prices of 840 (830, 872 and 916 for key management), expected volatility of 22.2%, option life disclosed above, annual risk free interest rate of 8.9%, and expected dividends yield of 2.0%. The expected volatility is based on the historic volatility over the last 36 months before the grant date. Expected leave rate is 15% per year (9% for key employees).

The fair value of options granted in 2005 determined using the Black-Scholes valuations model was ISK 1,127 million which will be amortised over contractual life of options. The significant inputs into the model were share prices of 600 (600, 630 and 660 for key management), expected volatility of 15%, option life disclosed above, annual risk free interest rate of 7.4%, and expected dividends yield of 2.3%. The expected volatility is based on the historic volatility over the last 12 months before the grant date.

The Board of Directors of FIH Erhvervsbank has granted the employees of FIH a stock option scheme which can be exercised 2008, 2009 and 2010. The options can only be exercised for 30 days after the Financial Statements have been published. During 2006, ISK 347 million (2005: ISK 43 million) has been entered among Salaries and related expenses and ISK 360 million (2005: ISK 39 million) in the Balance Sheet as liability.

Events after the Balance Sheet date

100. There have been no material post Balance Sheet events which would require disclosure or adjustments to the 31 December 2006 Financial Statements. On 29 January 2007, the Board of Directors approved the Financial Statements and authorised for publication.

Subsidiaries

101. Shares in main subsidiaries are specified as follows:

Company	Country	Currency	Business Segments	Share capital in millions	Equity interest accum %
Arion Custody Service hf.	Iceland	ISK	OD	115	100.0
Eik fasteignafelag hf.	Iceland	ISK	OD	707	100.0
FI-Holding A/S	Denmark	DKK	IB, CM, Tr, Ba, AM&PB	842	100.0
Kaupthing Bank Luxembourg S A	Luxembourg	EUR	CM, Tr, Ba, AM & PB	16,611	100.0
Kaupthing Bank Oyj	Finland	EUR	IB, CM, Tr, Ba, AM & PB	1,670	100.0
Kaupthing Foroyar Virdisbraevameklarafelag P/F	Faroe Islands	DKK	IB, CM, AM & PB	112	100.0
Kaupthing Holding UK Ltd (KTSF)	UK	GBP	IB, CM, Tr, Ba, AM & PB	31,839	100.0
Kaupthing New York Inc	USA	USD	CM	432	100.0
Kaupthing Norge AS	Norway	NOK	IB, CM, AM & PB	1,433	100.0
Kaupthing Sverige AB	Sweden	SEK	IB, CM, Tr, Ba, AM & PB	2,807	100.0
Kaupthing Liftryggingar hf.	Iceland	ISK	Ba	17	100.0
Kirna ehf.	Iceland	ISK	IB, Tr	31,770	100.0
New Bond Street Asset Management LLP	UK	GBP	Tr	-	100.0
Norvestia Oyj	Finland	EUR	CM	4,455	30.6
Kaupthing Bank Asset Management Company hf.	Iceland	ISK	AM & PB	44	100.0
Vidjar ehf.	Iceland	ISK	Ba	1	100.0

Sparisjodur Kaupthings hf.	Iceland	ISK	Ba	100	100.0

1) IB Investment Banking, CM Capital Markets, Tr Treasury, Ba Banking, AM & PB Asset Management and Private Banking, OD Other Divisions

The Bank wields 54.4% of the votes in Norvestia Oyj and the company is thus considered to be a subsidiary of the Bank.

RISK MANAGEMENT INFORMATION

102. Kaupthing is a northern European bank offering comprehensive retail, corporate and investment banking services to individuals, companies and institutional investors. The Bank has five core business segments: Banking, Asset Management and Private Banking, Investment Banking, Capital Markets and Treasury. It also has ancillary divisions such as Risk Management, Finance, Sales and Marketing, Information Technology, Legal Department, Back Office and Human Resources.

The Bank faces various types of risks related to its business as a financial institution arising from its day-to-day operations. Management devotes a significant portion of its time to the management of these risks. The mainstays of effective risk management are the identification of significant risk, the quantification of the risk exposure, actions to limit risk and the constant monitoring of risk. The most significant of these risks are discussed below.

Material risks

a) 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 enhanced if the assigned collateral only partly covers the claims made on the borrower or if its value is variable or uncertain. Credit risk arises any time the Bank commits its funds, resulting in capital or earnings being dependent on counterparty, issuer or borrower performance. The risk comprises concentration risk, residual risk, credit risk in securitisation, cross border (or transfer) risk and more.

b) Market risk

Market risk is the current or prospective risk that changes in financial market prices and rates will reduce the value of a security or portfolio. The risk arises from market making, dealing, and position taking in bonds, securities, currencies, commodities, derivatives, and any other commitment depending on market prices and rates.

c) Operational risk

Operational risk is the risk of loss, resulting from inadequate or failed internal processes, human and system error, or from external events that affect the Bank's operations and can result in direct losses. The risk is present in all five core business areas and in the ancillary divisions.

d) Liquidity risk

Liquidity risk is the risk arising from the possible inability of the Bank to meet its liabilities when they come due. It is an unavoidable source of risk in Kaupthing's operations as the Bank requires funding to support its investments.

Credit risk strategy

Carefully monitored credit risk is a base for stable profits. Undertaking credit risk is a cornerstone in the Bank's strategy for maintaining at least 15% long term return on equity. The main asset of the Bank is its loan portfolio, and therefore managing and analysing the loan portfolio is very important. The emphasis is on keeping a high quality credit portfolio, by seeking business with strong parties, maintaining a strict credit process, critically inspecting loan applications, identifying and reacting to possible problem loans at an early stage and other measures.

a) Credit structure

A fundamental requirement is to have a comprehensive structure for credits which is coherent across the Bank and within each subsidiary as well. The highest authority in credits is the Parent Company's Board Credit Committee. The structure is based on a hierarchy of Credit Committees below the Board Credit Committee which operate on 2-3 levels and within different limits depending on the size of subsidiaries. The principle of central management of risk is maintained by having the Bank's Group CEO or his deputy as a member of the Board Credit Committee in each subsidiary. This is necessary since the Group CEO is responsible for maintaining the Bank's exposures within legal and policy limits and then the decision authority needs be included.

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.

It is the aim of the credit strategy that, in the long run, write-offs should be less than 5% of interest income. All aspects of the credit process should be designed and implemented 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.

The Bank's total credit risk should be limited through diversification of the loan portfolio across sectors and by limiting large exposures.

b) Quantification and Rating model description

The basic elements for the quantification of credit risk are the probability of default, the loss given 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 in regard to the counterparty and to its general economic situation in order to estimate its creditworthiness. Furthermore, a facility rating should be performed to determine the loss parameters in case of a default.

The policy of the Bank 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 the Bank's Basel II strategy.

Sources of credit risk

a) Loan portfolio

The main assets of Kaupthing Bank are its loans, to maintain and further improve the quality of the loan portfolio it is imperative to scrutinise all applications and weed out potential problem loans as early as possible, as well as constantly monitor the current loan portfolio. However, it is not the policy of the Bank to solely issue credit of very low risk but it is important that the price of issued credit reflects both risk and costs incurred. This means that a detailed assessment of individual customers, their financial position and the collateral is a prerequisite for granted credits.

b) Commitments and guarantees

The Bank often commits itself to and ensures that funds are available to customers as required. The most common commitments to extend credit are in the form of limits on check accounts, credit cards and credit lines. Potential loss on these accounts is equal to the amount of the limits although they may only be partly used at any one time. In practise, the potential loss is less severe since many of these commitments can be recalled immediately by the Bank in case the clients do not meet credit standards.

Guarantees carry the credit risk to the full amount similar as loans, since they represent irrevocable assurances that the Bank will make payments in the event that a customer cannot meet its obligations to third parties.

c) Derivatives trading

Derivative financial instruments used by the Bank include swaps, futures, forwards, options and other similar types of contracts whose value changes in response to changes in interest rates, foreign exchange rates, security prices, commodity prices or price indices. Limits on the net open derivative positions on these types of contracts are strictly controlled by the Bank. These limits are generally client specific and may refer specifically to different categories of contracts. Generally, collateral is required to cover potential losses on a contract. Acceptable collateral for margin accounts is in the front of very liquid assets, e.g. cash or traded stocks. In case the net negative position of the contract falls below a certain level, a call for added collateral is made. If extra collateral is not supplied, the contract is closed.

d) Master netting agreements

Frequently, exposure to credit losses is reduced by entering into master netting agreements with clients that counterparties have significant and/or diverse credit related business with the Bank. Master netting agreements do not generally result in an offset of Balance Sheet assets and liabilities, as transactions are usually settled on a gross basis. However, the credit risk associated with favourable contracts is reduced by these types of agreements since, in the case of default, all amounts of the counterparty are terminated and settled on a net basis.

Loan provisioning

An allowance for credit losses is established if there is objective evidence that the Bank will be unable to collect all amounts due on a claim, i.e. a loan, commitment, guarantee etc, according to the original contractual terms or the equivalent value. An allowance for credit losses is reported as a reduction of the carrying value of a claim on the Balance Sheet, whereas for an off-Balance Sheet item such as a commitment, a provision for credit loss is reported in Other liabilities. Additions to the allowances and provisions for credit losses are made through impairment on loans. Allowances and provisions for credit losses are evaluated at a counterparty-specific level and collectively based on the following principles:

a) Counterparty-specific

A claim is considered impaired when there is an object evidence that it is probable that the Bank will not be able to collect all amounts due according to the original contractual terms or the equivalent value. Individual credit exposures are evaluated based upon the borrower's character, overall financial condition, resources and payment record, the prospects for support from any financially responsible guarantors, and, where applicable, the realisable value of any collateral.

The estimated recoverable amount is the present value, using the loans original effective interest rate, of expected future cash flows, which may result from restructuring or liquidation. Impairment is measured and allowances for credit losses are established for the difference between the carrying amount and the estimated recoverable amount.

Upon impairment, the accrual of interest income based on the original terms of the claim is discontinued, but the increase of the present value of impaired claims due to the passage of time is reported as Interest income.

All impaired claims are reviewed and analysed at least every three months. Any subsequent changes to the amounts and timing of the expected future cash flows compared to the prior estimates will result in a change in the allowances for credit losses and be charged or credited through impairment on loans.

An allowance for impairment is reversed only when the credit quality has improved such that there is reasonable assurance of timely collection of principal and interest in accordance with the original contractual terms of the claim agreement.

A write-off is made when all or part of a claim is deemed uncollectible or forgiven. Write-offs are charged against previously established allowances for credit losses or directly to credit loss expense and reduce the principal amount of a claim. Recoveries in part or in full of amounts previously written off are credited to credit loss expense.

b) Collectively

All loans for which no impairment is identified on a counterparty-specific level are grouped into economically homogeneous portfolios to collectively assess whether impairment exists within a portfolio. Allowances from collective assessment of impairment are recognised as credit loss expense and result in an offset to the loan position. As the allowance cannot be allocated to individual loans, interest is accrued on all loans according to contractual terms.

Market risk strategy

Kaupthing's strategy is to invest its own capital on a limited and carefully selected basis in transactions, underwritings and other activities that involve market risk. The main types of market risk are price risk of listed and unlisted securities, both shares and bonds, interest rate risk, currency risk or other market variables influenced by market forces.

These investments are either taken as a service to clients for example as an underwriting commitment, a co-investment in an acquisition, market making in capital markets etc. - or the investments are made with the strategy of the Bank in mind and then primarily in financial service companies.

The Bank should keep firm track of the market risk embedded in market investments at Group level and make sure that the total estimated market risk does not exceed the market risk allowance set by the Bank's Board of Directors. The aim is to monitor the market risk in real time so that market risk operations can take the best investment opportunities available at each time without violating their risk limits. Additional provisions are imposed depending on the type of market risk operation.

Derivatives

103. The Bank's use of derivatives is mainly through derivative sales, but derivatives are also in trading portfolios. The types of derivatives used by the Bank include swaps, futures, forwards, options, credit derivatives, and other similar types of contracts.

Derivative sales offer companies and institutional investors foreign exchange and a range of interest rate and currency derivatives for position taking and risk management. The market risk associated with derivatives sales is hedged on a portfolio basis and on a back-to-back basis.

The Bank's trading portfolios take positions in traded and over-the-counter instruments, including derivatives, to take advantage of short-term market movements in equities and bonds and in currency prices and interest rates, and they also use derivatives to hedge certain market exposures. The level of exposure is controlled using individual trading limits as with other market risk.

Interest rate risk

104. Interest-rate risk increased quite significantly at year end 2004 following the introduction of fixed-interest mortgage products, but it remains closely monitored. The table below shows the interest rate risk by currency and maturity. Trading interest rate risk refers to exposures in trading book where positions are marked-to-market and profit or loss is recognised immediately but banking interest rate risk refers to exposure in banking book where profit or loss is realised over the lifetime of the exposure.

The total amount of indexed assets of the Bank amounted to ISK 325,845 million (2005 ISK 237,218 million), and the total amount of indexed liabilities amounted to ISK 180,241 million (2005 129,917 million), respectively, at year end.

The Bank's 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, the Bank is also exposed to basis risk, which is the difference in repricing characteristics of the various floating rate indices, such as the savings rate and six months LIBOR and different types of interest. Risk management activities are aimed at optimising net interest income, given market interest rate levels consistent with the Bank's business strategies. Interest rate risk is monitored centrally with duration reports and yield curve stress testing for each currency. Interest rate risk by currency and duration.

Interest rate risk is measured by shifting all yield curves by 100bp simultaneously. The table lists the resulting profit and loss broken down by currency and duration buckets for both banking and trading book.

Currency		Within 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
2006							
ISK	Trading	(712)	33	535	1,916	(254)	1,518
	Banking	(903)	(109)	(313)	(738)	(15,048)	(17,111)
DKK	Trading	106	1,120	134	103	(2,745)	(1,282)
	Banking	(10)	(37)	(30)	360	(3,673)	(3,390)
EUR	Trading	(40)	135	416	(529)	1,493	1,475
	Banking	55	50	(123)	518	(692)	(192)
GBP	Trading	2	503	(126)	(151)	(2)	226
	Banking	(19)	(87)	(644)	(120)	(853)	(1,723)
USD	Trading	1	(302)	83	828	2	612
	Banking	(8)	(34)	(86)	(72)	(133)	(333)
CHF.	Trading	51	89	(56)	3	0	87
	Banking	(2)	(40)	(92)	(21)	(37)	(192)

Currency		Within 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Other	Trading	(762)	196	(44)	735	(15)	110
	Banking	(9)	(68)	(113)	72	(332)	(450)

Currency		Within 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
2005							
ISK	Trading	0	(1)	(1)	(94)	(578)	(674)
	Banking	10	19	2	22	(13,446)	(13,393)
DKK	Trading	162	43	(106)	(865)	(768)	(1,534)
	Banking	(28)	(171)	(367)	(418)	(455)	(1,439)
EUR	Trading	(175)	(156)	(23)	(59)	19	(394)
	Banking	233	358	(25)	261	398	1,225
GBP	Trading	(29)	(33)	(1)	(6)	12	(57)
	Banking	41	251	(146)	(25)	(139)	(18)
USD	Trading	(1)	(33)	(16)	(1)	(1)	(52)
	Banking	39	55	(35)	(123)	(866)	(930)
CHF.	Trading	7	2	(2)	0	0	7
	Banking	4	35	(87)	(6)	18	(36)
Other	Trading	0	(13)	(10)	(57)	29	(51)
	Banking	25	26	(27)	5	40	69

The table shows interest rate risk by currency and maturity in millions of ISK. Risk is measured by assuming a 1% simultaneous upward shift in all yields curves in the relevant maturity band.

Market price risk

105. Market price risk is the risk of loss due to changes in market prices. The Bank's main exposures are through equities and bonds, but the management of currency risk is handled separately. Market price risk is measured with Value-at-Risk, and the total Bank Value at Risk (99%, 10 days) was ISK 5.5 billion (2005 ISK 3.4 billion) at 31 December 2006.

The following table shows the calculated VaR (99% confidence interval 10 day holding period). Results are itemised by type of market risk and market location.

	Iceland	Scandinavia	Other
2006			
Equity risk	989	4,374	10
Interest risk	306	697	
VaR	**1,035**	**4,429**	**10**
Group VaR			**5,476**
2005			
Equity risk	1,571	2,130	5
Interest risk	232	589	
VaR	**1,588**	**2,209**	**5**
Group VaR			**3,446**

The following table shows high, low and average values for the calculated VaR (99% confidence interval 10 day holding period).

2006	High	Low	Average
Equity risk	6,261	2,150	3,637

Interest risk	585	596	814
Overall risk	**6,302**	**2,218**	**3,719**
2005			
Equity risk	4,022	1,146	2,868
Interest risk	809	373	560
Overall risk	**4,004**	**1,273**	**2,922**

Currency risk

Currency risk is the risk of loss due to adverse movements in foreign exchange rates. The Bank is exposed to some foreign exchange risk, in particular regarding the repatriation of non-ISK results. The Bank hedges part of the equity base against adverse movements in foreign exchange rates. Net exposures per currency are monitored centrally in the Bank.

If the ISK exchange rate index depreciated by 25% from its year end 2006 level, then it would affect the equity ratio of the Bank by 0%.

The total amount of assets in foreign currencies in the Bank's Consolidated Financial Statements is ISK 3,437 billion (2005 ISK 2,242 billion), and the total amount of liabilities amounted to ISK 3,048 billion (2005 ISK 2,198 billion), respectively, at year end. Included in these assets and liabilities are forward contracts and interest rate swaps.

106. Breakdown of assets and liabilities by currency:

Assets	**ISK**	**EUR**	**DKK**	**GBP**	**Other**	**Total**
Cash and balances with central banks	964	5,986	34,516	65,007	488	106,961
Loans to credit institutions	31,897	128,141	92,504	129,696	103,096	485,334
Loans to customers	351,196	451,171	582,576	553,032	600,634	2,538,609
Bonds and debt instruments	19,330	73,180	158,251	25,198	42,305	318,264
Shares and equity instruments	54,055	40,409	16,609	10,034	37,913	159,020
Derivatives	14,151	19,899	7,560	5,876	17,968	65,454
Derivatives used for hedging	0	1,836	3,500	0	1,117	6,453
Securities used for hedging	101,279	2,429	2,539	803	8,888	115,938
Investments in associates	2,075	0	1,136	11	2,082	5,304
Intangible assets	6,694	173	32,009	28,551	874	68,301
Investment property	14,551	4,202	9,783	3,048	0	31,584
Property and equipment	5,996	686	651	22,594	539	30,466
Tax assets	0	184	0	3,868	1,782	5,834
Other assets	16,606	5,404	74,336	9,555	11,973	117,874
Total assets	**618,794**	**733,700**	**1,015,970**	**857,273**	**829,659**	**4,055,396**

Liabilities and equity	**ISK**	**EUR**	**DKK**	**GBP**	**Other**	**Total**
Due to credit institutions and central banks	11,533	65,411	2,120	6,755	24,637	110,456
Deposits	185,580	104,291	55,553	276,199	129,035	750,658
Borrowings	111,085	1,238,924	47,695	279,304	722,931	2,399,939
Subordinated loans	14,660	76,478369		6,976	117,547	216,030
Financial liabilities measured at fair value	12,176	7,914	27,068	10,492	13,614	71,264
Tax liabilities	10,161	3,100	5,526	4,199	223	23,209
Other liabilities	13,736	17,082	68,597	22,682	26,851	148,948
Equity and minority interest	324,093	10,774	0	25	0	334,892
Total liabilities and equity	**683,024**	**1,523,974**	**206,928**	**606,632**	**1,034,838**	**4,055,396**
Net on-Balance Sheet position	**(64,230)**	**(790,274)**	**809,042**	**250,641**	**(205,179)**	
Net off-Balance Sheet position	**(108,554)**	**843,712**	**(749,479)**	**(206,904)**	**221,225**	
Net position	**(172,784)**	**53,438**	**59,563**	**43,737**	**16,046**	

Operational risk strategy

107. Operational risk is inherent in every activity undertaken within the Bank, in outsourced activities and in all interaction with external parties. The Bank aims to reduce the frequency and impact of operational risk events in a cost-effective manner. The Bank can reduce its exposure to operational risk with selection of internal control and quality management, well educated and qualified staff. The Bank can choose to transfer Operational risk through outsourcing the activity or to transfer the financial consequences through insurance programs.

The Bank should keep firm track of the Operational risk the Bank is exposed to. Measurement should be done through Control and Risk Self Assessment, registration of loss events, near misses and quality deficiencies and through monitoring of potential risk indicators and other early-warning signals. Operational risk can be reduced through staff training, process re-design and enhancement of the control environment.

Risk capital for operational risk is measured as a fixed percentage of gross income for each Business Segment, measured according to the Standardised approach outlined in the Capital Requirements Directive (CRD). The fixed percentage serves as a proxy for the likely scale of operational risk exposure within the business line. The fixed percentage is as follows:

Business lines	
Investment Banking	18%
Trading and sales	18%
Payment and settlement	18%
Corporate Banking	15%
Retail Banking	15%
Agency services	15%
Asset Management	12%
Retail brokerage	12%

The Bank's business segments are mapped onto above business lines.

Liquidity risk strategy

108. Liquidity risk is an unavoidable source of risk in Kaupthing's operations. Liquidity risk is the current or prospective risk that the Bank, though solvent, either does not have sufficient financial resources available to meet its liabilities when they fall due, or can secure them only at excessive cost. Liquidity risk arises from the inability to manage unplanned decreases or changes in funding sources. The funding Liquidity risk limit is quantified by calculating liquidity ratios, including the number of days currently covered by expected cash flow

The Bank calculates the secured liquidity from a pool of secured liquid assets (secured assets are deposits, repo-able bonds, the securitisation pipeline, and unused revolvers with maturity above 360 days and no MAC clauses) against future liabilities. With the secured liquidity, the Bank has to be able to serve and repay all maturing debts for 360 days without any access to capital markets. Each of the subsidiaries quantifies the secured liquidity in the same way as the secured liquidity is consolidated on a Group level.

At year end, the number of days covered by the secured liquidity was 427.

Liquidity of Kaupthing Bank:	**Up to 1 month**	**1-3 month**	**3-6 months**	**6-12 months**	**12-18 months**	**18-24 months**
Secured liquidity	856,000	573,000	360,000	121,000	(136,000)	(237,000)

109. The breakdown by contractual maturity of assets and liabilities:

Assets	**On demand**	**Up to 3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**Total**
Cash and balances with central banks	106,961	0	0	0	0	106,961
Loans to credit institutions	87,284	320,642	23,672	47,597	6,139	485,334
Loans to customers	202,564	437,861	326,551	796,445	775,188	2,538,609
Bonds and debt instruments	1,097	53,114	4,861	157,506	101,686	318,264

Shares and equity instruments	88,944	69,912	0	164	0	159,020
Derivatives	4	18,517	12,190	25,176	9,567	65,454
Derivatives used for hedging	0	623	146	1,185	4,499	6,453
Securities used for hedging	115,938	0	0	0	0	115,938
Investments in associates	0	0	0	0	5,304	5,304
Intangible assets	0	0	0	0	68,301	68,301
Investment property	0	0	0	0	31,584	31,584
Property and equipment	0	0	0	0	30,466	30,466
Tax assets	0	0	26	5,808	0	5,834
Other assets	0	0	117,874	0	0	117,874
Assets 31.12.2006	**602,792**	**900,669**	**485,320**	**1,033,881**	**1,032,734**	**4,055,396**
Assets 31.12.2005	484,756	575,861	210,311	602,215	667,668	2,540,811

Liabilities	**On demand**	**Up to 3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**Total**
Due to credit institutions and central banks	10,384	90,269	4,045	3,605	2,153	110,456
Deposits	226,966	409,317	86,755	21,459	6,161	750,658
Borrowings	3,569	489,330	442,860	1,105,436	358,744	2,399,939
Subordinated loans	0	0	0	3,437	212,593	216,030
Financial liabilities measured at fair value	3,503	15,658	7,684	32,277	12,142	71,264
Tax liabilities	0	0	10,180	13,029	0	23,209
Other liabilities	91,661	0	57,287	0	0	148,948
Liabilities 31.12.2006	**336,083**	**1,004,574**	**608,811**	**1,179,243**	**591,793**	**3,720,504**
Liabilities 31.12.2005	189,965	616,536	294,778	936,184	300,836	2,338,299
Assets - liabilities 31.12.2006	266,709	(103,905)	(123,491)	(145,362)	440,941	334,892
Assets - liabilities 31.12.2005	294,791	(40,675)	(84,467)	(333,969)	366,832	202,512

Fair value of financial instruments

110. The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties, i.e. not during a forced sale or liquidation. The existence of published price quotations in an active market is the best evidence of fair value and when they exist they are used by the Bank to measure financial assets and financial liabilities. If quoted prices for a financial instrument fail to represent actual and regularly occurring transactions in active market transactions or if quoted prices are not available at all, fair value is established by using an appropriate valuation technique.

The following table presents the fair value of financial instruments, including those not reflected in the Financial Statements at fair value. It is accompanied by a discussion of the methods used to determine fair value for financial instruments.

Assets	**Carrying value 2006**	**Fair value 2006**	**Unrealised gain (loss) 2006**
Cash and balances with central banks	106,961	106,961	0
Loans	3,023,943	3,028,923	4,980
Financial assets measured at fair value	664,965	664,965	0
Financial assets available-for-sale	164	164	0
Liabilities			
Due to credit institutions and central banks	110,456	110,456	0
Deposits	750,658	750,292	366
Borrowings	2,399,939	2,397,319	2,620
Subordinated loans	216,030	217,850	(1,820)
Financial liabilities measured at fair value	71,264	71,264	0

Net unrealised gains not recognised in the Income Statement	**6,146**

Methods for establishing fair value

a) Fair value established from quoted market prices

The best evidence of the fair value of a financial instrument at initial recognition is the transaction price, unless the fair value can be evidenced by comparison with other observable current market transactions, or is based on a valuation technique whose variables include only data from observable markets.

In some cases, the carrying value of the financial instrument is, as in note 65, used as an approximation for the fair value of the instrument. This is straight forward for cash and cash equivalents but is also used for short-term investments and borrowings to highly rated counterparties, such as credit institutions, on contracts that carry interests close to or equal to market rates and expose the Bank to little or no credit risk.

For listed and liquid stocks and bonds, certain financial derivatives and other market traded securities, such as commodities, the fair value is derived directly from the market prices. These instruments are disclosed in following Balance Sheet items, Trading assets and Trading liabilities.

For financial instruments, for which the market is not active, the Bank applies specific working procedures and valuation techniques to attain a fair value using as much market information as available. Valuation techniques include using recent arm's length market transactions between knowledgeable, willing parties, if available, reference to the current fair value of another instrument that is substantially the same, discounted cash flow analysis, option pricing models or other commonly accepted valuations techniques used by market participants to price the instrument.

b) Fair value established using valuation techniques

For financial instruments for which quoted prices on active markets are not available, the fair values are derived using various valuation techniques. This applies in particular to OTC-derivatives such as options, swaps, futures and unlisted equities but also some other assets and liabilities.

In most cases, the valuations are based on theoretical financial models, such as the Black-Scholes models or variations thereof. These techniques also include forward pricing and swap models using present value calculations.

Furthermore, in many cases there is little or no market data to rely on for fair value calculations. The most common valuation technique is present value calculations. Such calculations involve the estimation of future cash flow and the assessment of appropriate discount rate. The discount rate should both reflect current market rates and the uncertainty in the future cash flow. In such cases internal models and methods are used to calculate the fair value. The models may be statistical in nature, based on internal or external history of financial instruments with similar characteristics and/or based on internal knowledge and experience. For example, the credit margin on most loans to customers - which is added to the current and suitable interest rate to arrive at an appropriate discount rate - is estimated using credit rating and loss parameters in case of default that have been derived from internal models.

Equity instruments that do not have a quoted market price are evaluated using methods and guidelines from pertinent international organisations. In most cases, intrinsic value is the basis for the assessment but other factors, such as cash flow analysis, can also modify the results.

The fair value for deposits with stated maturities was calculated by discounting estimated cash flows using current market rates for similar maturities. For deposits that can be withdrawn immediately, the fair value is the amount payable on demand, which is equal to the carrying amount in the Balance Sheet.

Although the Bank follows market standards and relies on well accepted methods, there is still wide room for choice, both in the models themselves and the assumptions that must be supplied and cannot be derived from market data. Consequently, different assumptions and choices could lead to different estimates.

INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Shareholders of Kaupthing Bank hf..

We have audited the accompanying Consolidated Balance Sheet of Kaupthing Bank hf.. "the Bank" as of 31 December 2005 and the related Consolidated Income Statement, changes in equity and Cash flows for the year then ended. These Consolidated Financial Statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these Financial Statements based on our audit.

We conducted our audit in accordance with International Standards on Auditing. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the Financial Statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the Financial Statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall Financial Statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the Consolidated Financial Statements give a true and fair view of the financial position of the Bank as of 31 December 2005 and of the results of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU.

Reykjavik, 25 January 2006

Sigurdur Jonsson

Reynir Stefan Gylfason

KPMG Endurskodun hf..

CONSOLIDATED INCOME STATEMENT FOR THE YEAR 2005

	2005	2004	Notes
Interest income	100,009	40,074	
Interest expenses	(67,299)	(21,815)	
Net interest income	**32,710**	**18,259**	38
Fee and commission income	23,508	15,481	
Fee and commission expenses	(1,080)	(2,173)	
Net fee and commission income	**22,428**	**13,308**	39
Dividend income	1,808	3,972	40
Net gain on financial assets / liabilities not at fair value	147	492	41
Net gain on financial assets / liabilities at fair value	33,920	12,755	42-46
Net foreign exchange difference	1,407	(892)	
Share of profit of associates	1,396	240	72
Other operating income	8,069	1,834	47
Net operating income	**101,884**	**49,968**	
Salaries and related expenses	(20,317)	(12,851)	49
Administration expenses	(11,594)	(9,428)	
Depreciation and amortisation	(2,818)	(1,347)	77-78
Impairment on loans and advances	(2,450)	(3,825)	52
Impairment on other assets	(1,939)	0	52
Net loss on non-current assets held for sale	(483)	(22)	
Profit before income tax	**62,284**	**(22,495**	
Income tax	(11,228)	(4,236)	53
Net earnings	**51,056**	**18,259**	
Attributable to:			
Shareholders of Kaupthing Bank hf	49,260	17,707	
Minority interest	1,796	552	
	51,056	**18,259**	
Earnings per share	75.2	35.6	54
Diluted earnings per share	73.9	35.1	54

CONSOLIDATED BALANCE SHEET AS AT 31 DECEMBER 2005

	31.12.2005	1.1.2005	Notes
ASSETS			
Cash and cash balances with central banks	34,877	6,290	55
Loans and advances	1,739,294	1,154,416	56-63
Financial assets measured at fair value	612,366	304,454	64-70
Financial assets available-for-sale	167	1,507	71
Investments in associates	13,888	3,649	72
Intangible assets	54,943	35,098	73-74
Investment property	24,156	19,155	75-76
Property and equipment	22,433	6,092	77-78
Tax assets	5,004	1,092	92-94
Non-current assets and disposal groups classified as held-for-sale	2,302	3,631	80
Other assets	31,380	19,069	81
TOTAL ASSETS	**2,540,811**	**1,554,453**	
LIABILITIES			
Deposits from credit institutions and central banks	69,643	32,488	83
Other deposits	486,176	202,193	84
Borrowings	1,556,567	968,512	85-86
Subordinated loans	102,688	57,623	87
Financial liabilities measured at fair value	60,273	68,011	88-90
Provisions	3,271	0	91
Tax liabilities	18,458	4,408	92-94
Liabilities included in disposal groups classified as held-for-sale	1,161	1,402	95
Other liabilities	40,062	60,907	96-97
TOTAL LIABILITIES	**2,338,299**	**1,395,544**	
EQUITY			
Share capital	6,638	6,521	
Share premium	114,606	110,559	
Reserves	(1,540)	(670)	
Retained earnings	74,479	32,960	
TOTAL SHAREHOLDERS' EQUITY	**194,183**	**149,370**	98-101
Minority interest	8,329	9,539	
TOTAL EQUITY	**202,512**	**158,909**	
TOTAL LIABILITIES AND EQUITY	**2,540,811**	**1,554,453**	
Off Balance Sheet Items:			
Obligations			103-105

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR 2005

	Shareholders' equity					
	Share Capital and premium	**Reserves**	**Retained earnings**	**Total**	**Minority interest**	**Total equity**
Changes in equity in 2004:						
Equity 1 January 2004	28,004		17,925	45,929		45,929
Changes due to IFRS			(271)	(271)	8,991	8,720
Equity 1 January 2004, adjusted	28,004	0	17,654	45,658	8,991	54,649
Translation difference		(670)		(670)		(670)
Net earnings not posted in Income Statement.		(670)		(670)		(670)
Net earnings for the year			17,707	17,707	552	18,259
Total earnings for the year		**(670)**	**17,707**	**17,037**	**552**	**17,589**
Dividends paid			1,322)	(1,322)		(1,322)
Issued new shares	92,443			92,443		92,443
Purchases and sales of treasury stock	(3,208)			(3,208)		(3,208)
Exercised stock options	(159)			(159)		(159)
Equity 31 December 2004	**117,080**	**(670)**	**34,039**	**150,449**	**9,543**	**159,992**
Changes in equity in 2005:						
Equity 31 December 2004	117,080	(670)	34,039	150,449	(9,543)	(159,992
Changes due to IFRS			(1,079)	(1,079)	(4)	(1,083)
Equity 1 January 2005, adjusted	**117,080**	**(670)**	**32,960**	**149,370**	**9,539**	**158,909**
Translation difference		(388)		(388)		(388)
Fair value changes in AF5 financial assets		(2)		(2)		(2)
Deferred pension liability		(480)		(480)		(480)
Net earnings not posted in Income Statement.		(870)		(870)		(870)
Net earnings for the year			49,260	49,260	1,796	51,056
Total earnings for the year		**(870)**	**49,260**	**48,390**	**1,796**	**50,186**
Dividends paid			(3,298)	(3,298)		(3,298)
Purchases and sales of treasury stock	3,706			3,706		3,706
Restating the initial investments in shares			(4,886)	(4,886)		(4,886)
Changes in minority interest				0	(3,006)	(3,006)
Exercised stock options	458			458		458
Other reserves			443	443		443
Equity 31 December 2005	**121,244**	**(1,540)**	**74,479**	**194,183**	**8,329**	**202,512**

CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR 2005

	2005	2004
Operating activities:		
Net earnings before income tax	62,284	22,495
Adjustments to reconcile net earnings to cash flow from (used in) operating activities:		
Non-cash items included in net profit and other adjustments	4,936	5,762
Operating assets and liabilities, changes	23,234	(30,118)
Income taxes paid	(1,455)	(481)
Net cash provided by (used in) operating activities	**88,999**	**(2,342)**
Investing activities:		
Investment in associated companies	(1,805)	(546)
Dividend received from associated companies	102	268
Payment for acquisition of subsidiaries (less cash acquired)	(60,356)	(87,899)
Net cash inflow from disposal of subsidiaries	6,111	1,448
Purchase of intangible assets	(2, 884)	0
Purchase of investment properties	(4,839)	(2,852)
Proceeds from sale of investment properties	208	0
Purchase of property and equipment	(4,965)	(2,741)
Proceeds from sale of property and equipment	1,452	1,466
Other changes	(4,855)	(2,179)
Cash used in investing activities	**(71,831)**	**(93,035)**
Financing activities:		
Subordinated loan capital issued	42,731	20,930
Subordinated loan capital repaid	(3,524)	(1,688)
Sales (purchases) of own shares to meet share awards and share option awards	3,706	(3,208)
Proceeds from the issue of shares	0	92,443
Dividends paid	(3,298)	(1,322)
Cash from financing activities	**39,615**	**107,155**
Increase in cash and cash equivalents	56,783	11,778
Effect of exchange rate changes on cash and cash equivalents	(2,010)	(330)
Cash and cash equivalents at beginning of the year	26,985	15,537
Cash and cash equivalents at year-end	**81,758**	**26,985**
Additional information:		
Paid and total purchase price of subsidiaries	63,708	89,035
Received and total sale price of subsidiaries	6,111	1,448

CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR 2005 - SPECIFICATION

	2005	2004
Non-cash items in the Income Statement and other adjustments:		
Impairment on loans and advances	2,450	3,825
Depreciation of property and equipment	2,437	1,142
Impairment on property and equipment	1,150	0
Amortisation of intangible assets	864	205
Impairment on goodwill	1,521	0
Net earnings of associated companies	(1,396)	240)
Investment properties, fair value change	(365)	0
Indexation and exchange rate difference	1,243	1,172
Net gain on disposal on property and equipment	(248)	222)
Net gain on a disposal of a subsidiary	(3,093)	142)
Share based payment expenses	42	0
Changes in other non cash items	331	22
	4,936	**5,762**
Changes in operating assets and liabilities:		
Loans and advances, changes	(394,644)	(81,642)
Financial assets measured at fair value, change	68,042)	49,659)
Financial assets available for sale, change	118,012)	786)
Tax assets, change	(1,276)	220
Other assets, changes	(10,096)	643
Deposits, changes	233,892	13,535
Borrowings, changes	421,593	84,672
Financial liabilities, measured at fair value, changes	(14,988)	4,744
Provisions, change	3,271	0
Tax liabilities, change	(1,422)	3,515)
Other liabilities, changes	(27,042)	1,670
	23,234	**(30,118)**

Cash and cash equivalents at year-end:	**2005**	**2004**	**2003**
Cash in hand and demand deposits	16,828	764	763
Due from credit institutions	64,930	26,221	14,774
Cash and cash equivalents at year-end	**81,758**	**26,985**	**15,537**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

ACCOUNTING POLICIES

General information

Kaupthing Bank hf.. is a company incorporated and domiciled in Iceland. The Consolidated Financial Statements for the year 2005 comprise Kaupthing Bank hf.. (the parent) and its subsidiaries (together referred to as "the Bank").

The Consolidated Financial Statements are presented in Icelandic krona (ISK), rounded to the nearest million.

The Financial Statements were authorised for issue by the Board of Directors of Kaupthing Bank hf.. on 25 January 2006.

Summary of significant accounting policies

1. Statement of compliance

The Consolidated Financial Statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU. These are the Bank's first IFRS annual Consolidated Financial Statements and IFRS 1 First-time Adoption of International Financial Reporting Standards has been applied.

An explanation of how the transition to IFRS has affected the reported financial position and financial performance of the Bank is provided in note 123. This note includes reconciliations of equity and profit or loss for comparative periods reported under Icelandic GAAP (previous GAAP to those reported under IFRS).

The amendments made in June 2005 to IAS 39, IAS 32 and IFRS 1 relating to the fair value option have been adopted in the Consolidated Financial Statements before their effective date. The effect on the Income Statement and equity of adopting these amendments is disclosed in note 123.

2. Basis of preparation

The Consolidated Financial Statements are prepared on the historical cost basis except the following assets and liabilities that are stated at their fair value, derivative financial instruments, financial instruments held for trading, financial instruments designated at fair value through profit and loss, financial instruments classified as available-for-sale and investment properties.

Non-current assets and disposal groups held for sale are stated at the lower of carrying amount and fair value less costs to sell, unless IFRS 5 requires that another measurement basis shall be used.

The preparation of the Financial Statements in conformity with IFRS requires management to make judgements, estimates and assumptions. These judgements, estimates and assumptions affect the reported amounts of assets and liabilities, as well as income and expenses in the Financial Statement presented. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual outcome can later to some extent differ from the estimates and the assumptions made.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

Judgements made by management in the application of IFRS that have significant effect on the Financial Statements and estimates with a significant risk of material adjustment in the next year are discussed in note 33.

Transition to IFRS

The preparation of the Consolidated Financial Statements in accordance with IFRS resulted in changes to the accounting policies as compared with the most recent annual Financial Statements prepared under previous GAAP. The accounting policies set out below have been applied consistently to all periods presented in these Consolidated Financial Statements except for IAS 32 and IAS 39 as explained hereafter. They have also been applied in preparing an opening IFRS Balance Sheet at 1 January 2004 for the purposes of the transition to IFRS, as required by IFRS 1, except for IAS 32 and IAS 39 as explained hereafter.

The Bank has decided to make use of the exemption provided in IFRS 1 First-time Adoption of International Financial Reporting Standards, regarding restatement of comparative information and did not restate comparative information for the year 2004 so as to comply with IAS 32 Financial Instruments. Disclosure and Presentation and IAS 39 Financial Instruments Recognition and Measurement.

Instead, the Bank applied its previous GAAP in the comparative information to financial instruments within the scope of IAS 32 and IAS 39, except for comparative amounts presented in the Balance Sheet, which are the amounts reported under previous GAAP as of 31 December 2004, adjusted for the adoption of IAS 32 and IAS 39 on 1 January 2005 as explained in note 123.

The Bank has decided to take the following exemptions affecting comparative financial data.

(i) *Business combinations*

The Bank has decided not to restate business combinations that took place prior to the 1 January 2004 transition date.

(ii) *Fair value or revaluation as deemed cost*

The Bank decided to measure individual items of property at fair value at the date of transition to IFRS and use that fair value as deemed cost at that date.

(iii) Cumulative translation differences

The accounting policies have been applied consistently throughout the Bank for purposes of these Consolidated Financial Statements.

3. Basis of consolidation

a) *Subsidiaries*

Subsidiaries are entities controlled by the Bank. Control exists when the Bank has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Control usually exists when the Bank holds more than 50% of the voting power of the subsidiary. In assessing control, potential voting rights that are currently exercisable or convertible, if any, are taken into account. The Financial Statements of subsidiaries are included in the Consolidated Financial Statements from the date that control commences until the date that control ceases.

The purchase method of accounting is used to account for the acquisition of subsidiaries by the Bank. The cost of an acquisition is measured as the fair value, at the date of exchange, of the assets given, liabilities incurred or assumed and equity instruments issued, plus cost directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Bank's share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the Income Statement.

b) *Associates*

Associates are those entities over which the Bank has significant influence, i.e. the power to participate in the financial and operating policy decisions of the associates, but not control or joint control over those policies. Significant influence generally exists when the Bank holds between 20% and 50% of the voting power, including potential voting rights, if any. Investments in associates are initially recognised at cost. The Bank's investment in associates includes goodwill (net of any accumulated impairment loss) identified on acquisition (see note 29).

Investments in associates held as venture capital in Investment Banking are not accounted for on an equity basis but are designated upon initial recognition as financial assets at fair value through profit or loss and accounted for in accordance with IAS 39 Financial Instruments Recognition and Measurement (see note 72).

The Consolidated Financial Statements include the Bank's share of the total recognised gains and losses of associates on an equity accounted basis, from the date that significant influence commences until the date that significant influence ceases. When the Bank's share of loss exceeds its interest in an associate, the Bank's carrying amount is reduced to zero and recognition of further losses is discontinued except to the extent that the Bank has incurred legal or constructive obligations or made payments on behalf of the associate. If the associate subsequently reports profits, the investor resumes recognising its share of those profits only after its share of the profits equals the share of losses not recognised.

If an investment in an associate is classified as held for sale the equity method is no longer applied and the investment is accounted for under IFRS 5 Non-current Assets Held for Sale and Discontinued Operations (see note 18).

c) *Transactions eliminated on consolidation*

Intrabank balances, unrealised gains and losses or income and expenses arising from intrabank transactions, are eliminated in the Consolidated Financial Statements. Unrealised gains arising from transactions with associates and jointly controlled entities are eliminated to the extent of the Bank's interest in the entity. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

4. Foreign currency

a) *Functional currencies*

Items included in the Financial Statements of each of the Bank's entities are measured using the functional currency of the respective entity.

b) *Foreign currency translations*

Transactions in foreign currencies are translated into functional currencies at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the Balance Sheet date are translated into functional currencies at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the Income Statement in a separate line. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated at foreign exchange rates ruling at the dates the fair value was determined.

c) *Financial Statements of foreign operations*

The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on consolidation, are translated to the presentation currency, Icelandic krona, at foreign exchange rates current at the Balance Sheet date. The revenues and expenses of foreign operations are translated to Icelandic kronas at rates approximating the foreign exchange rates current at the dates of the transactions. Foreign exchange differences arising on translation are recognised directly in a separate component of equity.

5. Derivatives

A derivative is a financial instrument or other contract within the scope of IA5 39, the value of which changes in response to a change in an underlying variable (such as share, commodity or bond prices, an index value or an exchange or interest rate), which requires no initial net investment, or initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors and which is settled at a future date.

The Bank uses derivatives for trading purposes and to hedge its exposure to market price risk, foreign exchange and interest rate risk arising from operating, financing and investing activities.

Derivatives are recognised at fair value. Fair value changes are recognised in the Income Statement, except in the case of derivatives that are designated and are effective hedging instruments, whose fair value changes are recognised in accordance with the accounting policies in note 6. Fair values of derivatives are split into (i) interest income (see note 38), (ii) foreign exchange differences (see note 43) and other gains and losses (note 44). Interest income is recognised on accrual basis. Derivatives with positive fair values are recognised as trading assets and derivatives with negative fair values are recognised as trading liabilities (see notes 65 and 89).

Derivatives embedded in host contracts are treated as separate derivatives when their economic characteristics and risks are not closely related to those of the host contract and the host contract is not carried at fair value through profit and loss. These embedded derivatives are measured at fair value with changes in fair value recognised in the Income Statement. They are presented in the Balance Sheet in the same line as the host contracts.

The fair value of derivatives is determined in accordance with the accounting policy presented in note 8.

6. Hedging

Due to the Bank's risk positions and funding structure, its risk management policies require that the Bank should minimise its exposure to changes in foreign currency rates and manage interest rate, credit risk and market price risk exposure within certain guidelines (see also separate section on risk management). The Bank uses both derivative and non-derivative financial instruments to manage the potential earnings impact of these risks.

Several types of derivatives are used for this purpose, including interest rate swaps and currency swaps, options, financial futures, forward contracts and other derivatives. The purpose of the Bank's hedging activities is to protect the Bank from the risk that the net cash inflows will be adversely affected by changes in interest or exchange rates, credit ratings or market prices. The Bank enters into transactions to ensure that it is economically hedged in accordance with risk management policies. For qualifying hedge relationships, the Bank uses hedge accounting.

Each qualifying hedge relationship is evidenced and driven by management's approach to risk management and the decision to hedge the particular risk. Where hedge accounting is applied the Bank assesses, both at the inception of the hedge and each time the Bank prepares its annual or Financial Statements, whether the derivatives used as hedges are highly effective in offsetting the changes in value or cash flows associated with the hedged items. A hedge is normally regarded as highly effective if the changes in fair value or cash flows of the hedged item are expected to almost fully offset the changes in fair value or cash flows of the hedging instrument. Actual effectiveness results must be within a range of 80 to 125 percent on a cumulative basis. The designation and effectiveness measurement follows the methodologies that management has in place for risk identification and measurement. The ineffective portion of any gain or loss on a hedging instrument is recognised in the Income Statement.

The Bank's risk management activities concentrate on hedging the Bank's net exposure based on its asset and liability positions. Therefore the Bank monitors its interest rate risk exposures by reviewing the net asset or liability gaps within repricing bands. For hedge accounting purposes, the Bank designates the benchmark interest rate exposure of a portion of the underlying gross exposure as the hedged item and the hedge relationship is viewed at a micro level, considering only the relationship between the hedged item and the hedging instrument.

Where the Bank hedges a portfolio of loans in respect of interest rate risk it groups the loans into homogenous layers, each with specific maturities.

The Bank designates hedge relationships only for fair value hedge accounting and net investments in foreign operations.

a) *Fair value hedges*

Fair value hedges seek to eliminate risks of changes in the fair value of a recognised asset or liability that will give rise to a gain or loss that will be recognised in the Income Statement.

When a derivative hedges the changes in fair value of recognised assets or liabilities or an identified portion of such assets or liabilities, any gain or loss on the hedging instrument is recognised in the Income Statement. The hedged items are also stated at fair value in respect of the risk being hedged, with any gain or loss being recognised in the Income Statement. The gains and losses on the hedging instruments and hedge items are presented together in the Income Statement as Net *gain* on financial assets at fair value.

b) *Hedges of net investments in foreign operations*

Hedges of net investments in foreign operations seek to eliminate the exposure to foreign currency risks of the net investments.

Exchange differences arising from the translation of the net investment in foreign operations and of related hedges are taken to Translations reserve in equity. The portion of the gain or loss on an instrument used to hedge a net investment in a foreign operation that is determined to be an effective hedge is recognised directly in equity. The ineffective portion is recognised immediately in the Income Statement. They are recycled and recognised in Income Statement upon disposal of the operation. In respect of all foreign operations, any differences that have arisen before 1 January 2004, the date of transition to IFRS, are presented as retained earnings in the equity statement.

7. Loans and advances

Loans and advances are non-derivative financial instruments with fixed or determinable payments that are not quoted in an active market, other than those that the Bank upon initial recognition designates as at fair value through profit or loss. Loans and advances include loans provided by the Bank to its customers, participation in loans from other lenders and purchased loans that are not quoted in an active market and which the Bank has no intention of selling immediately or in the near future.

Loans and advances are initially reported at disbursement of the loan. They are initially recognised at fair value, which is the cash given to originate the loan, including any transaction costs, and are subsequently measured at amortised cost using the effective interest method. Accrued interest is included in the carrying amount of the loans and advances.

8. Financial assets measured at fair value through profit and loss

a) *Trading assets*

Trading assets are financial instruments acquired principally for the purpose of generating profits from short-term price fluctuations or from a dealer's margin.

b) *Financial assets designated at fair value through profit or loss*

The Bank classifies certain financial assets upon their initial recognition as financial assets held at fair value with fair value changes recognised in the Income Statement if doing so results in more relevant information because:

i) it eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases; or
ii) financial assets and/or financial liabilities are managed and their performance is evaluated on a fair value basis, in accordance with the Bank's risk management or investment strategy, and information about it is provided internally on that basis to the Bank's key management personnel.

When the Bank becomes a party to instruments containing embedded derivatives which meet specific conditions, the Bank classifies the instruments into this category in order to avoid the complexity of applying the rules on separation and accounting for the embedded derivatives.

The assets classified according to the above-mentioned conditions consist of:

i) fixed interest rate loans originated by the Bank whose fixed interest has been changed into floating by entering into corresponding interest rate swaps,
ii) equity and debt instruments which are acquired by the Bank with a view to profiting from their total return and which are managed and evaluated on a fair value basis, including equity instruments held by the venture capital organisation of the Bank which give the Bank significant influence over the issuer but not control (see note 3a) and 3b)),
iii) structured products that contain embedded derivatives,
iv) mortgage loans originated by the Bank's subsidiary in Denmark. These are financial assets that are granted by the Bank by providing money directly to a debtor. They are initially recorded at fair value, which is the cash given to originate the loan and are subsequently measured at fair value. The fair value of mortgage loans is based on the fair value of the underlying mortgage bonds.

Financial assets designated at fair value through profit or loss are measured at fair value and changes in their fair value are recognised in the Income Statement as Net gain on financial assets at fair value. Interest and dividend income that arises from these assets are included in Interest income and Dividend income, respectively. Interest income on debt instruments is calculated using the effective interest rate method.

9. Financial assets available-for-sale

Financial assets available-for-sale consist of unlisted equity instruments held for long time investment purposes.

Financial assets available-for-sale are recognised at fair value. Unrealised gains or losses on available-for-sale investments are recognised in equity, net of income taxes, until such investments are disposed of or until they are determined to be impaired. On disposal of an available-for-sale investment, the accumulated unrealised gain or loss included in equity is transferred to the Income Statement and recognised as Other operating income. Gains and losses on disposal are determined using the average cost method.

Dividend income on available-for-sale financial assets are included in Dividend income in the Income Statement. Exchange rate differences arising on equity instruments are recognised in equity.

10. Determination of fair value

The determination of fair value of financial assets and financial liabilities that are quoted in an active market is based on quoted prices. For all other financial instruments fair value is determined by using valuation techniques. A market is considered active if quoted prices are readily and regularly available and those prices represent actual and regularly occurring market transactions on an arm's length basis. Further information on determination of fair value on financial instruments is contained in note 121.

Valuation techniques include recent arm's length transactions between knowledgeable, willing parties, if available, reference to the current fair value of other instruments that are substantially the same, the discounted cash flow analysis and option pricing models. Valuation techniques incorporate all factors that market participants would consider in setting a price and are consistent with accepted methodologies for pricing financial instruments. Periodically, the Bank calibrates the valuation technique and tests it for validity using prices from any observable current market transactions in the same instrument, without modification or repackaging, or based on any available observable market data.

The best evidence of the fair value of a derivative at initial recognition is the transaction price (i.e. the fair value of the consideration given or received) unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument (i.e. without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets. When such evidence exists, the Bank recognises profits on day one.

11. Recognition and derecognition of financial assets and financial liabilities

Purchases and sales of financial assets are recognised using trade date accounting, i.e. they are recognised on the date on which the Bank commits to purchase or sell the asset, except for loans which are recognised when cash is advanced to the borrowers.

Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the Bank has transferred substantially all risks and rewards of ownership.

Financial liabilities are recognised when the Bank becomes a party to the contractual provisions of the liability instrument. Financial liabilities are derecognised when the obligation of the Bank specified in the contract is discharged or cancelled or expires.

For more complex instruments, the Bank uses proprietary models, which usually are developed from recognised valuation models. Some or all of the inputs into these models may not be market observable, and are derived from market prices or rates or estimated based on assumptions. When entering into a transaction, the financial instrument is initially recognised at the transaction price, which is the best indicator of fair value, although the value obtained from the valuation model may differ from the transaction price. This initial difference, usually an increase, in fair value indicated by valuation techniques is recognised in income depending upon the individual facts and circumstances of each transaction and not later than when the market data becomes observable.

The value produced by a model or other valuation technique is adjusted to allow for a number of factors as appropriate, because valuations techniques cannot appropriately reflect all factors market participants take into account when entering into a transaction. Valuation adjustments are recorded to allow for model risks, bid-ask spreads, liquidity risks, as well as other factors. Management believes that these valuation adjustments are necessary and appropriate to fairly state financial instruments carried at fair value on the Balance Sheet.

12. Offsetting financial assets and financial liabilities

Financial assets and liabilities are offset and the net amount reported in the Balance Sheet when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

13. Repurchase agreements

A repurchase agreement involves the sale of securities subject to the simultaneous agreement to repurchase the same securities at a certain later date and at an agreed price. In repurchase agreements, the cash received, including accrued interest, is recognised in the Balance Sheet. The proceeds from the legal sale of these securities are reported as borrowings.

The control of the securities remains with the Bank throughout the entire term of the transaction and the securities continue to be reported in the Bank's Balance Sheet as Financial assets measured at fair value, as appropriate. Interest incurred is recognized as interest expense over the life of each agreement.

14. Leases

The Bank classifies leases based on the extent of the transfer of risks and rewards incidental to ownership of leased assets. A lease is classified as a finance lease if the lessor transfers substantially all the risks and rewards incidental to ownership. A lease is classified as an operating lease if the lessor does not transfer substantially all the risks and rewards incidental to ownership.

a) *Finance leases*

The Bank's receivables from leases classified as finance leases are presented in the Balance Sheet within loans and advances. Finance leases are initially recognised at an amount equal to the net investment in the lease and subsequent lease payments are applied against the gross investment in the lease to reduce both the principal and the unearned finance income.

The Bank recognises its finance income as interest income based on a pattern reflecting a constant periodic rate of return on the Bank's net investment in the finance lease. The interest rate implicit in the lease is defined in such a way that the initial direct costs are included automatically in the finance lease receivable and therefore the initial direct costs are recognised over the lease term.

b) *Operating leases*

Lease payments under operating leases where the Bank is the lessee are recognised as an expense on a straight-line basis over the lease term. Property and equipment which the Bank leases to third party under operating leases are classified in the Balance Sheet as investment property or property and equipment.

15. Intangible assets

a) *Goodwill*

All business combinations after 1 January 2004 are accounted for by applying the purchase method. Goodwill has been recognised on the acquisition of subsidiaries and associates. In respect of business acquisitions that have occurred since 1 January 2004, goodwill represents the difference between the cost of the acquisition and the fair value of the net identifiable assets acquired.

In respect of acquisitions prior to this date, goodwill is included on the basis of its deemed cost, which represents the amount recorded under previous GAAP. The classification and accounting treatment of business combinations that occurred prior to 1 January 2004 has not been reconsidered in preparing the Bank's opening IFRS Balance Sheet at 1 January 2004, see note 123.

Goodwill is stated at cost less any accumulated impairment losses. Goodwill is allocated to cash-generating units and is no longer amortised but is tested annually for impairment, see note 29 b. In respect of associates, the carrying amount of goodwill is included in the carrying amount of the investment in the associate.

b) *Other intangible assets*

Intangible assets other than goodwill that are acquired by the Bank are stated at cost less accumulated amortisation and impairment losses.

Expenditure on internally generated goodwill and brands is recognised in the Income Statement as an expense as incurred.

c) *Subsequent expenditure*

Subsequent expenditure on capitalised intangible assets is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred.

d) *Amortisation*

Amortisation is charged to the Income Statement on a straight-line basis over the estimated useful lives of intangible assets. Goodwill with an indefinite useful life is systematically tested for impairment at each Balance Sheet date. Other intangible assets are amortised from the date they are available for use. The estimated useful lives are as follows:

Software .... 5 years
Customer base .... 10 years

16. Investment property

Investment properties are properties which are held to earn rental income for capital appreciation or both. Investment properties are stated at fair value. The Bank uses internal real estate experts who determine the fair value of investment property by applying recognised valuation techniques. In cases where prices of recent market transactions of comparable properties are available, fair value is determined by reference to these transactions. The fair values are based on market values, being the estimated amount for which a property could be exchanged on the date of valuation between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion.

Properties under an operating lease are classified as an investment property on a property-by-property basis when the Bank holds it to earn rentals or for capital appreciation or both. Any such property interest under an operating lease classified as an investment property is carried at fair value, see note 75.

Any gain or loss arising from a change in fair value is recognised in the Income Statement as Other operating income.

When an item of property and equipment is transferred to investment property following a change in use, any differences arising at the date of transfer between the carrying amount of the time immediately prior to transfer and its fair value is recognised directly in equity if it is a gain. Upon disposal of the item the gain is transferred to retained earnings. Any loss arising in this manner is recognised immediately in profit or loss.

If an investment property becomes owner-occupied it is reclassified as property and equipment and its fair value at the date of reclassification becomes its cost for accounting purposes. When the Bank begins to redevelop an existing investment property for continued future use as investment property, the property remains an investment property, which is measured at fair value, and is not reclassified as property and equipment during redevelopment.

The Bank recognises in the carrying amount of an item of investment property the cost of replacing part of such an item when that cost is incurred if it is probable that the future economic benefits embodied with the item will flow to the Bank and the cost of the item can be measured reliably. The subsequent costs is added to the carrying amount of the investment property if identified component or part of such component, has been replaced or not, or if the nature of the subsequent cost means a contribution of a new component. All other costs are recognised in the Income Statement as an expense as incurred.

17. Property and equipment

a) *Owned assets*

Items of property and equipment are stated at cost less accumulated depreciation and impairment losses, according to the cost model in IAS 16.

Property that is being constructed or developed for future use as investment property is classified as property and equipment and stated at cost until construction or development is complete, at which time it is reclassified as investment property.

Where parts of an item of property and equipment have different useful lives, those components are accounted for as separate items of property and equipment.

b) *Leased assets*

Assets held for leasing under operating lease are recorded as fixed assets. Operating lease rentals receivable are recognised on an accruals basis over the period of the lease. Operating lease assets are depreciated over their useful life on an actuarial basis to their anticipated residual value with a view to ensuring that the overall margin provides a constant periodic return on the net cash investment.

c) *Subsequent costs*

The Bank recognises in the carrying amount of an item of property and equipment the cost of replacing part of such an item when that cost is incurred if it is probable that the future economic benefits embodied with the item will flow to the Bank and the cost of the item can be measured reliably. The decision if subsequent costs are added to the acquisition cost of the property or equipment, is based on whether an identified component, or part of such component, has been replaced or not, or if the nature of the subsequent cost means a contribution of a new component. All other costs are recognised in the Income Statement as an expense as incurred.

d) *Depreciation*

The depreciable amount of property and equipment is determined after deducting its residual value. Depreciation is charged to the Income Statement on a straight-line basis over the estimated useful lives of each part of an item of property and equipment. The estimated useful lives are as follows:

Buildings	25-50 years
Fixtures	5 years
Machinery and equipment	3-5 years
Vehicles	6 years

The residual value is reassessed annually.

18. Non-current assets and disposal groups held for sale

Immediately before classification as held for sale, the measurement of the assets and all assets and liabilities in a disposal group is brought up-to-date in accordance with applicable IFRS. Then, on initial classification as held for sale, non-current assets and disposal groups are recognised at the lower of carrying amount and fair value less costs to sell. Investment Property held for sale is carried at fair value. Impairment losses on initial classification as held for sale are included in the Income Statement, even when there is a revaluation. The same applies to gains and losses on subsequent remeasurement.

Non-current assets and disposal groups held for sale are mainly mortgages foreclosed and disposal entities. Disposal entities are consolidated as "one-line" consolidation.

19. Insurance contracts

Insurance contracts are contracts under which the Bank accepts significant insurance risk from policyholders by agreeing to compensate the policyholders if a specified uncertain future event adversely affects them. The Bank mainly issues insurance contracts from life insurance operations such as life insurance and critical illness. The insurance risk reflects the risk of a policyholder dying or contracting an illness that the insurance covers. These risks are calculated based on mortality rate, frequency of critical diseases and experience.

Contracts that have the legal form of an insurance contract but do not expose the insurer to significant insurance risk, for example life insurance contracts in which the insurer bears no significant mortality risk are classified as investment contracts and are recognised and measured in accordance with IAS 39.

Income due to investment contracts where the policyholder carries the investment risk is recognised as a commission income in the Income Statement.

IFRS 4 Insurance Contracts exempts an insurer temporarily from some requirements of IFRS, including the requirement to consider the Framework in selecting accounting policies for insurance contracts. Accordingly, insurance contracts issued by the Bank and reinsurance contracts that it holds are accounted for in accordance with previous GAAP. However, the Bank does not recognise provisions for possible claims under contracts that are not in existence at the reporting date (such as catastrophe and equalisation provisions). The Bank tests the adequacy of recognised liabilities and it tests reinsurance assets for impairment.

Insurance liabilities in the Balance Sheet comprise premium provision, claim provision and performance-based provision. Premium provision is the part of the premium assumed to insurance risk during the year that belongs to the next reporting year. Claim provision is the total amount of claims existing but not settled plus an actuarial estimate of claims that have occurred but have not been notified. Performance-based provision is the amount that is set aside and used to pay performance-based insurances and discounts.

20. Borrowings

Some of the borrowings of the Bank are classified as other financial liabilities and are initially recognised at fair value less attributable transaction costs. Subsequent to initial recognition, borrowings are measured at amortised cost with any difference between cost and redemption amount being recognised in the Income Statement over the period of the borrowings on an effective interest basis. Accrued interest is included in the carrying amount of the borrowings.

21. Subordinated loans

Subordinated loans are classified as other financial liabilities and consists of liabilities in the form of subordinated loan capital which, in case of the Bank's voluntary or compulsory winding-up, will not be repaid until after the claims of ordinary creditors have been met. In the calculation of the capital ratio, the bonds are included within Tier I and Tier II, as shown in note 100. On the one hand, there are subordinated loans with no maturity date that the Bank may not retire until 2011 and 2014 and then only with the permission of the Financial Supervisory Authority. These loans qualify as Tier I capital in the calculation of the equity ratio. On the other hand, there are subordinated loans with various dates of maturity over the next 10 years.

Subordinated loans are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, subordinated loans are stated at amortised cost with any difference between cost and redemption value being recognised in the Income Statement over the period of the borrowings on an effective interest basis.

22. Financial liabilities measured at fair value

a) *Trading liabilities*

Trading liabilities primarily consist of derivatives with negative fair values and delivery obligations for short sales of securities. Hedging derivatives such as those used for internal risk control but not qualifying for hedge accounting under IAS 39 are also disclosed under this item.

Trading liabilities are measured at fair value. Gains and losses realised on disposal or redemption and unrealised gains and losses from changes in the fair value of trading liabilities are reported as Net gain on financial assets/ liabilities measured at fair value. Interest expenses on trading liabilities are included in Interest expenses.

b) *Financial liabilities designated at fair value through profit or loss*

The Bank classifies certain financial liabilities upon their initial recognition as financial liabilities at fair value with fair value changes recognised in the Income Statement if doing so results in more relevant information because:

i) it eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different base; or
ii) financial assets and/or financial liabilities are managed and their performance is evaluated on a fair value basis, in accordance with the Bank's risk management or investment strategy, and information about it is provided internally on that basis to the Bank's key management personnel.

If the Bank becomes a party to instruments containing embedded derivatives which meet specific conditions, the Bank classifies the instruments into this category in order to avoid the complexity of applying the rules on separation and accounting for the embedded derivatives.

The liabilities classified according to the above-mentioned conditions consist of:

(i) Mortgage bonds issued by the Bank are financial liabilities that are created by the Bank by issuing bonds that correspond to the terms of the underlying mortgage loans.

(ii) Transaction costs related to financial liabilities designated at fair value through profit and loss are disclosed in the Income Statement as Interest expenses.

(iii) Mortgage funding is recognised when cash is advanced to the Bank from issuing bonds. They are initially recorded at fair value, which is the cash received and are subsequently measured at fair value. Fair value of issued mortgage bonds is the current market price. Illiquid mortgage bonds will be carried at a value calculated by discounting cash flows.

(iv) Financial liabilities designated at fair value through profit or loss are measured at fair value and changes in their fair value are recognised in the Income Statement as Net gain on assets/liabilities at fair value. Interest expenses that arise from these liabilities are included in Interest expenses. Interest expenses are calculated using the effective interest method.

23. Provisions

A provision is recognised in the Balance Sheet when the Bank has a present legal or constructive obligation as a result of a past event and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

24. Other assets and other liabilities

Other assets and other liabilities are stated at cost.

25. Stock option contracts

Stock option contracts enable the Bank's employees to acquire shares in the Bank. The purchase price equals the market value or higher of the shares at the grant date. The Bank's cost is evaluated as the time of conclusion according to the Black-Scholes method of evaluating stock option agreements. The cost thus evaluated is expensed during the term of the agreement. It is expensed in the Income Statement and posted separately among equity.

26. Share Capital

a) *Treasury shares*

Acquired own shares and other equity instruments (treasury shares) are deducted from equity. No gain or loss is recognised in Income Statement on the purchase, sale, issue or cancellation of treasury shares. Consideration paid or received is recognised directly in equity.

Incremental transaction costs of treasury share transaction are accounted for as a deduction from equity (net of any related income tax benefit).

When classifying a financial instrument (or component of it) in the Consolidated Financial Statements, all terms and conditions agreed between members of the Bank and the holders of the instrument are considered. To the extent there is an obligation that would give rise to a financial liability, the instrument is classified as financial liability, rather than an equity instrument.

b) Dividend on shares

Dividends on shares are recognised in equity in the period in which they are approved by the Bank's shareholders. Dividends for the year that are declared after the Balance Sheet date are dealt with in the subsequent events note.

27. Cash and cash equivalents

Cash and cash equivalents in the Consolidated Statement of cash flows consist of cash, demand deposits with the central banks and demand deposits with other credit institutions.

28. Income and Expense

a) *Interest income and expense*

Interest income and expense are recognised in the Income Statement as it accrues, taking into account the effective yield of the asset or an applicable floating rate. Interest income and expense includes the amortisation of any discount or premium or other differences between the initial carrying amount of an interest bearing instrument and its amount at maturity calculated on an effective interest rate basis.

The effective interest rate method is a method of calculating the amortised cost of a financial asset or a financial liability (or group of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Bank estimates cash flows, considering all contractual terms of the financial instrument, but does not consider future credit losses. The calculation generally includes all fees and amounts paid or received between parties to the contract that are an integral part of the effective interest rate, as well as transaction costs and all other premiums or discounts.

Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised at the rate of interest used to discount the impairment loss. Interest income on financial assets which have been written down as a result of impairment is calculated based on the net amount of the financial asset taking the write-down into consideration.

b) *Fee and commission income*

The Bank provides various services to its clients and earns income there from, such as income from Investment Banking, Corporate Banking, Capital Markets, Asset Management and Retail Banking. Fees earned from services that are provided over a certain period of time are recognised as the services are provided. Fees earned from transaction-type services are recognised when the service has been completed. Fees that are performance-linked are recognised when the performance criteria are fulfilled.

c) *Dividend income*

Dividend income is recognised in the Income Statement on the date that the dividend is declared. Income from equity investments and other non-fixed income investments is recognised as dividend income when it accrues.

d) *Insurance premium*

Insurance premium represents that part of the premium used to provide insurance coverage in that year, less reinsurers' share.

e) *Insurance claims*

Insurance claims expensed in the Income Statement are claims incurred during the period, plus the increase or decrease due to claims for previous years less reinsurers' share.

29. Impairment

The carrying amount of the Bank's assets, other than tax assets and financial assets measured at fair value with changes recognised in the Income Statement is reviewed at each Balance Sheet date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated, see note 29 d.

An impairment loss is recognised whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. Impairment losses are recognised in the Income Statement.

a) *Impairment on loans and advances*

The Bank recognises losses for impaired loans promptly where there is objective evidence that impairment of a loan or portfolio of loans has occurred. This is done on a consistent basis in accordance with the Bank's guidelines.

There are two basic methods of calculating impairment losses, those calculated on individual loans and those losses assessed on a collective basis. Losses expected as a result of future events, no matter how likely, are not recognised.

Objective evidence of impairment includes observable data about the following loss events:

(i) significant financial difficulty of the borrower;

(ii) a breach of contract, such as a default on installments or on interest or principal payments;

(iii) the Bank granting to the borrower, for economic or legal reasons relating to the borrower's financial difficulty, a refinancing concession, that the lender would not otherwise consider;

(iv) it becomes probable that the borrower will enter bankruptcy or undergo other financial reorganisation;

(v) the disappearance of an active market for that financial asset because of financial difficulties; or

(vi) observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of loans since the initial recognition of those assets, even if the decrease cannot yet be identified with the individual financial assets in the group, including:

- adverse changes in the payment status of borrowers in the group; or
- general national or local economic conditions connected with the assets in the group.

Individually assessed loans

Impairment losses on individually assessed accounts are determined by an evaluation of the exposures on a case-by-case basis. The Bank assesses at each Balance Sheet date whether there is any objective evidence that a loan is impaired. This procedure is applied to all accounts that are considered individually significant. In determining such impairment losses on individually assessed accounts, the following factors are considered:

- the Bank's aggregate exposure to the customer;
- the amount and timing of expected receipts and recoveries;
- the likely dividend available on liquidation or bankruptcy;
- the complexity of determining the aggregate amount and ranking of all creditor claims and the extent to which legal and insurance uncertainties are evident;
- the realisable value of security (or other credit mitigants) and likelihood of successful repossession; and
- the likely deduction of any costs involved in recovery of amounts outstanding.

Impairment loss is calculated by comparing the present value of the expected future cash flows, discounted at the original effective interest rate of the loan, with its current carrying value and the amount of any loss is charged in the Income Statement. The carrying amount of impaired loans is reduced through the use of an allowance account In the case of a loan at variable interest rates, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract.

Collectively assessed loans

Where loans have been individually assessed and no evidence of loss has been identified, these loans are grouped together on the basis of similar credit risk characteristics for the purpose of calculating a collective impairment loss. This loss covers loans that are impaired at the Balance Sheet date but which will not be individually identified as such until some time in the future.

The collective impairment loss is determined after taking into account:

- future cash flows in a group of loans evaluated for impairment are estimated on the basis of the contractual cash flows of the assets;
- historical loss experience in portfolios of similar risk characteristics (for example, by industry sector, loan grade or product);
- the estimated period between a loss occurring and that loss being identified and evidenced by the establishment of an allowance against the loss on an individual loan;
- future cash flows in a group of loans evaluated for impairment are estimated on the basis of the contractual cash; and
- management's experienced judgement as to whether the current economic and credit conditions are such that the actual level of inherent losses is likely to be greater or less than that suggested by historical experience.

The estimated period between a loss occurring and its identification is determined for each identified portfolio.

Estimates of changes in future cash flows for groups of assets should be consistent with changes in observable data from period to period (for example, changes in property prices, payment status, or other factors indicative of changes in the probability of losses on the group and their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Bank to minimise any differences between loss estimates and actual losses.

Loan write-offs

Loans (and the related impairment allowance accounts) are normally written off, either partially or in full, when there is no realistic prospect of recovery of these amounts and, for collateralised loans, when the proceeds from the realisation of security have been received.

Reversals of impairment

If, in a subsequent period, the amount of an impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed. The amount of any reversal is recognised in the Income Statement.

Assets acquired in exchange for loans

Non-financial assets acquired in exchange for loans in order to achieve an orderly realisation are recorded as assets held for sale and reported in the Balance Sheet. The asset acquired is recorded at the lower of its fair value less costs to sell and the carrying amount of the loan, net of impairment allowance amounts, at the date of exchange. No depreciation is provided in respect of assets held for sale. Any subsequent write-down of the acquired asset to fair value less costs to sell is recorded as an impairment loss and included in the Income Statement. Any subsequent increase in the fair value less costs to sell, to the extent this does not exceed the cumulative impairment loss, is recognised in the Income Statement.

b) *Impairment of goodwill*

The Bank assesses whether there is any indication of impairment of goodwill on annual basis, with expert analysis being commissioned if necessary. Goodwill is written down for impairment. Gains or losses realised on the disposal of subsidiaries include any unamortised balance of goodwill relating to the subsidiary disposed of.

c) *Impairment of financial assets available-for-sale*

The Bank determines that available-for-sale equity investments are impaired when there has been a significant or prolonged decline in the fair value below its cost. This determination of what is significant or prolonged requires judgement. In making this judgement, the Bank evaluates among other factors, the normal volatility in share price. In addition, impairment may be appropriate when there is evidence of deterioration in the financial strength of the investee, industry and sector performance, changes in technology, and operational and financing cash flows. The amount of impairment loss is recognised in the Income Statement. Impairment losses are subsequently reversed if the reasons for the impairment loss charged no longer apply.

d) *Calculation of recoverable amount*

The recoverable amount of the Bank's investments in financial assets carried at amortised cost is calculated as the present value of estimated future cash flows, discounted at the original effective interest rate (i.e. the effective interest rate computed at initial recognition of these financial assets).

The recoverable amount of other assets is the greater of their net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

e) *Reversals of impairment*

An impairment loss in respect of financial assets carried at amortised cost is reversed if the subsequent increase in recoverable amount can be related objectively to an event occurring after the impairment loss was recognised.

An impairment loss in respect of an investment in an equity instrument classified as available-for-sale is not reversed through profit or loss. If the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in the Income Statement, the impairment loss shall be reversed, with the amount of the reversal recognised in the Income Statement.

An impairment loss in respect of the goodwill is not reversed.

In respect of other assets, an impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount.

An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

30. Income tax

Income tax on the profit or loss for the period comprises current and deferred tax. Income tax is recognised in the Income Statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the period, using tax rates enacted or substantially enacted at the Balance Sheet date, and any adjustment to tax payable in respect of previous years.

The deferred income tax asset / liability has been calculated and entered in the Balance Sheet. The calculation is based on the difference between Balance Sheet items as presented in the tax return on the one hand, and in the Financial Statements on the other, taking into consideration a carry-forward tax loss. This difference is due to the fact that tax assessments are based on premises that differ from those governing the Financial Statements, mostly because revenues, especially of financial assets, are recognised earlier in the Financial Statements than in the tax return. A calculated tax asset is only offset against income tax liability if they are due to tax assessment from the same tax authorities.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

31. Segment reporting

Business segment is a distinguishable component of the Bank that is engaged either in providing products or services (business segment) which is subject to risks and rewards that are different from those of other segments.

32. Changes within the Bank

In February 2005 the Bank sold all of its shares in the wholly owned subsidiary Lýsing hf.. At the same time it bought back 82.3% of shares in Elk fasteignafelag hf.. that was owned by Lýsing hf.. As a result, Lysing hf.. ceases to be a subsidiary of Kaupthing Bank hf.. from 1 January 2005 and therefore it is not included in the Bank's Consolidated Financial Statements from that date, but Elk fasteignafelag hf.. is still part of the Consolidated Financial Statement of the Bank. The shares were paid for in cash.

In April Kaupthing Bank hf.. announced through a wholly owned subsidiary an offer to acquire the British bank Singer & Friedlander plc. The offer was conditional on, among other things, the approval of the financial supervisory authorities in Iceland, the United Kingdom and the Isle of Man. Such approval was granted in July 2005 and all the conditions for the acquisition had thereby been fulfilled. In July 2005 the Bank announced that it had received valid acceptances of the existing issued share capital in Singer & Friedlander plc.

Changes within the Bank are specified as follows:

	Lysing hf..	**Singer & Friedl. plc**	**Total**
ASSETS:			
Cash and balances with central banks	0	144	144
Loans and advances	(29,385)	202,000	172,615
Financial assets	(121)	120,640	120,519
Investment in associates	(269)	21	(248)
Investment property	(6,807)	9	(6,798)
Property and equipment	(789)	16,286	15,497
Intangible assets	0	3,322	3,322
Tax assets	0	2,636	2,636
Other assets	(274)	2,488	2,214
TOTAL ASSETS	**(37,645)**	**347,546**	**309,901**

LIABILITIES:

	Lysing hf..	Singer & Friedl. plc	Total
Deposits	(368)	87,614	87,246
Borrowings	(32,915)	191,518	158,603
Subordinated loans	(187)	6,769	6,582
Financial liabilities	0	7,250	7,250
Tax liabilities	(646)	3,020	2,374
Other liabilities	(511)	9,794	9,283
TOTAL LIABILITIES	**(34,627)**	**305,965**	**271,338**
Equity at disposal / acquisition	(3,018)	41,581	38,563
Intangible	0	22,127	22,127
Gain on disposal	(3,093)	0	(3,093)
TOTAL (SALE PRICE) / COST OF ACQUISITION	**(6,111)**	**63,708**	**57,597**

Critical accounting estimates and judgements in applying accounting policies

33. The Bank makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

a) *Impairment losses on loans and advances*

The Bank reviews its loan portfolios to assess impairment at least on a quarterly basis. In determining whether an impairment loss should be recorded in the Income Statement, the Bank makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

b) *Fair value of derivatives*

The fair value of financial instruments that are not quoted in active markets are determined by using valuation techniques. Where valuation techniques (for example, models) are used to determine fair values, they are validated and periodically reviewed by qualified personnel independent of the area that created them. All models are certified before they are used, and models are calibrated to ensure that outputs reflect actual data and comparative market prices. To the extent practical, models use only observable data, however areas such as credit risk (both own and counterparty), volatilities and correlations require management to make estimates. Changes in assumptions about these factors could affect reported fair value of financial instruments.

NOTES TO THE INCOME STATEMENT

Segment reporting

34. Segment information is presented in respect of the Bank's business. The primary format, business segments, is based on the Bank's management and internal reporting structure.

Inter-segment pricing is determined on an arm's length basis

Capital Markets is divided into two parts, Capital Markets and Proprietary Trading. Capital Markets handles securities brokerage for the Bank's clients. Proprietary Trading handles transactions for the Bank's own account in all major markets, as well as undertaking the Bank's market making for stocks and bonds.

Investment Banking provides various services to corporate clients through its four main products areas, Merger and Acquisition advisory, capital market transactions, acquisition and leverage finance and principle investment.

Treasury is responsible for inter-bank trading, the Bank's funding, derivatives and foreign exchange trading and brokerage.

Banking provides general banking services to retail customers in Iceland and services such as advice and assistance in financing to medium-sized and large companies, particularly in Iceland, Sweden, the UK and Denmark.

Asset Management and Private Banking manage financial assets for institutional, corporate and private clients' Asset Management is organised into three units, Alternative and Mutual Fund Management, Asset Management for Institutional Investors and Services for Institutional Investors' Private Banking consists of two units, Customer Relations and Portfolio Management.

Cost centres are Overhead, Back office, Risk Management, Finance, Legal department, Information Technology and Human Resources.

35. Summary of the Bank's profit centres' operations

2005	Capital Markets	Investment Banking	Treasury	Banking	Asset Management. and Private Banking	Elimination and cost centres	Total
Net interest income	(1,120)	(2,322)	4,733	32,076	632	(1,289)	32,710
Net fee and commission income	4,730	7,592	1,364	3,165	5,256	322	22,428
Net financial income	16,008	18,416	2,637	232	100	(112)	37,282
Other income	35	163	0	2,739	0	6,047	8,984
Operating income	**19,653**	**23,849**	**8,734**	**38,212**	**5,988**	**4,968**	**101,404**
Operating expenses	(3,113)	(1,808)	(1,481)	(10,011)	(4,186)	(14,131)	(34,731)
Impairment	0	(22)	6	(2,395)	0	(1,978)	(4,389)
Total expenses	**(3,113)**	**(1,830)**	**(1,475)**	**(12,406)**	**(4,186)**	**(16,109)**	**(39,120)**
Gross profit	16,540	22,019	7,259	25,806	1,802	(11,141)	62,284
Allocated cost	(1,751)	(706)	(877)	(5,356)	(1,758)	10,448	0
Profit before income tax	**14,789**	**21,313**	**6,382**	**20,450**	**44**	**(693)**	**62,284**
Net segment revenue from external customers	22,830	25,620	(33,915)	77,801	4,482	4,586	101,404
Net segment revenue from other segments	(3,177)	(1,771)	42,649	(39,589)	1,506	382	0
Operating income	**19,653**	**23,849**	**8,734**	**38,212**	**5,988**	**4,968**	**101,404**
Total assets	70,277	80,433	428,027	1,849,845	1,823	110,406	2,540,811
Depreciation and amortisation	19	22	4	1,475	15	1,283	2,818

2004	Capital Markets	Investment Banking	Treasury	Banking	Asset Management and Private Banking	Elimination and cost centers	Total
Net interest income	(182)	(802)	2,040	17,896	(188)	(505)	18,259
Net fee and commission income	2,808	2,743	1,353	2,883	2,954	567	13,308
Net financial income	6,245	8,449	651	76	0	906	16,326
Other income	0	33	0	61	0	1,958	2,052
Operating income	**8,871**	**10,423**	**4,044**	**20,916**	**2,766**	**2,926**	**49,945**
Operating expenses	(2,483)	(1,150)	(922)	(4,830)	(1,527)	(12,713)	(23,625)
Impairment	0	0	(24)	(3,795)	0	(6)	(3,825)
Total expenses	**(2,483)**	**(1,150)**	**(946)**	**(8,625)**	**(1,527)**	**(12,719)**	**(27,450)**
Gross profit	6,388	9,273)	3,098	12,291	1,239	(9,793)	22,495
Allocated cost	(1,399)	(887	(678)	(3,974)	(1,122)	(8,097)	0
Profit before income tax	**4,989**	**8,386**	**2,420**	**8,317**	**117**	**(17,890)**	**22,495**
Net segment revenue from external customers	11,481	12,092	(7,510)	29,499	1,644	2,740	49,945
Net segment revenue from other segments	(2,610)	(1,669)	11,554	(8,583)	1,122	186	0
Operating income	**8,871**	**10,423**	**4,044**	**20,916**	**2,766**	**2,926**	**49,945**
Total assets	64,667	51,732	223,310	1,151,079	589	63,076	1,554,453
Depreciation and amortisation	29	12	3	223	1	1,079	1,347

Geographic analysis

36. Operating income specified by location of its markets and customers

The geographical analysis of operating income is provided in order to comply with IFRS, and does not reflect the way the Bank is managed.

2005	**Iceland**	**Scandinavia**	**UK**	**Luxembourg**	**Other**	**Total**
Net interest income	10,224	10,642	7,698	3,715	431	32,710
Net fee and commission income	8,859	3,815	6,364	2,896	495	22,428
Net financial income	6,218	10,218	18,015	1,907	925	37,282
Other income	5,253	1,743	1,986	2	0	8,984
Operating income	**30,554**	**26,418**	**34,063**	**8,520**	**1,851**	**101,404**

2004	**Iceland**	**Scandinavia**	**UK**	**Luxembourg**	**Other**	**Total**
Net interest income	7,667	7,368	1,103	1,679	442	18,259
Net fee and commission income	7,184	3,344	1,197	1,411	172	13,308
Net financial income	5,486	2,381	6,214	2,243	2	16,326
Other income	929	646	473	3	1	2,052
Operating income	**21,266**	**13,739**	**8,987**	**5,336**	**617**	**49,945**

Quarterly Statements

37. Summary of the Bank's operating results by quarters:

	2005 Q4	**2005 Q3**	**2005 Q2**	**2005 Q1**	**Total**
Net interest income	9,529	9,487	6,647	7,046	32,710
Net fee and commission income	6,203	6,862	4,930	4,433	22,428
Net financial income	13,960	4,771	11,773	6,777	37,282
Other income..................................	2,855	1,788	771	3,570	8,984
Operating income............................	32,547	22,909	24,120	21,826	101,404
Operating expenses	(11,277)	(9,512)	(7,335)	(6,605)	(34,732)
Impairment.....................................	(1,789)	(928)	(779)	(894)	(4,389)
Profit before income tax..................	19,481	12,469	16,007	14,327	62,284
Income tax......................................	(4,018)	(2,429)	(1,894)	(2,888)	(11,228)
Net earnings..................................	**15,463**	**10,040**	**14,113**	**11,439**	**51,056**
Attributable to					
Shareholders of Kaupthmg Bar.......	14,786	9,707	13,673	11,093	49,260
Minority interest.............................	677	333	440	346	1,796
Net earnings..................................	**15,463**	**10,040**	**14,113**	**11,439**	**51,056**

	2004 Q4	**2004 Q3**	**2004 Q2**	**2004 Q1**	**Total**
Net interest income.........................	6,510	5,118	3,133	3,498	18,259
Net fee and commission income......	5,279	2,196	2,623	3,210	13,308
Net financial income	1,681	7,755	4,215	2,675	16,326
Other income	1,077	249	474	252	2,052
Operating income	14,547	15,318	10,445	9,635	49,945
Operating expenses.........................	(7,443)	(5,921)	(5,315)	(4,945)	(23,625)
Impairment	(1,021)	(555)	1,113)	1,136)	(3,825)
Profit before income tax	6,063	6,842	4,017	3,554	22,495

Income tax	(1,293)	(1,862)	(534)	548)	(4,236)
Net earnings	**4,790**	**6,980**	**3,483**	**3,006**	**18,259**
Attributable to					
Shareholders of Kaupthmg Bank hf.	4,615	6,577	3,488	3,027	17,707
Minority interest	175	403	(5)	(21)	552
Net earnings	**4,790**	**6,980**	**3,483**	**3,006**	**18,259**

Net interest income

38. Interest income and expenses are specified as follows:

	2005	2004
Interest income on cash and balances with central banks	367	1
Interest income on loans and advances	79,297	28,770
Net interest income from assets measured at amortised cost	79,664	28,771
Interest income from trading assets	9,293	5,184
Interest income from assets designated at fair value through profit and loss	5,106	1,272
Interest income from derivatives used for hedging	957	0
Interest income from financial lease	3,375	0
Other interest income	1,614	4,847
Total interest income	**100,009**	**40,074**
Interest expenses on deposits and balances	(18,856)	(8,374)
Interest expenses on borrowings	(37,776)	(10,987)
Interest expenses on subordinated loans	(3,646)	(2,242)
Net interest expenses on liabilities measured at amortised cost	(60,278)	(21,603)
Interest expenses on liabilities designated at fair value through profit and loss	(1,000)	(175)
Interest expenses on derivatives used for hedging	(1,154)	0
Interest expenses on other loans (including financial lease)	(4,708)	0
Other interest expenses	(160)	(37)
Total interest expenses	(67,299)	(21,815)
Net interest income	**32,710**	**18,259**

Net fee and commission income

39. Fee and commission income and expenses are specified as follows:

	2005	2004
Commission from securities trading	8,263	5,266
Commission from derivatives	1,680	1,116
Commission from lending	1,665	1,582
Other commission income	11,900	7,517
Total fee and commission income	**23,508**	**15,481**
Commission expenses on received guarantees	(61)	(100)
Commission expenses - securities trading	(937)	(1,418)
Other commission expenses	(82)	(655)
Total fee and commission expenses	**(1,080)**	**(2,173)**
Net fee and commission income	**22,428**	**13,308**

Dividend income

40. Dividend income are specified as follows:

Dividend income on available-for-sale financial assets	50	77
Dividend income on trading assets	1,723	3,803
Dividend income on assets at fair value through profit and loss	35	92
Total dividend income	1,808	3,972

Net gain on financial assets and liabilities not at fair value

41. Net gain on financial assets and liabilities not at fair value are specified as follows:

Realised gain on loans, advances and finance leases	3	0
Realised gain on available-for-sale assets	138	499
Realised gain on financial liabilities measured at amortised cost	6	0
Total realised gain	147	499
Realised losses on loans, advances and finance leases	0	(7)
Total realised losses	0	(7)
Net gain on financial assets and liabilities not at fair value	147	492

Net gain on financial assets and liabilities at fair value

42. Net gain on financial assets and liabilities at fair value:

	2005	**2004**
Net gain on trading portfolio	14,223	11,219
Net gain on assets designated at fair value through profit and loss	19,226	1,536
Fair value adjustments on hedge accounting	471	0
Net gain on financial assets and liabilities at fair value	33,920	12,755

43. Net gain on trading portfolio are specified as follows:

Gain on equity instruments and related derivatives	12,961	6,861
Gain on interest rate instruments and related derivatives	44	3,335
Gain on foreign exchange trading	751	1,013
Losses on commodities and related derivatives	(44)	0
Gain on credit derivatives	369	10
Gain on other hybrid derivatives	142	0
Net gain on trading portfolio	14,223	11,219

44. Net gain on assets at fair value designated through profit and loss are specified as follows:

Fair value changes on mortgage loans and related bonds issued	13	1,841
Gain (losses) on other assets and liabilities designated at fair value	19,213	(305)
Net gain on assets at fair value through profit and loss	19,226	1,536

45. Fair value changes on mortgage loans and related bonds issued are specified as follows:

Net fair value changes on real credit loans	(328)	1,937
Net fair value changes on mortgage fundings	341	(96)
Fair value changes on mortgage loans and related bonds issued	13	1,841

46. Fair value adjustments in hedge accounting are specified as follows:

Net gain on fair value adjustments in hedge accounting	471	0
Fair value adjustments in hedge accounting	471	0

Other operating income

47. Other operating income is specified as follows:

Gain on disposals of assets other than held for sale	3,896	346
Fair value adjustments on investment properties	400	0
Realised gain on investment properties	67	0
Insurance premium	500	467
Other operating income	3,533	1,210
Policyholders benefits and claims	(153)	(150)
Other operating expenses	(174)	(39)
Other operating income, total	8,069	1,834

Personnel

48. The Bank's total number of employees is as follows:

	2005	2004
Average number of full time equivalent positions during the year	2,318	1,501
Full time equivalent positions at year-end	2,368	1,606

49. Salaries and related expenses are specified as follows:

Salaries	11,041	9,092
Bonus payments	5,407	2,290
Salary related expenses	2,554	558
Defined contribution expenses	1,315	911
Salaries and related expenses	20,317	12,851

Executive employment terms

50. Salaries to the executives of the Bank, their stock options and shares owned at year-end, are specified as follows:

	Salaries	Benefits	Bonuses	Pension fund payment	Stock options shares	Shares at year-end
CEO						
Hreidar Mar Sigurdsson	39.6	2.2	39.6	25.0	3.2	2.8
Directors						
Sigurdur Emarsson, Chairman	39.6	28.9	39.6	25.0	3.2	3.7
Asgeir Thoroddsen	3.5					-
Bjarnfredur Olafsson	4.2					-
Brynja Halldorsdottir	3.5					-
Finnur Ingolfsson	3.5					-
Gunnar Pall Palsson	3.5					-
Hjorleifur Thor Jakobsson	3.5					-
Tommy Persson	3.5					-
Peter Gatti	1.3					-
Niels de Comnck-Smith	2.3					-
CEO in Iceland and Denmark						
Ingolfur Helgason	11.1	1.7	40.0	0.0	0.1	2.8
Lars Johansen	37.0	2.7	10.5	10.0		0.0
Five Group Managing Directors	84.1	87.0	84.1		0.3	4.1

Bjarnfredur Olafsson, a Board member of the Bank, is a partner in the law firm Taxis. The firm has provided the Bank legal service and the total fee paid to the firm was ISK 16 million for the year 2005.

The CEO, the Chairman of the Board and five Group Managing Directors exercised in 2005 stock options that were granted 2002. The difference in exercise price and market price were ISK 191 million, ISK 407 million and ISK 183 million respectively.

Should the Chairman of the Board resign he shall receive salary payments for 12 months onwards, but otherwise his salary payments shall continue for 48 months from the date of the termination of employment. The CEO's term of notice is 12 months, but should his employment terminate due to other reasons his salary payments shall continue for 48 months.

Auditor's fee

51. Auditor's fee is specified as follows:

	2005	2004
Audit of the Financial Statements	140	101
Other related audit service	33	53
Review of the Interim Financial Statements	42	31
Other service	71	50
Auditor's fee	286	235
Fee to others than the Parent Company's auditors, included in the above total	237	184

Impairment

52. Impairment is specified as follows:

Impairment on loans and advances	2,450	3,825
Impairment on goodwill	1,521	0
Impairment on property and equipment	418	0
Impairment on other assets	1,939	0
Impairment on assets	4,389	3,825

53. Tax assets and tax liabilities recognised in the Income Statement

Current tax expenses	8,115	1,455
Deferred tax expenses	3,113	2,781
Total income tax expenses	11,228	4,236

Reconciliation of effective tax rate	2005		2004	
Profit before income tax		62,284		22,495
Income tax using the domestic corporation tax rate	18.0%	11,211	18.0%	4,049
Effect of tax rates in foreign jurisdictions	0.8%	526	1.3%	284
Non-deductible expenses	0.4%	252	0.2%	56
Tax exempt revenues	-0.2%	(145)	-0.3%	(71)
Tax incentives not recognised in the Income Statement	-0.9%	(532)	-0.4%	(82)
Other changes	-0.1%	(84)	0.0%	0
	18.0%	11,228	18.8%	4,236

Earnings per Share

54. Earnings per share are specified as follows:

	2005	2004
Net earnings attributable to the shareholders of Kaupthing Bank hf.	49,260	17,707
Weighted average share capital		
Weighted average of outstanding shares for the year	655.2	497.4
Effects of stock options	10.9	7.6
Weighted average of outstanding shares for the year diluted	666.1	505.0
Earnings per share	75.2	35.6
Diluted earnings per share	73.9	35.1
Numbers of shares at the end of the year, million	663.8	652.1
Numbers of shares at the end of the year diluted, million	674.8	659.7
Average numbers of own shares, million	5.7	3.9
Numbers of own shares, end of year, million	0.7	8.5

Earnings per share

Earnings per share are calculated by dividing the net earnings attributable to equity holders of the Bank by the weighted average number of ordinary shares outstanding during the year.

Diluted earnings per share

Diluted earnings per share are calculated by adjusting the weighted average number of ordinary shares outstanding to assume conversion of all dilutive potential ordinary shares. The Bank calculates dilutive potential ordinary shares by determining the number of shares that could have been acquired at fair value (determined as the average annual market share price of the Company's shares) based on the monetary value of the subscription rights attached to outstanding share options. The number of shares calculated as above is compared with the number of shares that would have been issued assuming the exercise of the share options.

NOTES TO THE BALANCE SHEET

Cash and cash balances with central banks

55. Cash and cash balances with central banks are specified as follows:

	31.12.2005	1.1.2005
Cash and cash balances	16,869	5,512
Cash equivalent	18.008	778
Cash and cash balances with central banks	34,877	6,290

Loans and advances

56. Loans and advances are specified as follows:

Loans to credit institutions	195,594	174,310
Loans to customers	1,556,653	992,400
Provision for losses	(12,953)	(12,294)
Loans and advances	1,739,294	1,154,416

57. Loans to credit institutions specified by types of loans:

Bank accounts	46,881	15,307
Overdraft	1,733	1,739
Money market loans	97,544	140,879
Other loans	49,436	16,385
Loans to credit institutions	195,594	174,310

58. Loans to credit institutions specified by maturity:

On demand	42,860	41,192
Up to 3 months	110,644	117,311
Over 3 months and up to a year	12,483	6,953
Over 1 year and up to 5 years	26,074	5,254
Over 5 years	3,533	3,600
Loans to credit institutions	195,594	174,310

59. Loans to customers specified by types of loans:

Overdrafts	82,787	41,103
Subordinated loans	7,647	7,023
Other loans	1,270,459	862,444
Advances	125,882	0
Finance lease	51,212	58,719
Finance lease - Current assets	18,666	23,111
Loans to customers	1,556,653	992,400

60. Loans to customers specified by sectors:

	31.12.2005	1.1.2005
Municipalities	2.8%	4.3%
Business enterprises		
Agriculture	0.6%	0.6%
Fishing industry	0.8%	1.0%
Industry	11.0%	31.1%
Commerce	23.7%	7.5%
Service	43.6%	43.3%

Individuals	17.4%	12.2%
Loans to customers	100.0%	100.0%

61. Loans to customers specified by maturity:

On demand	69,543	36,199
Up to 3 months	296,268	129,117
Over 3 months and up to a year	161,068	114,062
Over 1 year and up to 5 years	515,101	367,876
Over 5 years	514,673	345,146
Loans to customers	1,556,653	992,400

Non-performing loans are classified as aggregated exposures of customers for which the Bank has made specific provisions in part or in full Non-performing loans amounted at year end 2005 to ISK 15,078 million, 0.98% of total loans to customers.

62. Specifications of subordinated loans:

Loans to customers	5,796	5,117
Bonds and other fixed income securities	1,851	1,906
Subordinated loans	7,647	7,023

63. Changes in the provision on loans and advances are specified as follows:

	2005
Balance at the beginning of the year	12,294
Acquisition through business combination	1,765
Impairment on loans and advances during the year	2,450
Exchange rate difference on translation	(518)
Write offs during the year	(3,212)
Payment of loans previously written off	174
Provision on loans and advances	12,953

Included within interest income is ISK 552 million with respect of interest income accrued on impairment on financial assets and ISK 112 million with respect to the unwind of the impairment provision discount.

Financial assets measured at fair value	**31.12.2005**	**1.1.2005**

64. Financial assets measured at fair value are specified as follows:

Trading assets	337,157	205,185
Financial assets designated at fair value	258,717	63,695
Mortgage loans measured at fair value	12,033	31,754
Derivatives used for hedging	4,459	3,820
Financial assets measured at fair value	612,366	304,454

65. Trading assets are specified as follows:

	31.12.2005	**1.1.2005**
Bonds	197,116	142,864
Other debt instruments	1,286	0
Futures	18	84
OTC derivatives	12,644	11,070

Other trading derivatives	8,385	1,931
Shares	114,463	46,491
Other equity instruments	3,245	2,745
Trading assets	337,157	205,185

66. The Bank has entered into derivatives a mounting to ISK 53,388 million against its investments in shares. Derivatives on listed shares amount to ISK 51,180 million and derivatives on unlisted shares amount to ISK 2,208 million. The agreements are entered at market value.

The Bank's market risk on bonds, derivatives included, amounts to ISK 187,410 million.

67. Financial assets designated at fair value are specified as follows:

Bonds	88,730	28,316
Debt instruments	120,098	0
Shares	46,583	26,224
Other equity instruments	3,306	9,155
Financial assets designated at fair value	258,717	63,695

68. Mortgage loans measured at fair value specified by sectors:

Municipalities	1.9%	2.0%
Business enterprises		
Agriculture	0.2%	0.3%
Industry	22.6%	31.9%
Commerce	36.3%	21.0%
Construction	4.5%	3.9%
Transportation	0.4%	3.7%
Electricity, gas, steam and hot water supply	0.0%	0.0%
Service	34.1%	37.2%
Mortgage loans measured at fair value	100.0%	100.0%

69. Mortgage loans measured at fair value specified by maturity:

Up to 3 months	232	516
Over 3 months and up to a year	543	1,202
Over 1 year and up to 5 years	2,676	6,636
Over 5 years	8,582	23,400
Mortgage loans measured at fair value	12,033	31,754

70. Derivatives used for hedging are specified as follows:

Fair value hedge	982	370
Portfolio hedge of interest rate risk	3,477	3,450
Derivatives used for hedging	4,459	3,820

Financial assets available -for-sale

71. Financial assets available-for-sale are specified as follows:

	31.12.2005	**1.1.2005**
Equity instruments	167	1,507

72. Investment in associates are specified as follows:

	2005
Carrying amount at the beginning of the year	3,649
Additions	1,805
Disposals	(42)

Transfers	7,671
Income	1,396
Dividend paid	(102)
Foreign currency translation	(490)
Carrying amount at the end of the year	13,888

Main associates are specified as follows:	Ownership	Profit share	Nominal value	Book value
Vátryggmgafelag Íslands hf.., Iceland	24.7%	1,446	161	8,252
Icopal Holding A/5, Denmark	25.0%	0	190	1,903
Drake Management LLC, USA	20.0%	149	10	1,168
Mezzanm Kapital A/5, Denmark	22.7%	(24)	13	429
GreidslunmSlun hf. Iceland	21.1%	91	84	386
P/f Fastogn, Faeroe Islands	47.8%	23	218	268
Reiknistofa Bankanna, Iceland	18.0%	0	2	265
Netdesign Invest A/5, Denmark	25.4%	0	3	254
Credit Info Group hf. , Iceland	42.4%	8	158	247
Kreditkort hf. , Iceland	20.1%	46	9	225
JHM Hoisted Holding A/S, Denmark	25.0%	0	16	155
Thirteen other associates		(343)	18	336
		1,396		13,888

Intangible assets

73. Goodwill is distributed among cash-generating units (CGU) in keeping with the main emphasis of monitoring and managing activities. The emphasis of the group has been shifting such that the subsidiaries are less considered the core of operations. Instead, operations are tending more towards placing emphasis on the Bank's operational units. The integration of these changes in emphasis into the Bank's organization has begun and a number of organisational changes have already been made, all with the aim of uniting the Bank and increasing its transparency.

The Bank has now defined the five independent CGU of the Bank's operation, each devising its own budget and responsible for its own results. Furthermore, the costs of the ancillary units are distributed proportionally among the CGU. The CGU are as follows: 1) capital markets, 2) investment banking, 3) asset management & private banking, 4) treasury and 5) banking. With regard to this operational restructuring and planning within the group, goodwill in the Bank's accounts has been distributed among the cash generating units according to its origin. As part of the apportioning of the Bank's goodwill, the recoverable amount is measured by value in use.

Each CGU is assessed on its own, in which expectations for return on equity, payout ratio, equity and yield are the main variables in the assessment of each CGU. An independent operating budget acts as the basis for results for the first year of the scheme, after which the next three years are based on the return objectives for each CGU and after that it is based on long-term yield of comparable units. The Bank aims to achieve consolidated 15% return on equity over the next four years. Return objectives are different within each CGU. In the budget for 2006, return on equity is expected to be higher than the Bank's objective. In the assessment, future return on equity is expected to be similar to the average of group of comparable units to each CGU.

The discount rate for each CGU is as follows:

Capital Markets	10.9%
Investment Banking	10.9%
Treasury	10.9%
Asset Management and Private Banking	9.0%
Banking	8.2%

A sensitivity analysis of the budgets and key premises revealed that a significant deviation from the budget or a breakdown must take place in order to effect an impairment of the goodwill that has been distributed to any of the Bank's CGU.

Intangible assets

74. Intangible assets are specified as follows:

	Goodwill	Other Intangible assets	Total 2005	Total 2004
Book value 1 January	34,011	1,087	35,098	6,374
Acquisition through business combination	394	942	1,336	0
Exchange rate difference	(1,178)	(69)	(1,247)	(1,172)
Additions during the year	18,775	2,883	21,658	30,101
Impairment	(1,521)	0	(1,521)	0
Amortisation	0	(381)	(381)	(205)
Book value 31 December	50,481	4,462	54,943	35,098

Investment property

75. Investment properties for renting are specified as follows:

	2005
Book value 1 January	19,155
Exchange rate difference	5
Additions during the year	4,839
Disposals during the year	(208)
Revaluation during the year	365
Book value 31 December	24,156

The Bank's investment properties were revalued at 31 December 2005 by independent professionally qualified valuers. Valuations were based on current prices in an active market for all properties except for the properties located in Iceland where the Bank used discounted cash flow projections.

76. Leases as lessor

The Bank leases out investment property under operating leases (see note 14 b). The future minimum lease payments under non-cancellable leases are as follows:

	31.12.2005	1.1.2005
Less than one year	917	3,832
Over 1 year and up to 5 years	3,768	2,620
Over 5 years	15,263	11,050
Minimum lease payments under non-cancellable leases	19,948	17,502

During the year ended 31 December 2005 ISK 1,530 million was recognised as rental income in the Income Statement and ISK 2 million in respect of repairs and maintenance was recognised as an expense in the Income Statement relating to investment property. Comparative amounts for the year 2004 amounted ISK 778 million and ISK 52 million, respectively.

In the Income Statement, direct operating expenses include ISK 5 million relating to investment property that was unlet compared to ISK 5 million for the year before.

Property and equipment

77. Property and equipment are specified as follows:

	Real estate for own use	Machinery and equipment for own use	Operating lease	Total 2005	Total 2004
Balance 1 January	5,078	5,703	0	10,781	9,470
Acquisitions through business combination	3,218	2,697	16,969	22,884	412
Exchange rate difference	(90)	(321)	0	(411)	(291)
Additions during the year	635	975	3,355	4,965	2,741
Disposals during the year	(177)	(1,026)	(956)	(2,159)	(1,55)
Impairment	(388)	(30)	0	(418)	0
Total value 31 December	8,276	7,998	19,368	35,642	10,781
Previously depreciated	1,151	3,538	0	4,689	4,130
Acquisitions through business combination	339	1,197	5,738	7,274	116
Exchange rate difference	(12)	(223)	0	(235)	0
Depreciation during the year	187	1,061	1,189	2,437	1,142
Disposals during the year	0	(97)	(858)	(955)	(699)
Total depreciation 31 December	1,665	5,476	6,069	13,210	4,689
Book value at 31 December	6,611	2,523	13,299	22,433	6,092

78. Depreciation and amortisation in the Income Statement is specified as follows:

	2005	2004
Depreciation of property and equipment	2,437	1,142
Amortisation of intangible assets	381	205
Depreciation and amortisation in the Income Statement	2,818	1,347

79. Property under construction

During the year ended 31 December 2005, the Bank commenced construction of a new building for future use as headquarters; costs incurred up to the Balance Sheet date totalled ISK 590 million including the acquisition cost of the land in the year 2005.

Non-current assets and disposal groups classified as held for sale

80. Non-current assets and disposal groups classified as held for sale are specified as follows:

	31.12 .2005	1.1.2 005
Mortgages foreclosed - tangible assets held for sale	572	979
Mortgages foreclosed - total assets of legal entities held for sale	1,730	2,652
Non-current assets and disposal groups classified as held for sale	2,302	3,631

Other assets

81. Other assets are specified as follows:

Unsettled securities trading	16,091	2,337
Reinsurers' share in insurance fund	136	107
Accounts receivables	6,997	4,237
Sundry assets	401	10,601
Prepaid expenses	2,887	660
Accrued income	4,868	1,127

Other assets	31,380	19,069

Unsettled securities trading was settled in less than three days from the accounting date.

82. Reinsurers' share in insurance fund are specified as follows:

Premium reserve for reinsurers' share in insurance fund	30	20
Claims reserve for reinsurers' share in insurance fund	106	87
Reinsurers' share in insurance fund	136	107

Deposits from credit institutions and central banks

83. Deposits from credit institutions and central banks mature as follows:

	31.12.2005	1.1.2005
On demand	11,176	18,017
Up to 3 months	52,820	3,252
Over 3 months and up to a year	3,890	6,838
Over 1 year and up to 5 years	0	2,118
Over 5 years	1,757	2,263
Deposits from credit institutions and central banks	69,643	32,488

Other deposits

84. Other deposits mature as follows:

On demand	163,426	80,084
Up to 3 months	253,963	82,980
Over 3 months and up to a year	18,156	6,838
Over 1 year and up to 5 years	39,834	23,922
Over 5 years	10,797	6,434
Other deposits	486,176	202,193

Borrowings

85. Borrowings are specified as follows:

Bonds issued	1,158,806	779,931
Bills issued	164,910	35,726
Money market loans	200,581	111,901
Other loans	32,270	40,954
Borrowings	1,556,567	968,512

86. Borrowings mature as follows:

On demand	10,684	9,685
Up to 3 months	300,885	145,277
Over 3 months and up to a year	214,935	125,907
Over 1 year and up to 5 years	862,240	581,107
Over 5 years	167,823	106,536
Borrowings	1,556,567	968,512

Subordinated loans

87. Subordinated loans are specified as follows:

Original interest	Interest change	Interest after	Maturity date	31.12.2005 Book value	1.1.2005 Book value

				change			
Loans that qualify as Tier 1 capital:							
Issued in 2001	ISK	8.7%	2011		None	1,232	1,190
			3m Eurobor				
Issued in 2004	EUR	5.9%	2014	+ 245bps	None	12,545	12,757
Issued in 2005	EUR	6.3%	2010	63%	None	13,517	
Issued in 2005	ISK				None	3,352	
Issued in 2005	USD	5.1%			None	10,555	
Loans that qualify as Tier 1 capital total:						**41,201**	**13,947**
Loans that qualify as Tier II capital:							
Issued in 1996	DKK	0.0%			2007	370	684
Issued in 1999	EUR	6.4%			2009	2,545	2,505
Issued in 1999	JPY	0.0%			2032	3,057	5,919
Issued in 2000	ISK	6.0%	2005	7.5%	2010	1,216	1,470
Issued in 2000	ISK	7.0%	2007	9.0%	2012	1,974	2,128
Issued in 2001	ISK	6.0%	2006	7.5%	2011	129	122
Issued in 2001	ISK	8.0%	2006	10.0%	2011	1,223	1,421
Issued in 2002	ISK	6.0%	2007	7.5%	2012	948	904
Issued in 2002	ISK	7.5%	2009	10.0%	2014	1,334	1,279
Issued in 2002	ISK	8.0%	2026	247			
		3 m Euribor	3 m Euribor				
Issued in 2002	EUR	+ 115bps.	2007	+ 365bps	2012	374	418
Issued in 2003	GBP	75%	2019	5,646			
Issued in 2004	ISK	5.4%	2009	7.4%	2014	1,557	1,917
		3 m Euribor	3 m Euribor				
Issued in 2004	EUR	+ 65bps.	2009	+ 165bps	2014	22,284	24,909
Issued in 2004	DKK	3.0%	2008	112			
Issued in 2005	USD	0.0%	2032	3,660			
				4x(CMS 10y/2y)			
Issued in 2005	USD	7.5%	2010	10%/3,75%	2045	4,835	
				4x(CMS 10y/2y)			
Issued in 2005	EUR	6.5%	2010	9%/3%	2045	6,227	
		3 m Euribor		3 m Euribor			
Issued in 2005	EUR	+ 40bps	2012	+ 140bps	2017	3,749	
Loans that qualify as Tier II capital total:						**61,487**	**43,676**
Total						**102,688**	**57,623**

Financial liabilities measured at fair values

88. Financial liabilities measured at fair value through profit and loss are specified as follows:

	31.12.2005	1.1.2005
Trading liabilities	32,003	13,916
Derivatives used for hedging	13,276	19,219
Mortgage funding measured at fair value	14,994	34,876
Financial liabilities measured at fair value through profit and loss........................	60,273	68,011

89. Trading liabilities are specified as follows:

Short position in equity instruments held for trading...	3,765	743
Derivatives held for trading	27,942	13,173
Other liabilities held for trading..	296	0
Trading liabilities	32,003	13.916

90. Derivatives used for hedging are specified as follows:

Portfolio hedge of interest rate risk	13,276	19,219

Provisions

91. Provisions are specified as follows:

	31.12.2005
Provision for pensions	2,815
Other provisions	456
Provisions	3,271

Tax assets and tax liabilities

92. Tax assets and liabilities are specified as follows:

	Assets	Liabilities
Current tax	0	8,115
Deferred tax	5,004	10,343
Total tax assets and liabilities	5,004	18,458

93. Deferred tax assets and liabilities are specified as follows:

Deferred tax at the beginning of the year	1,092	4,408
Acquisition through business combination	3,987	4,333
Disposals during the year	0	(474)
Exchange rate difference on translation	(150)	(932)
Calculated income tax for the year	75	11,303
Income tax because of 2005 to be paid in year 2006	0	(8,115)
Deferred tax assets and liabilities at the end of the year	5,004	10,343

94. Deferred tax assets and liabilities are specified as follows:

	Assets	Liabilities
Shares in other companies	70	1,586
Currency linked assets and liabilities	0	502
Loans	0	5,643
Derivatives	0	(841)
Fixed assets	0	455
Other assets and liabilities	3,677	3,010
Carry forward taxable loss	1,257	(12)
Deferred tax assets and liabilities at the end of the year	5,004	10,343

Liabilities included in disposal groups classified as held for sale

95. Liabilities included in disposal groups classified as held for sale are specified as follows:

	31.12.2005	1.1.2005
Loans on mortgages foreclosed	14	75
Loans on mortgages foreclosed - total liabilities of legal entities held for sale	1,147	1,327
Liabilities included in disposal groups classified as held for sale	1,161	1,402

Other liabilities

96. Other liabilities are specified as follows:

Insurance liabilities	5,965	1,345
Unsettled securities trading	8,478	2,903
Accounts payable	3,573	2,332
Other liabilities	22,046	54,327
Other liabilities	40,062	60,907

Unsettled securities trading was settled in less than three days from the accounting date.

97. Insurance liabilities are specified as follows:

Provision for unearned premiums	297	782
Claims outstanding	227	194
Provision for bonuses	21	369
Life insurance provision due to unit linked policies	5,420	0
Insurance liabilities	5,965	1,345

Equity

Shareholders' equity

98. According to the Parent Company's Articles of Association, total share capital amounts to ISK 6,645 million. At year-end 2005 own shares amounted to ISK 7 million and share capital, according to the Balance Sheet, thus amounted to ISK 6,638 million One share has a nominal value of ISK 10. One vote is attached to each share.

Increase of share capital during the year is broken down as follows:	**Share Capital**	**Market Value**
2005		
Shares outstanding at 1 January	6,521	293,732
Issued new shares	39	416
Purchases and sales of treasury stock	78	3,706
Shares outstanding at 31 December	6,638	495,194
Own shares	7	485

2004	**Share Capital**	**Market Value**
Shares outstanding at 1 January	4,384	204,497
Issued new shares	2,201	92,443
Purchases and sales of treasury stock	(64)	(2,949)
Shares outstanding at 31 December	6,521	288,228
Own shares	86	3,801

99. Movement in share capital during the year segregates as follows:

2005	**Share capital**	**Share premium**	**Stock options**	**Total**
Balance at 1 January 2005, adjusted	6,521	110,402	157	117,080
Purchases and sales of treasury stock	78	3,628		3,706
Issued new shares in November	39	377		416
Exercised stock options		30	(30)	0
Stock option expense			42	42
Balance 31 December 2005	**6,638**	**114,437**	**169**	**121,244**

Share premium is specified as follows:

Share premium account	114,071
Statutory reserve	366
Share premium total	114,437

2005	Share capital	Share premium	Stock options	Total
2004	**Share capital**	**Share premium**	**Stock options**	**Total**
Balance at 1 January 2004, adjusted	4,384	23,304	316	28,004
Issued new shares	2,201	90,242		92,443
Purchases and sales of treasury stock	64)	(3,144)	(159)	(3,367)
Balance 31 December 2004, adjusted at 1 January 2005	6,521	110,402	157	117,080

Share premium is specified as follows:	
Share premium account	110,036
Statutory reserve	366
Share premium total	110,402

100. Movement in reserves were as follows:

2005	Pension reserve	Fair Value AFS reserve	Translation reserve	Total
Balance at 1 January, adjusted	0	0	(670)	(670)
Translation difference			(388)	(388)
Changes in fair value of available-for-sale financial assets		(2)		(2)
Deferred pension liability	(480)			(480)
Balance 31 December	(480)	(2)	(1,058)	(1,540)

2004	Translation reserve	Total
Balance at 1 January, adjusted	0	0
Translation difference	(670)	(670)
Balance 31 December	(670)	(670)

Pension reserve

The pension reserve includes the changes in the pension obligation.

Translation reserve

The translation reserve compromise all foreign exchange differences arising from the translation of the Financial Statements of foreign operations that are not integral to the operations of the Bank, as well as from the translation liabilities that hedge the Bank's net investment in a foreign subsidiary.

Fair value AFS reserve

The fair value reserve includes the cumulative portion of the cumulative net change in fair value of available-for-sale investments until the investment is derecognised.

101. Equity at the end of the year amounts to I5K 202,512 million. The equity ratio, calculated in accordance to Article 84 of the Act on Financial Undertakings, was 12.2%. According to the law the ratio may not go below 8.0%.

The ratio is calculated as follows:

	31.12.2005		31.12.2004	
	Book Value	**Weighted value**	**Book value**	**Weighted value**
Risk 1				
Assets recorded in the Financial Statements	2,540,811	1,841,833	1,534,020	1,166,377
Assets deducted from equity		(62,590)		(50,335)
Guarantees and other items not included in the Balance Sheet		166,029		73,129
		1,945,272		**1,189,171**

Equity:		
Tier 1 capital:.		
Equity	202,512	158,749
Intangible assets	(54,943)	(34,208)
Assets subtracted from equity	(6,741)	(1,232)
Subordinated loans	41,201	13,947
Tier 11 capital:		
Subordinated loans	61,285	43,108
Investment in credit institutions	(6,451)	(11,598)
	236,862	**168,766**
Equity ratio	12.2%	14.2%
Thereof Tier 1 ratio	9.4%	11.5%

Derivatives

102. Derivatives remaining maturity date of principal and book value are specified as follows:

	Principal				Book value	
2005	**Up to 3 months**	**Over 3 months and up to a year**	**Over 1 year**	**Total**	**Assets**	**Liabilities**
Currency and interests rate derivatives, agreements unlisted:						
Forward exchange rate agreements	519,031	44,442	595	564,068	5,820	4,264
Interest rate and exchange rate agreements	78,372	167,328	777,591	1,023,291	14,558	40,044
Options - purchased agreements	2,399	4,395	25,945	32,739	661	0
Options - sold agreements	7,310	6,401	21,504	35,214	143	432
	607,111	**222,566**	**825,635**	**1,655,312**	**21,383**	**44,740**
Equity derivatives:						
Equity swaps, agreements unlisted	60,252	17,987	0	78,239	2,517	4,729
Equity options, purchased, agreements unlisted	5,501	0	2,000	7,501	56	0
Equity options, sold, agreements unlisted	2,357	0	2,000	4,357	0	144
Futures, agreements listed	920	0	0	920	0	2
	69,030	**17,987**	**4,000**	**91,017**	**2,573**	**4,876**
Bond derivatives:						
Bond swaps, agreements unlisted	6,343	4,218	25,155	35,717	71	1,154
Derivatives total	**682,484**	**244,772**	**854,790**	**1,782,046**	**24,027**	**50,769**

The objective of the above-mentioned agreements is to control currency and interest rate risk of the Bank. The credit risk is valued at ISK 27,158 million when calculating the capital ratio of the Bank.

	Principal				Book value	
2004	**Up to 3 months**	**Over 3 months and up to a year**	**Over 1 year**	**Total**	**Assets**	**Liabilities**
Currency and interests rate derivatives, agreements unlisted:						
Forward exchange rate agreements	279,196	17,507	306	297,009	4,170	3,427
Interest rate and exchange rate agreements	109,933	199,415	728,588	1,037,936	11,351	45,167
Options - purchased agreements	12,530	2,989	2,357	17,876	293	0

Options - sold agreements	8,848	5,094	22,819	36,761	0	188
	410,507	**225,005**	**754,070**	**1,389,582**	**15,814**	**48,782**
Equity derivatives:						
Equity swaps, agreements unlisted	6,015	5,106	2,581	13,702	879	528
Equity options, purchased, agreements unlisted		2,089	2,000	4,089	31	0
Equity options, sold, agreements unlisted	0	721	2,000	2,721	0	96
Futures, agreements listed	0	0	0	0	0	6
	6,015	**7,916**	**6,581**	**20,512**	**910**	**630**
Bond derivatives:						
Bond swaps, agreements unlisted	45,546	1,335	0	46,881	181	2,941
Derivatives total	**462,068**	**234,256**	**760,651**	**1,456,975**	**16,905**	**52,353**

OFF BALANCE SHEET INFORMATION

Obligations

103. The Bank has granted its customers guarantees, overdraft permissions, loan commitments, assets under management and custody agreements. These items are specified as follows:

	31.12. 2005	1.1.20 05
Guarantees	196,793	1,223
Credit default swaps average rate A	179,147	114,937
Unused overdrafts	42,558	14,787
Loan commitments	165,066	144,688

The credit risk is valued at ISK 141 million for Guarantees, Credit default swaps, Unused overdrafts and Loan commitments when calculating the capital ratio of the Bank.

Assets under management	1,073,651	507,755
Assets under custody	1,426,448	909,994

Operating lease commitments

104. At 31 December 2005, the Bank was obligated under a number of non-cancellable operating leases for premises and equipment. The significant premises leases usually include renewal options and escalation clauses in line with general office rental market conditions as well as rent adjustments based on price indices. However, the lease agreements do not contain contingent rent payment clauses and purchase options.

105. The Bank has concluded lease agreements regarding the real estate it uses for its operations. The lease agreement is for a period of up to 20 years and the Bank has priority right of purchase or right to extend the lease agreement at the end of that period. The net present value of the Bank's obligation in relation to lease is at year end 2005 ISK 4,113.

ADDITIONAL INFORMATION

Deposit Insurance Fund

106. According to the Act on the Deposit Insurance Fund for Owners of Saving Deposits and Investors, the total assets of the Fund shall be a minimum of 1.0% of the average insured deposits in Commercial Banks and Savings Banks for the previous year.

Pledged assets

107. Assets have been pledged as security in respect of the following liabilities and contingent liabilities:

Liabilities

Repo agreements with central banks	14,364	18,017

Details of the carrying amounts the assets pledged as collateral are as follows:

Assets pledged		
Housing loans securities	15,458	19,390

Stock options

108. The Board of Directors of Kaupthing Bank hf.. has decided on the basis of the Bank's stock option scheme to grant employees in the group stock options to buy shares in the Bank. Stock option holders are entitled to exercise one third of their total stock option every year for three years between 20 January and 25 February, and the first period in which options can be exercised is from 20 January to 25 February 2007. The option has an exercise price of ISK 600 per share. The Board of Directors granted options on a total of 3.9 million shares.

At the same time as granting stock options to all employees, the Board of Directors of the Bank has also granted

330 employees stock options to buy 8.7 million shares over a three-year period, during which they can exercise one third of the stock options each year. The period in which options can be exercised is also from 20 January to 25 February each year, with the first exercise period in 2007. The option has an exercise price of ISK 600 per share during the first exercise period, ISK 630 per share during the 2008 exercise period and ISK 660 per share during the 2009 exercise period. The exercise of the options can be postponed each time until last exercise date but the strike price will increase to the price indicated by the relevant exercise date.

The terms and conditions of the grants are as follows, whereby all options are settled by physical delivery of shares.

Grant date / employees entitled:	**Number of shares in thousands**	**Vesting conditions:**	**Contractual life of options**	**Exercise price**
October 2002	240	Five years of service Exercisable at expiry date	5 years	120
March 2004.................................	6,496	Four years of service The stock option is exercisable 2006-2008	4 years	303
December 2002...........................	1,433	Six years of service One third of total stock option is exercisable 2006-2008.	6 years	114.9
Options granted to employees......		Three years of service One third of total stock		
at 16 November 2005..................	3,922	option is exercisable every year for three years	3 years	600
Options granted to employees......		Three years of service One third of total stock		600/630
at 16 November 2005..................	8,720	option is exercisable every year for three years.	3 years	/660
Total share options......................	20,811			

The number and weighted average exercise prices of share options is as follows:

	2005 Weighted average exercise price	**Weighted Number of option contracts**	**2004 average exercise price**	**Number of options contracts**
Outstanding at the beginning of the year..........................	209	346	108	762
Forfeited during the year..	112	62	104	47
Exercised during the year...	108	269	215	691
Granted during the year..	641	2,636	303	2
Outstanding at the end of the year....................................	494	2,649	209	346

The options outstanding at 31 December 2005 have an exercise price in the range of 114.9 to 660 and a weighted average contractual life of 2.8 years.

The fair value of services received in return for share options granted is measured by reference to the fair value of share options granted. The estimate of the fair value of the services received is measured based on the Black-Scholes model. The contractual life of the option is used as an input into this model. Expectations of early exercise are not incorporated into the Black-Scholes model.

The fair value of options granted during the period determined using the Black-Scholes valuations model was ISK 1,127 million which will be amortised over contractual life of options. The significant inputs into the model were share prices of 600 (600, 630 and 660 for key management), expected volatility of 15%, option life disclosed above, annual risk free interest rate of 7.4%, and expected dividends yield of 2.3%. The expected volatility is based on the historic volatility over the last 12 months from the grant date.

With a declaration dated 30 December 2005, employees of Kaupthing Bank hf.. waived their put options on purchased shares in the Bank.

The Board of Directors of FIH Erhvervsbank has granted the employees of FIH a stock option scheme which can be exercised 2008, 2009 and 2010. The options can only be exercised for 30 days after the Financial Statements have been published. During 2005 ISK 43 million has been entered among Salaries and related expenses and ISK 39 million in the Balance Sheet as liability.

Related parties

109. The Bank has a related party relationship with its subsidiaries (see note 122), associates (see note 72), the Board of Directors of the parent company, the managing directors of the Bank, the managing directors of the biggest subsidiaries, close family members of individuals referred to herein, and entities with significant influence as the largest shareholders of the Bank which are Exista B.V. (21.1%), Egla hf.. (10.8%) and Vatryggingafelag islands hf. (4.0%) This definition is based on IAS 24. Information regarding related parties is as follows:

Significant related companies:	**2005**	**2004**
Loans:		
Balance at the beginning of the year	3,128	3,128
Additions	15,604	0
Reductions	(15,669)	0_
Balance at the end of the year	3,063	3,128

The Bank has granted loans to its key management. The outstanding balance of loans to the management and close family members amounted to ISK 7,545 million at 31 December 2005 and ISK 1,955 million at 31 December 2004. The terms and conditions are similar for the key management as loans granted to other customers of the Bank. The aforementioned amounts do not include loans related to the business activities of the key management.

No unusual transactions took place with related parties in the year 2005. Transactions with related parties have been conducted on arm's length basis.

Salaries, remuneration and salary related expenses to the executive board and the Board of Directors are shown in note 50.

Events after the Balance Sheet date

110. There have been no material post Balance Sheet events which would require disclosure or adjustment to the 31 December 2005 Financial Statements. On 25 January 2006 the Board of Directors reviewed the Financial Statements and authorised them for publication. These Financial Statements will be submitted to the Annual General Meeting of shareholders to be held on 17 March 2006 for approval.

Risk management disclosure

111. Kaupthing Bank faces various types of risks related to its business as a financial institution, which arise from its day to day operations. Management devotes a significant portion of its time to the management of these risks. The mainstays of effective risk management are the identification of significant risk, the quantification of the Bank's risk exposure, actions to limit risk and the constant monitoring of risk. The most significant of these risks are discussed below. The most important types of financial risk to which the Bank is exposed are credit risk, liquidity risk and market risk. Market risk includes currency risk, interest rate risk and equity price risk.

Risk policy of Kaupthing Bank

The assessment of risk, in particular the determination of its true price along with actions aimed at limiting the risk with sensible credit and investments in other assets, is one of the major tasks of banks and other financial institutions. Many risk factors can adversely affect Kaupthing Bank. It is the policy of the Board of Directors that the various risks that Kaupthing Bank faces in its business are to be constantly monitored and managed. For these purposes the Bank operates a centralised risk management division. In addition, Kaupthing Bank's internal auditor oversees the operations in order to ensure that its rules are implemented in accordance with resolutions made by the Board of Directors.

The Board of Directors determine Kaupthing Bank's goals in terms of risk by issuing a risk policy. The risk policy both defines acceptable levels of risk for day-to-day operations, as well as the willingness of Kaupthing Bank to incur risk weighed against the expected rewards. The risk policy is detailed in the Internal Control and Procedural Handbook.

It is incumbent upon the Risk Management division to enforce the risk policy and report risk to the management and Board Risk management for the Bank is centralised and located at the parent company. Some types of risk in subsidiaries are managed directly from central Risk Management. In other cases risk in subsidiaries is handled locally but reported to and managed on a higher level by central Risk Management.

The process for risk management and risk control

a) *Products containing credit risk*

The Bank's primary exposure to credit risk arises through its loans and advances. The amount of credit exposure in this regard is represented by the carrying amounts of the assets on the Balance Sheet. The Bank is exposed to credit risk on various other financial assets, including derivative instruments used for hedging and debt investments, the current credit exposure in respect of these instruments is equal to the carrying amount of these assets in the Balance Sheet. In addition, the Bank is exposed to off Balance Sheet credit risk through commitments to extend credit and guarantees issued.

Loan portfolio: The main assets of Kaupthing Bank are its loans, to maintain and further improve the quality of the loan portfolio it is imperative to scrutinise all applications and weed out potential problem loans as early as possible, as well as constantly monitor the current loan portfolio. However, it is not the policy of the Bank to solely issue credit of very low risk but it is important that the price of issued credit reflects both risk and costs incurred. This means that a detailed assessment of individual customers, their financial position and the collateral is a prerequisite for granted credits.

Derivatives trading: Derivative financial instruments used by the Bank include swaps, futures, forwards, options and other similar types of contracts whose value changes in response to changes in interest rates, foreign exchange rates, security prices, commodity prices or price indices. Limits on the net open derivative positions on these types of contracts are strictly controlled by the Bank. These limits are generally client specific and may refer specifically to different categories of contracts. Generally, collateral is required to cover potential losses on a contract. Acceptable collateral for margin accounts is in the front of very liquid assets, e.g. cash or traded stocks. In case the net negative position of the contract falls below a certain level a call for added collateral is made. If extra collateral is not supplied the contract is closed.

Commitments and guarantees: The Bank often commits itself to and ensures that funds are available to customers as required. The most common commitments to extend credit are in the form of limits on check accounts, credit cards and credit lines. Potential loss on these accounts is equal to the amount of the limits although they may only be partly used at any one time. In practise, the potential loss is less severe since many of these commitments can be recalled immediately by the Bank in case the clients do not meet credit standards.

Guarantees carry the credit risk to the full amount similar as loans, since they represent irrevocable assurances that the Bank will make payments in the event that a customer cannot meet its obligations to third parties.

b) *Master netting agreements*

Frequently, exposure to credit losses is reduced by entering into master netting agreements with clients that counterparties have significant and/or diverse credit related business with the Bank Master netting agreements do not generally result in an offset of Balance Sheet assets and liabilities, as transactions are usually settled on a gross basis. However, the credit risk associated with favourable contracts is reduced by these types of agreements since in the case of default all amounts of the counterparty are terminated and settled on a net basis.

c) *Credit risk strategy*

In recent years, the Bank emphasised on maintaining a healthy loan portfolio and improving the quality of loans. An example of this is the Bank's entry into the Icelandic mortgage market, which began in the latter half of 2004. A large number of customers have opted for refinancing of their consumer loans, which generally bear higher risk, with high quality mortgage loans. Mortgage loans now constitute more than half of the retail portfolio in Iceland. However, it is not the Bank's aim to grant solely credits of very low risk but it is important that the price of the credit, i.e. the margin, offered to substantial clients reflects the risks taken. Credit analysis is therefore a prerequisite for any positive credit decision and the pricing must take into account the risks and the required return on capital.

d) *Credit process and authority*

The Bank's Credit Committee is at the pinnacle of the credit process and has overruling authority in matters related to credit, the only exception in addition to exposures exceeding 10% of the Bank's capital need the approval of the Board Credit Committee. Moreover, the Group Credit Committee covers all large credit tenders, limits the lending authority of personnel, and restricts exposures to different types of entities.

In order to make use of the local expertise, a large part of the credit and collateral risk is maintained on a local level in the Bank's subsidiaries. The same or similar credit rules apply in every subsidiary but, in addition, further requirements stipulated by local regulations may apply. To maintain a group-wide overview, the CEO or his deputy is a member of all local board level credit committees.

e) *Credit risk monitoring*

Credit risk is monitored within Risk Management. The Research and Development division within Risk Management is responsible for developing and maintaining credit monitoring and reporting systems and maintaining overview of the work done in this regard at the subsidiaries. The unit also performs numerical analysis of the loan portfolio on a group level, e.g. estimates expected loss, concentrations within the loan portfolio and maps defaults in a systematic way. These findings are reported to management where possible risk concentrations toward counterparties, sectors, countries etc. are highlighted.

Furthermore, to respond to specific signs of increased credit risk, two divisions that concentrate on different aspects of the credit portfolio are within Risk Management. Credit Control focuses on distressed clients and in co-operation with the relevant profit centre tries to minimise or prevent loss on behalf of the Bank by special monitoring of clients with deteriorating creditworthiness. It also oversees specific provisions and write-offs. Credit Risk Analysis monitors the integrity of the credit process, i.e. in regard to data collection, limit compliance, application preparation, documentation and collateral registration and valuation. Local Risk Management units perform these tasks in subsidiaries and monitor credit risk within subsidiaries and report to the Bank's Risk Management.

Loan provisioning

An allowance for credit losses is established if there is objective evidence that the Bank will be unable to collect all amounts due on a claim, i.e. a loan, commitment, guarantee etc., according to the original contractual terms or the equivalent value. An allowance for credit losses is reported as a reduction of the carrying value of a claim on the Balance Sheet, whereas for an off-Balance Sheet item such as a commitment a provision for credit loss is reported in Other liabilities. Additions to the allowances and provisions for credit losses are made through impairment on loans. Allowances and provisions for credit losses are evaluated at a counterparty-specific level and collectively based on the following principles:

f) *Counterparty-specific*

A claim is considered impaired when there is an object evidence that it is probable that the Bank will not be able to collect all amounts due according to the original contractual terms or the equivalent value. Individual credit exposures are evaluated based upon the borrower's character, overall financial condition, resources and payment record, the prospects for support from any financially responsible guarantors, and, where applicable, the realisable value of any collateral.

The estimated recoverable amount is the present value, using the loan's original effective interest rate, of expected future cash flows, which may result from restructuring or liquidation. Impairment is measured and allowances for credit losses are established for the difference between the carrying amount and the estimated recoverable amount.

Upon impairment, the accrual of interest income based on the original terms of the claim is discontinued, but the increase of the present value of impaired claims due to the passage of time is reported as interest income.

All impaired claims are reviewed and analysed at least every three months. Any subsequent changes to the amounts and timing of the expected future cash flows compared to the prior estimates will result in a change in the allowances for credit losses and be charged or credited through impairment on loans.

An allowance for impairment is reversed only when the credit quality has improved such that there is reasonable assurance of timely collection of principal and interest in accordance with the original contractual terms of the claim agreement.

A write-off is made when all or part of a claim is deemed uncollectible or forgiven. Write-offs are charged against previously established allowances for credit losses or directly to credit loss expense and reduce the principal amount of a claim. Recoveries in part or in full of amounts previously written off are credited to credit loss expense.

g) *Collectively*

All loans for which no impairment is identified on a counterparty-specific level are grouped into economically homogeneous portfolios to collectively assess whether impairment exists within a portfolio. Allowances from collective assessment of impairment are recognised as credit loss expense and result in an offset to the loan position. As the allowance cannot be allocated to individual loans, interest is accrued on all loans according to contractual terms.

h) *Credit risk models*

Emphasis has been placed within the Kaupthing Bank Group on improving credit risk modelling on a group-wide scale. Most of this work has been done within the Basel II framework, i.e. emphasis has been placed on models that estimate the probability of default of clients and loss parameters in case of default. Where applicable, and together with the internal credit rating, the Bank uses the services of external credit rating agencies and collection services to strengthen the credit process even further. The credit evaluation process is not only dependent upon quantitative numbers but on an array of qualitative factors as well. The general rule is that the larger the exposure the more detailed analysis is performed. For smaller exposures the due process is, however, fundamentally the same but requires less scrutiny and data Guarantors are analyzed in the same manner.

Risk Management Disclosure

Monitoring and controlling liquidity risk

112. Liquidity risk is the risk of loss arising from the Bank's inability to meet its liabilities as they become due.

The Bank's liquidity policy is threefold. The first requirement is to have enough secured liquidity to be able to serve and repay all maturing debts for at least 180 days without any access to capital markets (secured assets are deposits, repo-able bonds and unused revolvers). The second key liquidity requirement stipulates that a minimum of 360 days of sufficient unsecured liquidity is needed to cover liabilities within that timeframe (unsecured liquidity is defined as secured liquidity in addition to unused Euro Commercial Paper room and unused Money Market lines). The third requirement is to cover short term liabilities for 390 days with unsecured liquidity when including listed and liquid securities. The Bank liquidity risk is monitored centrally with the exception of FIH which monitors its liquidity risk independently but co-ordinated with the group. Short term liquidity is shown in the figures below.

Liquidity of Kaupthing Bank	**Up to 1 month**	**1-3 months**	**3-6 months**	**6-12 months**	**l-2 years**
Secured liquidity	247,000	18,000	(82,000)	(241,000)	(548,000)
Unsecured and liquid assets	574,000	345,000	246,000	86,000	(220,000)

113. The breakdown by contractual maturity of financial assets and liabilities, at 31 December 2005.

Maturity analysis of financial assets and liabilities	**On demand**	**Up to 3 months**	**3-12 months**	**1-5 years**	**Over 5 years**
Cash and central banks balances	34,877	0000			
Loans and advances............................	111,572	403,904	173,269	537,175	514,374
Financial assets measured at fair value...	338,140	171,957	2,958	61,438	37,873
Financial assets available-for-sale......	167	0000			
Total assets.......................................	**484,756**	**575,861**	**175,227**	**598,613**	**552,247**
Deposits from credit institutions and central banks	11,176	52,826	0	3,890	1,751
Other deposits	163,426	253,963	18,156	39,834	10,796
Borrowings...	10,684	300,885	214,935	862,240	167,823
Financial liabilities measured at fair value...	4,679	8,862	5,746	18,965	22,021

Total liabilities	189,965	616,536	238,837	924,929	202,391
Assets – liabilities.............................	**294,791**	**(40,675)**	**(63,610)**	**(326,316)**	**349,856**

114. The Bank's policy is to monitor its Group level market risk closely and to make sure that limits set by the Board of Directors are not exceeded. Market risk is managed by exposure limits and with limits on risk measures, both monitored on a daily basis. Risk weighted assets associated with market risk should not exceed 25% of total risk weighted assets.

Derivatives

115. The Bank's use of derivatives is mainly through derivative sales, but derivatives are also in trading portfolios. The types of derivatives used by the Bank include swaps, futures, forwards, options and other similar types of contracts.

Derivative sales offer companies and institutional investors foreign exchange and a range of interest rate and currency derivatives for position taking and risk management. The market risk associated with derivatives sales is hedged on a portfolio basis and on a back-to-back basis.

The Bank's trading portfolios take positions in traded and over-the-counter instruments, including derivatives, to take advantage of short-term market movements in equities and bonds and in currency prices and interest rates, and they also use derivatives to hedge certain market exposures. The level of exposure is controlled using individual trading limits as with other market risk.

Interest rate risk

116. The Bank's 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 the Bank is also exposed to basis risk, which is the difference in repricing characteristics of the various floating rate indices, such as the savings rate and six months LIBOR and different types of interest. Risk management activities are aimed at optimising net interest income, given market interest rate levels consistent with the Bank's business strategies. Interest rate risk is monitored centrally with duration reports and yield curve stress testing for each currency.

Interest-rate risk increased quite significantly at year-end 2004 following the introduction of fixed-interest mortgage products, but it remains closely monitored. The table below shows the interest rate risk by currency and maturity. Trading interest rate risk refers to exposures in trading book where positions are market-to-market and profit or loss is recognised immediately but banking interest rate risk refers to exposure in banking book where profit or loss is realised over the lifetime of the exposure.

The total amount of indexed assets of the Bank amounted to ISK 237,218 million, and the total amount of indexed liabilities amounted to ISK 129,917 million, respectively, at year-end.

Interest rate risk

117. Interest rate risk by currency and maturity

Currency		**Within 1 month**	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**Total**
ISK	Trading..........................	(0)	(1)	(1)	(94)	(578)	(674)
	Banking.........................	10	19	2	22	(13,447)	(13,394)
DKK	Trading..........................	162	43	(106)	(865)	(769)	(1,533)
	Banking.........................	(28)	(171)	(367)	(418)	(455)	(1,439)
EUR	Trading..........................	(175)	(156)	(23)	(59)	20	(393)
	Banking.........................	233	358	(25)	261	398	1,225
GBP	Trading..........................	(29)	(33)	(1)	(6)	12	(57)
	Banking.........................	41	251	(146)	(25)	(139)	(18)
USD	Trading..........................	(1)	(33)	(16)	(1)	(1)	(52)
	Banking.........................	39	55	(35)	(123)	(866)	(930)
CHF	Trading..........................	7	2	(2)	(0)	0	7

	Banking..........................	4	35	(87)	(6)	17	(36)
Other	Trading...........................	0	(13)	(10)	(57)	28	(52)
	Banking..........................	25	26	(27)	5	40	69

Table showing interest rate risk by currency and maturity in millions of ISK Risk is measured by assuming a 1% simultaneous upward shift in all yields curves in the relevant maturity band.

Market price risk

118. Market price risk is the risk of loss due to changes in market prices. The Bank's main exposures are through equities and bonds, but the management of currency risk is handled separately. Market price risk is measured with Value-at-Risk, and the total Bank Value at Risk (99%, 10 days) was ISK 3.4 billion at 31 December 2005.

Currency risk

119. Currency risk is the risk of loss due to adverse movements in foreign exchange rates. Kaupthing Bank is obliged by law to manage their currency exposure within strict limits. The Bank is allowed to have open currency exposure corresponding to a total of 30 per cent of risk capital and a maximum exposure of 15 per cent of risk capital in any one currency. The Bank is exposed to some FX risk, in particular regarding the repatriation of non-ISK results and depreciation of its ISK denominated risk capital relative to its foreign currency denominated assets. The Bank hedges this risk of depreciation by having foreign currency denominated assets in excess of the liabilities. If the ISK exchange rate index depreciated by 30% from its year end 2005 level then it would affect the CAD-ratio of the Bank by – 0.7%. Net exposures per currency are monitored centrally in the Bank.

120. Breakdown of assets and liabilities by currency:

The total amount of assets in foreign currencies in the Banks Financial Statement is ISK 2,242 billion, and the total amount of liabilities amounted to ISK 2,198 billion, respectively, at year-end. Included in these assets and liabilities are forward contracts and interest rate swaps, see note 102.

Fair value of financial instruments

121. The following table presents the fair value of financial instruments, including those not reflected in the Financial Statements at fair value. It is accompanied by a discussion of the methods used to determine fair value for financial instruments.

ASSETS	**Carrying value 31.12.2005**	**Fair value 31.12.2005**	**Unrealised gain (loss) 31.12.2005**
Cash and cash balances with central banks	34,877	34,877	0
Loans and advances...	1,739,294	1,754,596	15,302
Financial assets measured at fair value	612,366	612,366	0
Financial assets available-for-sale....................................	167	167	0
LIABILITIES			
Deposits from credit institutions and central banks...........	69,643	69,643	0
Other deposits	486,176	486,968	(792)
Borrowings...	1,556,567	1,555,487	1,080
Subordinated loans	102,688	102,627	61
Financial liabilities measured at fair value.......................	60,273	60,273	0
Net unrealised gains not recognised in the Income Statement			**15,651**

The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties, i.e. not during a forced sale or liquidation. The existence of published price quotations in an active market is the best evidence of fair value and when they exist they are used by the Bank to measure financial assets and financial liabilities. If quoted prices for a financial instrument fail to represent actual and regularly occurring transactions in an active market transaction or if quoted prices are not available at all, fair value is established by using an appropriate valuation technique.

The best evidence of the fair value of a financial instrument at initial recognition is the transaction price, unless the fair value can be evidenced by comparison with other observable current market transactions, or is based on a valuation technique whose variables include only data from observable markets.

In some cases, the carrying value of the financial instrument is as in note 64 used as an approximation for the fair value of the instrument. This is straightforward for cash and cash equivalents but is also used for short-term investments and borrowings to highly rated counterparties, such as credit institutions, on contracts that carry interests close to or equal to market rates and expose the Bank to little or no credit risk.

Fair value established from quoted market prices

For listed and liquid stocks and bonds, certain financial derivatives and other market traded securities, such as commodities, the fair value is derived directly from the market prices. These instruments are disclosed in following Balance Sheet items, Trading assets and Trading liabilities.

For financial instruments, for which the market is not active, the Bank applies specific working procedures and valuation techniques to attain a fair value using as much market information as available. Valuation techniques include using recent arm's length market transactions between knowledgeable, willing parties, if available, reference to the current fair value of another instrument that is substantially the same, discounted cash flow analysis, option pricing models or other commonly accepted valuations techniques used by market participants to price the instrument.

Fair value established using valuation techniques

For financial instruments for which quoted prices on active markets are not available, the fair values are derived using various valuation techniques. This applies in particular to OTC-derivatives such as options, swaps, futures and unlisted equities but also some other assets and liabilities.

In most cases the valuations are based on theoretical financial models, such as the Black-Scholes models or variations thereof. These techniques also include forward pricing and swap models using present value calculations.

Furthermore, in many cases there is little or no market data to rely on for fair value calculations. The most common valuation technique is present value calculations. Such calculations involve the estimation of future cash flow and the assessment of appropriate discount rate. The discount rate should both reflect current market rates and the uncertainty in the future cash flow. In such cases internal models and methods are used to calculate the fair value. The models may be statistical in nature, based on internal or external history of financial instruments with similar characteristics and/or based on internal knowledge and experience. For example, the credit margin on most loans to customers - which is added to the current and suitable interest rate to arrive at an appropriate discount rate - is estimated using credit rating and loss parameters in case of default that have been derived from internal models.

Equity instruments that do not have a quoted market price are evaluated using methods and guidelines from pertinent international organisations. In most cases intrinsic value is the basis for the assessment but other factors, such as cash flow analysis, can also modify the result.

The fair value for deposits with stated maturities was calculated by discounting estimated cash flows using current market rates for similar maturities. For deposits that can be withdrawn immediately, the fair value is the amount payable on demand, which is equal to the carrying amount in the Balance Sheet.

Although the Bank follows market standards and relies on well accepted methods there is still wide room for choice, both in the models themselves and the assumptions that must be supplied and cannot be derived from market data. Consequently, different assumptions and choices could lead to different estimates.

Subsidiaries

Company	Country	Currency	Business Group[1]	Share Capital in millions	Equity interest accum %
Anon Custody Service hf.	Iceland	ISK	OD	115	100.0
Eik fasteignafelag hf.	Iceland	ISK	OD	707	100.0
FI-Holding A/S	Denmark	DKK	IB, Tr, Ba	842	100.0
Kaupthing Bank Luxembourg S.A.	Luxembourg	EUR	CM , Tr, Ba, AM &PB	7,936	100.0

Company	Country	Currency	Business Group[1]	Share Capital in millions	Equity interest accum %
Kaupthmg Bank Oyj	Finland	EUR	IB, CM, Tr, Ba , AM & PB	1,670	100.0
Kaupthing Foroyar Virdisbraevameklarafel P/F	Faroe Islands	DKK	IB, CM, AM a PB	112	100.0
Kaupthing Holding UK Ltd (S&F)	UK	GBP	IB, CM, Tr, Ba , AM a PB	28,847	100.0
Kaupthing New York Inc.	USA	USD	CM	260	100.0
Kaupthing Norge AS	Norway	NOK	IB, CM, AM a PB	1,433	100.0
Kaupthing Sverige AB	Sweden	SEK	IB, CM, Tr, Ba , AM a PB	2,807	93.5
Kaupthing UK Ltd.	UK	GBP	IB, CM, Tr, Ba, AM a PB	364	100.0
KB Lif hf.	Iceland	ISK	Ba	17	100.0
Kirna ehf.	Iceland	ISK	IB, Tr	31,770	100.0
Norvestia Oyj	Finland	EUR	CM	4,455	30.6
Rekstrarfelag Kaupthings banka hf.	Iceland	ISK	AM & pb	44	100.0
Vidjar ehf.	Iceland	ISK	Ba	1	100.0
Spansjodur Kaupthings hf.	Iceland	ISK	Ba	100	100.0

1 IB:Investing Banking, CM: Capital Markets, Tr: Treasury, Ba :Banking, AM & PB: Asset Management and Private Banking. OO: Other Divisions

CHANGES TO ACCOUNTING POLICIES IN ACCORDANCE WITH INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)

As discussed in the note 1 on accounting policies, this is the first time the Bank has prepared its annual accounts in accordance with the International Financial Reporting Standards (IFRS).

The accounts for the operating year 2005 are prepared in accordance with the accounting policies discussed in the notes on accounting policies. This also applies to comparative figures for 2004 and the opening balance sheet of 1 January 2004, as changes become effective as of that date, which is referred to as the transition date.

Amounts in the opening Balance Sheet of 1 January 2004 have been changed in accordance with IFRS, but were previously presented in accordance with legislation on annual accounts and Icelandic GAAP (Generally Accepted Accounting Principles). The following tables and notes show the effects the change from Icelandic GAAP to IFRS has had on the financial position of the Bank, its financial results and cash flows. There are no significant changes to the cash flows summary according to IFRS compared with how it was previously under GAAP.

Changes in equity from previous GAAP to IFRS:		**Shareholders' equity**
Equity according to previous GAAP at 31 December 2004		149,443
Equity according to IFRS at 1 January 2005		149,370
Change in equity from previous GAAP to IFRS		(73)
Adjustments at the beginning of the year 2004:		
Impairment of goodwill	IFRS 3	(311)
Investment property	IAS 40	(20)
Recalculation of tax liabilities	IAS 12	60
Total transition to IFRS 1 January 2004		(271)
Adjustments in 2004:		
Net earnings according to previous GAAP 2004		(15,760)
Net earnings according to IFRS 2004		17,707

Translation difference in equity	IAS 21	(	670)
Total adjustments in 2004			1,277

Adjustments at the beginning of the year 2005:

Value changes because of hedge accounting	IAS 39	(	1,353)
Changes in impairment of loans	IAS 39		4,538
Value changes in loans because of embedded derivatives, upfront fee etc.	IAS 39	(	1,622)
Trading liabilities measured at fair value	IAS 39	(	1,654)
Value changes in financial assets designated at fair value through profit and loss	IAS 39		1,446
Value changes in borrowings because of embedded derivatives	IAS 39	(	600)
Investment in associates	IAS 28	(	461)
Adjustment of goodwill and reversal of amortisation	IFRS 3	(	941)
Other adjustments			8
Recalculation of tax liabilities	IAS 12	(	440)
Total transition to IFRS 1 January 2005		(	1,079)
Changes from previous GAAP to IFRS		(	73)

The total effect on shareholders' equity of the transition to IFRS is a decrease of ISK 73 million, i.e. a minor reduction from the previous GAAP. The following describes the effects of these new accounting policies on the Bank's Balance Sheet and Income Statement. Shareholders' equity is thereafter calculated at ISK 149.4 billion on 1 January 2005.

Origination fees

The main changes resulting from the introduction of the IFRS are as follows: origination fees will be accrued over the term of the loan instead of being recognised as income at the time of disbursement. As a result the Bank's interest income will decrease in the short term but the long term effects will be insignificant.

In the opening Balance Sheet the effective rate of interest on loans has been recalculated in accordance with IAS 39. As a result shareholders´ equity on 1 January 2005 decreased by ISK 1,622 million.

Impairment of loans and advances

In accordance with IAS 39 the Bank has performed the impairment of loans. As a result the Bank's shareholders' equity increased by ISK 4,538 million.

According to IAS 39 the Bank is obligated to review all loans to ascertain whether there is objective evidence of impairment that affects the size of expected cash flows from the loan. The loan will then be written down to the present value of expected future cash flows.

Goodwill

Goodwill will no longer be amortised. Instead, the value of goodwill will be tested annually for impairment. Shareholders' equity on 1 January 2004 decreased by ISK 311 million because goodwill was impaired. The amortisation of goodwill in 2004 was reversed and as a result Net earnings in year 2004 increased by ISK 1,289 million. In addition the goodwill from the acquisition of FI-Holding in July 2004 was recalculated in accordance with IFRS 3, Business Combinations, and as a result decreased by ISK 941 million. Total effect on shareholders' equity on 1 January 2005 was ISK 941 million.

Foreign currency translation

According to previous GAAP, income and expenses in foreign currency were translated into Icelandic krona using the exchange rates current at the time of recognition.

The income and expenses of the Bank’s non-Icelandic branches and subsidiaries were translated at average exchange rates, while Balance Sheet items were translated at the rates current at the end of the year. All exchange rate differences were included in the Income Statement under trading income.

Under IAS 21, the Effects of Changes in Foreign Exchanges Rates, translation differences from functional to presentation currency must be recognised directly in shareholders’ equity as a separate reserve. Exchanges rate adjustment of liabilities and derivatives used to hedge net investments are also recognised directly against shareholders' equity. As a result Net earnings in year 2004 increased by ISK 670 million and the translation reserve in shareholders’ equity decreased by the same amount.

Minority interest

Under the 2004 accounting policies, minority interest was presented as a separate item outside shareholders’ equity. According to IAS 27, Consolidated and Separate Financial Statements, minority interest shall be presented within equity, separately from the parent shareholders’ equity.

Unlisted assets entered at fair value

The Bank will now enter all its shares in unlisted companies at estimated fair value instead of purchase price or mark-to-market, if this was estimated to be lower than purchase price. These changes result in trading gains which are entered in the Income Statement. Upon the implementation of IFRS, shareholders’ equity on 1 January 2005 increased by ISK 1,446 million due to increase in unlisted assets to fair value. When calculating the fair value of Exista ehf., the company’s share in Kaupthing Bank are valued at cost.

Hedge accounting

The implementation of IAS 39 on hedge accounting affected the opening balance as of 1 January 2005. The Bank will use hedge accounting for financial assets and liabilities where relevant. All derivatives will be measured at fair value. The net effect of the conversion to hedge accounting applied under IFRS on the equity in the opening balance sheet of 1 January 2005 decreases equity amounting to ISK 1,353 million. The effect is a result of applying fair value to certain assets and related derivatives, as opposed to previously applying deferral hedge accounting (amortised cost principle).

In addition, initial recognition of income related to derivatives is reflected by a decrease in equity in opening balance amounting to ISK 600 million.

From previous GAAP

The following tables provide an overview of the effect of the transition to IFRS broken down by valuation and presentation.

According to previous GAAP	**Change in valuation**	**Change in presentation**			**According to IFRS**
Net interest income	18,900	0	(641)	18,259	Net interest income
Fees, commissions and other service charges	15,645	0	(2,337)	13,308	Net fee and commission income
Fees, commissions and other service charges	(2,348)	0	2,348	0	
Dividends from shares and other holdings	4,216	0	(244)	3,972	Dividend income
Trading gains	11,290	0	(10,798)	492	Net gain on financial assets/liabilities not at fair value
		0	12,755		Net gain on financial assets /liabilities at fair value
		670	(1,562)	(892)	Foreign exchange difference

According to previous GAAP	Change in valuation	Change in presentation			According to IFRS
		0	240	240	Share of profit of associates
Other operating income	866	0	968	1,834	Other operating income
Salaries and salary related expenses	(12,652)	0	(199)	(12,851)	Salaries and related expenses
Other administrative expenses	(9,108)	0	(320)	(9,428)	Administration expenses
Depreciation and amortisation	(2,642)	1,289	6	(1,347)	Depreciation and amortisation
Provision for losses	(3,819)	0	(6)	(3,825)	Impairment on loans and advances
		0	(22)	(22)	Loss from non-current assets held for sale
Income tax	(4,040)	(12)	(184)	(4,236)	Income tax
	16,308	1,947	4	18,259	Net earnings
Minority interest	(548)	0	(4)	(552)	Minority interest
Net earnings according to previous GAAP	15,760	1,947	0	17,707	Net earnings attributable to shareholders of Kaupthing Bank

Balance Sheet, change from previous GAAP to IFRS

Previous GAAP 31 December 2004		Change in valuation	Change in presentation		IFRS 1 January 2005
Cash and amounts due from credit Cash and cash balances institutions	113,543	0	(107,253)	6,290	Cash and cash balances with central bank
Loans, lease contracts	1,088,346	11,704	54,366	1,154,416	Loans and advanced
Bonds, shares and other securities	248,352	5,352	50,750	304,454	Financial assets measured at fair value
-		(28)	1,535	1,507	Financial assets available for sale
Shares in associated companies	8,266	(46 1)	(4,156)	3,649	Investment in associates
Goodwill	34,208	(11)	901	35,098	Intangible assets
-		377	18,7781	19,155	Investment property
Fixed assets	6,467	12	(387)	6,092	Propert and equipment
Deferred tax assets	1,039	0	53	1,092	Tax assets
-		(61)	3,692	3,631	Non-current assets and disposal groups classified as held for sale
Other assets	33,799	109	(14,839)	19,069	Other assets
Total Assets	1,534,020	16,993	3,440	1,554,453	**Total Assets**

Previous GAAP 31 December 2004		**Change in valuation**	**Change in presentation**		**IFRS 1 January 2005**
Amounts owed to credit institutions	147,455	0	(114,967)	32,488	Deposits from credit institutions and Central bank
Savings deposits	202,038	0	155	202,193	Other deposits
Borrowings	884,219	2,862	81,431	968,512	Borrowings
Subordinated loans	57,627	0	(4)	57,623	Subordinated loans
-		13,475	54,536	68,011	Financial liabilities measured at fair value
-			0		Insurance liabilities
-			0	0	Trading liabilities
-			0	0	Derivatives used for hedging
Provision for deferred income-tax liability	9,165	392	(5,149)	4,408	Tax liabilities
-		0	1,402	1,402	Liabilities included in disposal groups classified as held for sale
Other liabilities	74,767	337	(14,197)	60,907	Other liabilities
Equity	149,443	(73)	0	149,370	Shareholders' equity
Minority interest in subsidiaries' equity	9,306	0	233	9,539	Minority interest
Total Liabilities and Equity	1,534,020	16,993	3,440	1,554,453	**Total Liabilities and Equity**

INDEPENDENT AUDITORS' REVIEW REPORT

To the Board of Directors of Kaupthing Bank hf.

Introduction

We have reviewed the accompanying Consolidated Interim Balance Sheet of Kaupthing Bank hf. as of 31 March 2007 and the related statements of income, changes in equity and cash flows for the three-month period then ended and a summary of significant accounting policies and other explanatory notes. Management is responsible for the preparation and fair presentation of this interim financial information in accordance with International Financial Reporting Standard IAS 34, *Interim Financial Reporting.* Our responsibility is to express a conclusion on this interim financial information based on our review.

Scope Of Review

We conducted our review in accordance with International Standard on Review Engagements 2410, "Review of Interim Financial Information Performed by the Independent Auditor of the Entity". A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the accompanying interim financial information does not give a true and fair view of the financial position of the entity as at 31 March 2007, and of its financial performance and its cash flows for the three-month period then ended in accordance with IAS 34, *Interim Financial Reporting*.

Reykjavik, 25 April 2007

KPMG HF.

Saemundur Valdimarsson

Reynir Stefan Gylfason

CONSOLIDATED INTERIM INCOME STATEMENT
FOR THE PERIOD FROM 1 JANUARY TO 31 MARCH 2007

	2007	2006	Notes
	1.1 -31.3	1.1 -31.3	
Interest income	62,047	35,434	
Interest expense	(45,782)	(24,950)	
Net interest income	16,265	10,484	
Fee and commission income	15,413	9,454	
Fee and commission expense	(3,076)	(852)	
Net fee and commission income	12,337	8,602	
Net financial income	13,456	13,505	7-12
Share of profit of associates	144	1,038	
Other operating income	1,858	1,822	13
Operating income	44,060	35,451	
Salaries and related expenses	(10,534)	(7,420)	
Administration expenses	(5,516)	(3,749)	
Depreciation and amortisation	(1,534)	(1,293)	
Other operating expenses	(123)	(90)	
Impairment on loans	(1,423)	(710)	22
Earnings before income tax	24,930	22,189	
Income tax expense	(4,236)	(2,595)	
Net earnings	20,694	19,594	
Attributable to			
Shareholders of Kaupthing Bank hf	20,281	18,798	
Minority interest	413	796	
Net earnings	20,694	19,594	
Earnings per share			
Basic earnings per share	274	283	15
Diluted earnings per share	267	278	15

CONSOLIDATED INTERIM BALANCE SHEET AS AT 31 MARCH 2007

	31.3.2007	31.12.2006	Notes
Assets			
Cash and balances with central banks	133,901	106,961	16
Loans to credit institutions	452,359	485,334	17
Loans to customers	2,559,121	2,538,609	18-22
Bonds and debt instruments	362,852	318,264	23
Shares and instruments with variable income	170,536	159,020	23
Derivatives	58,820	65,454	23,36
Derivatives used for hedging	9,409	6,453	23,36
Securities used for hedging	234,986	115,938	23
Investments in associates	5,369	5,304	
Intangible assets	63,952	68,301	26
Investment property	30,625	31,584	27
Property and equipment	29,127	30,466	
Tax assets	7,045	5,834	
Other assets	80,283	117,874	28
Total Assets	4,198,385	4,055,396	40
Liabilities			
Due to credit institutions and central banks	119,871	110,456	
Deposits	892,170	750,658	
Financial liabilities measured at fair value	79,415	71,264	29-31
Borrowings	2,435,101	2,399,939	32
Subordinated loans	218,856	216,030	33
Tax liabilities	23,772	23,209	
Other liabilities	105,060	148,948	34
Total Liabilities	3,874,245	3,720,504	
Equity			
Share capital	7,344	7,321	
Share premium	163,984	164,028	
Reserves	(2,378)	17,220	
Retained earnings	144,950	134,941	
Total Shareholders' Equity	313,900	323,510	
Minority interest	10,240	11,382	
Total Equity	324,140	334,892	
Total Liabilities and Equity	4,198,385	4,055,396	

CONSOLIDATED INTERIM STATEMENT OF CHANGES IN EQUITY
FOR THE PERIOD FROM 1 JANUARY TO 31 MARCH 2007

	Share capital and premium	Reserves	Retained earnings	Total Share-holders' equity	Minority interest	Total equity
Changes in equity in Q1 2007:						
Equity 31 December 2006	171,349	17,220	134,941	323,510	11,382	334,892
Translation difference		(19,613)		(19,613)	(989)	(20,602)
Fair value changes in AFS financial assets		15		15		15
Net loss recognised directly in equity		(19,598)		(19,598)	(989)	(20,587)
Net earnings according to the Income Statement			20,281	20,281	413	20,694
Total recognised earnings for the period		(19,598)	20,281	683	(576)	107
Dividends paid to equity holders, ISK 14 per share			(10,272)	(10,272)		(10,272)
Purchases and sales of treasury stock	(238)			(238)		(238)
Exercised stock options	217			217		217
Other changes				0	(566)	(566)
Equity 31 March 2007	171,328	(2,378)	144,950	313,900	10,240	324,140
Changes in equity in Q1 2006:						
Equity 31 December 2005	121,244	(1,540)	74,479	194,183	8,329	202,512
Translation difference		7,354		7,354	79	7,433
Fair value changes in AFS financial assets		2		2		2
Net earnings recognised directly in equity		7,356		7,356	79	7,435
Net earnings according to the Income Statement			18,798	18,798	796	19,594
Total recognised earnings for the period		7,356	18,798	26,154	875	27,029
Dividends paid to equity holders, ISK 10 per share			(6,610)	(6,610)		(6,610)
Purchases and sales of treasury stock	19			19		19
Exercised stock options	104			104		104
Other changes		157		157	677	834
Equity 31 March 2006	121,367	5,973	86,667	214,007	9,881	223,888

CONDENSED CONSOLIDATED INTERIM STATEMENT OF CASH FLOWS
FOR THE PERIOD FROM 1 JANUARY TO 31 MARCH 2007

	2007	2006
	1.1-31.3	**1.1-31.3**
Net cash provided by operating activities	53,243	1,377
Net cash flow used in investing activities	(1,148)	(5,623)
Net cash flow (used in) provided by financing activities	(7,684)	4,634
Net increase in cash and cash equivalents	44,411	388
Cash and cash equivalents at beginning of the year	202,789	81,758
Effect of exchange rate changes on cash held	(17,703)	7,482
Cash and cash equivalents at end of the period	229,497	89,628

NOTES TO THE CONSOLIDATED INTERIM FINANCIAL STATEMENTS

ACCOUNTING POLICIES

General information

Kaupthing Bank hf.. is a company incorporated and domiciled in Iceland. The address of the Bank's registered office is Borgartun 19, Reykjavik, Iceland. The Consolidated Interim Financial Statements for the three months ended 31 March 2007 comprise Kaupthing Bank hf.. (the parent) and its subsidiaries (together referred to as "the Bank"). The Consolidated Interim Financial Statements were authorised for issue by the Board of Directors of Kaupthing Bank hf.. on 25 April 2007.

1. Statement of compliance

These Consolidated Interim Financial Statements have been prepared in accordance with International Financial Reporting Standard (IFRS) IAS 34 *Interim Financial Reporting* as adopted by the EU. They do not include all of the information required for full annual Financial Statements, and should be read in conjunction with the Consolidated Financial Statements of the Bank as at and for the year ended 31 December 2006.

2. Significant accounting policies

The accounting policies applied by the Bank in these Consolidated Interim Financial Statements are the same as those applied by the Bank in its Consolidated Financial Statements as at and for the year ended 31 December 2006.

The Consolidated Financial Statements of the Bank as at and for the year ended 31 December 2006 are available upon request from the Bank's registered office at Borgartun 19, Reykjavik or at www.kaupthing.net or www.omx.is.

The Consolidated Interim Financial Statements are presented in Icelandic krona (ISK) which is the Bank's functional currency, rounded to the nearest million.

SEGMENT REPORTING

3. Segment information is presented in respect of the Bank's business and geographical segments. The primary format, business segments, is based on the Bank's management and internal reporting structure.

Inter-segment pricing is determined on an arm's length basis. Business segments pay and receive interest to and from Treasury on an arm's length basis to reflect the allocation of capital and funding cost.

Business segments

The Bank comprises the following main business segments:

Capital Markets is divided into two parts, Capital Markets and Proprietary Trading. Capital Markets handles securities, derivatives and foreign exchange trading and brokerage for the Bank's clients. Proprietary Trading handles transactions for the Bank's own account in all major markets, as well as undertaking the Bank's market making for stocks and bonds.

Investment Banking provides various services to corporate clients through its four main products areas, M&A advisory, capital market transactions, acquisition and leverage finance and principle investment.

Treasury is responsible for inter-bank trading and the Bank's funding.

Banking provides general banking services to retail customers in Iceland and services such as advice and assistance in financing to medium-sized and large companies, particularly in Iceland, Sweden, the United Kingdom (UK) and Denmark.

Asset Management and Private Banking manage financial assets for institutional, corporate and private clients. Asset Management is organised into three units - Alternative and Mutual Fund Management, Asset Management for Institutional Investors and Services for Institutional Investors: Private Banking consists of two units - Customer Relations and Portfolio Management.

Cost centres are: Overhead, Back office, Risk Management, Finance, Legal department, Information Technology, Human Resources, Sales and Marketing.

Geographical segments

The Bank operates in four main geographical regions, being Iceland, Scandinavia, the United Kingdom and Luxembourg.

4. Summary of the Bank's business segments:

1.1-31.3.2007	Capital Markets	Investment Banking	Treasury	Banking	Asset Management and Private Banking	Elimination and cost centres	Total
Net interest income	(564)	(1,095)	4,428	13,423	324	(251)	16,265
Net fee and commission income	4,126	3,483	(75)	1,257	3,414	132	12,337
Net financial income	9,778	3,980	(441)	94	28	17	13,456
Other income	56	65	67	1,555	81	178	2,002
Operating income.................................	13,396	6,433	3,979	16,329	3,847	76	44,060
Operating expense	(2,412)	(708)	(875)	(4,380)	(2,002)	(7,330)	(17,707)
Impairment	0	0	0	(1,424)	0	1	(1,423)
Total expense..	(2,412)	(708)	(875)	(5,804)	(2,002)	(7,329)	(19,130)
Earnings before cost allocation	10,985	5,725	3,104	10,525	1,845	(7,253)	24,930
Allocated cost	(1,163)	(432)	(561)	(2,407)	(1,070)	5,633	0
Earnings before income tax	9,821	5,293	2,543	8,118	775	(1,620)	24,930
Net segment revenue from external customers...	18,112	6,456	(25,359)	45,179	1,962	(2,290)	44,060
Net segment revenue from other segments	(4,715)	(23)	29,337	(28,850)	1,885	2,366	0
Operating income.................................	13,396	6,433	3,979	16,329	3,847	76	44,060
Depreciation and amortisation	3	1	11	988	17	514	1,534
Total assets 31 3 2007...........................	379,416	117,545	1,630,837	2,508,260	13,805	(451,478)	4,198,385
Total liabilities 31 3 2007	342,739	81,976	1,577,889	2,318,907	6,033	(453,299)	3,874,245
Allocated equity 31 3 2007	36,677	35,569	52,948	189,353	7,772	1,821	324,140
Total liabilities and equity 31 3 2007 ...	379,416	117,545	1,630,837	2,508,260	13,805	(451,478)	4,198,385

1.1-31.3.2006	Capital Markets	Investment Banking	Treasury	Banking	Asset Management and Private Banking	Elimination and cost centres	Total
Net interest income	(218)	(850)	1,462	10,208	162	(280)	10,484
Net fee and commission income	2,798	2,019	(78)	1,133	2,628	102	8,602
Net financial income	7,752	4,235	1,402	203	196	(283)	13,505
Other income..	0	262	0	1,220	0	1,378	2,860
Operating income	10,332	5,666	2,786	12,764	2,986	917	35,451
Operating expense	(1,048)	(556)	(492)	(3,304)	(1,938)	(5,214)	(12,552)
Impairment	0	(1)	(6)	(705)	0	2	(710)
Total expense	(1,048)	(557)	(498)	(4,009)	(1,938)	(5,212)	(13,262)
Earnings before cost allocation	9,284	5,109	2,288	8,755	1,048	(4,295)	22,189
Allocated cost...	(646)	(222)	(455)	(2,033)	(965)	4,321	0
Earnings before income tax	8,638	4,887	1,833	6,722	83	26	22,189
Net segment revenue from external customers	11,576	6,188	(9,517)	23,485	1,928	1,791	35,451
Net segment revenue from other segments	(1,244)	(522)	12,303	(10,721)	1,058	(874)	0
Operating income	10,332	5,666	2,786	12,764	2,986	917	35,451
Depreciation and amortisation	2	2	2	734	6	547	1,293
Total assets 31.12.2006	328,176	108,946	1,536,197	2,597,032	12,386	(527,341)	4,055,396
Total liabilities 31.12.2006	288,327	47,998	1,487,116	2,421,953	4,171	(529,061)	3,720,504
Allocated equity 31.12.2006	39,849	60,948	49,081	175,079	8,215	1,720	334,892
Total liabilities and equity 31.12.2006.......	328,176	108,946	1,536,197	2,597,032	12,386	(527,341)	4,055,396

Geographical analysis

5. Operating income specified by location of its markets and customers.

The geographical analysis of operating income is provided in order to comply with IFRS and does not reflect the way the Bank is managed.

1.1-31.3.2007	Iceland	Scandinavia	UK	Luxembourg	Other	Total
Net interest income	4,652	5,122	4,491	1,510	490	16,265
Net fee and commission income	4,960	1,755	3,909	1,528	185	12,337
Net financial income	1,531	10,221	1,221	536	(53)	13,456
Other income	606	294	1,102	0	0	2,002
Operating income	11,749	17,392	10,723	3,574	622	44,060
1.1-31.3.2006						
Net interest income	2,305	3,625	3,136	1,158	260	10,485
Net fee and commission income	3,157	1,614	2,218	1,393	220	8,602
Net financial income	1,647	7,985	2,153	1,009	711	13,505
Other income	1,628	400	833	(1)	0	2,860
Operating income	8,737	13,624	8,340	3,559	1,191	35,451

The figures for net interest income for the first quarter in 2006 have been changed from previously published figures for geographical analysis, because of changed method in allocating equity by country at year-end 2006.

6. Assets specified by location of its markets and customers.

31.3.2007	Iceland	Scandinavia	UK	Luxembourg	Other	Total
Cash and cash balances with central banks	1,056	104,822	24,023	3,768	232	133,901
Loans to credit institutions	80,044	144,8 11	145,994	41,762	39,748	452,359
Loans to customers	559,802	1,035,784	566,485	298,361	98,689	2,559,121
Financial assets measured at fair value	450,654	315,824	21,708	45,993	2,424	836,603
Other assets	85,637	64,254	61,318	4,664	528	216,401
Total Assets	**1,177,193**	**1,665,495**	**819,528**	**394,548**	**141,621**	**4,198,385**
31.12.2006						
Cash and cash balances with central banks	964	40,616	65,007	42	332	106,961
Loans to credit institutions	88,421	126,909	139,308	50,414	80,282	485,334
Loans to customers	573,238	1,085,119	506,626	271,469	102,157	2,538,609
Financial assets measured at fair value	332,744	261,918	30,621	36,426	3,420	665,129
Other assets	76,149	111,685	66,316	4,899	314	259,363
Total Assets	**1,071,516**	**1,626,247**	**807,878**	**363,250**	**186,505**	**4,055,396**

NOTES TO THE INCOME STATEMENT

Net financial income

7. Net financial income is specified as follows:

	Q1 2007	Q1 2006
Dividend income	1,858	1,614
Net gain on financial assets and liabilities at fair value	11,526	11,137
Net foreign exchange gain	62	728
Net gain on financial assets and liabilities not at fair value	10	26
Net financial income	**13,456**	**13,505**

Dividend income

8. Dividend income is specified as follows:

Dividend income on trading assets	1,732	1,574
Dividend income on assets at fair value through profit and loss	126	40

Dividend income	**1,858**	**1,614**

Net gain on financial assets and liabilities at fair value

9. Net gain on financial assets and liabilities at fair value are specified as follows:

Net gain on assets designated at fair value through profit and loss	9,376	7,109
Net gain on trading portfolio	2,043	3,816
Fair value adjustments on hedge accounting	107	212
Net gain on financial assets and liabilities at fair value	**11,526**	**11,137**

10. Net gain on trading portfolio are specified as follows:

Gain on equity instruments and related derivatives	10,485	7,032
(Loss) gain on other derivatives	(1,120)	420
Gain (loss) on interest rate instruments and related derivatives	11	(343)
Net gain on trading portfolio	**9,376**	**7,109**

11. Net gain on assets designated at fair value through profit and loss are specified as follows:

Gain (loss) on interest rate instruments designated at fair value	488	(380)
Gain on equity instruments designated at fair value	1,555	4,196
Net gain on assets designated at fair value through profit and loss	**2,043**	**3,816**

Net gain on financial assets and liabilities not at fair value

12. Net gain on financial assets and liabilities not at fair value are specified as follows:

Net realised gain on loans and finance leases	8	22
Net realised gain on available-for-sale assets	2	2
Other net realised gain	0	2
Net gain on financial assets and liabilities not at fair value	**10**	**26**

Other operating income

13. Other operating income is specified as follows:	**Q1 2007**	**Q1 2006**
Income from operating lease	1,155	857
Fair value adjustments on investment properties	(57)	399
Realised gain on investment properties	0	94
Other income	760	472
Other operating income	**1,858**	**1,822**

Personnel

14. The Bank's total number of employees is as follows:	31 32007	31 12 2006
Average number of full time equivalent positions during the period	2,805	2,553
Full time equivalent positions at the end of the period	**2,847**	**2,719**

Earnings per share

15. Earnings per share are specified as follows:	**Q1 2007**	**Q1 2006**
Net earnings attributable to the shareholders of Kaupthing Bank hf.	20,281	18,798
Weighted average share capital		
Weighted average of outstanding shares for the period	739 1	663 7
Effects of stock options	21 4	11 7
Weighted average of total shares for the period, diluted	760 5	675 4

Basic earnings per share	27 4	28 3
Diluted earnings per share	26 7	27 8
Number of outstanding shares at the end of the period, million	734 4	663 6
Number of total shares at the end of the period, million, diluted	755 8	675 2
Average number of own shares, million	5 8	4 1
Number of own shares at the end of the period, million	6 1	1 0

NOTES TO THE BALANCE SHEET

Cash and balances with central banks

16. Cash and balances with central banks are specified as follows:	**31.3.2007**	**31.12.2006**
Cash and cash balances	32,881	10,537
Cash equivalent	101,020	96,424
Cash and balances with central banks	**133,901**	**106,961**

Loans to credit institutions

17. Loans to credit institutions specified by types of loans:

Money market loans	265,568	242,284
Bank accounts	95,595	95,828
Overdrafts	6,374	7,902
Repos	0	50,753
Other loans	84,822	88,567
Loans to credit institutions	452,359	485,334

Loans to customers

18. Loans to customers specified by types of loans:	**31.3.2007**	**31.12.2006**
Overdrafts	112,870	113,354
Finance lease	87,101	93,006
Subordinated loans	7,044	7,369
Other loans	2,368,661	2,341,462
Provision on loans	(16,555)	(16,582)
Loans to customers	**2,559,121**	**2,538,609**

19. Loans to customers specified by sectors:

Individuals	17 1%	1 6 6%
Holding companies	12 1%	13 5%
Industry	18 1%	20 3%
Real estate	179%	1 5 6%
Service	196%	199%
Trade	140%	125%
Transportation	1.2%	1.6%
Loans to customers	**100.0%**	**100 0%**

20. Specification of subordinated loans:

Loans to customers	4,725	4,907
Bonds and other fixed income securities	2,319	2,462

Subordinated loans	**7,044**	**7,369**

21. Provisions on loans are specified as follows:

Specific provision	12,699	13,404
Collective assessment	3,856	3,178
Provision on loans	**16,555**	**16,582**

22. Changes in the provision on loans are specified as follows:

	Q1 2007	Q1 2006
Balance at the beginning of the year	16,582	12,953
Impairment on loans during the period	1,423	710
Exchange rate difference on translation	(724)	864
Write-offs during the period	(760)	(992)
Payment of loans previously Written-off	34	82
Provision on loans at the end of the period	**16,555**	**13,617**

Included within interest income is ISK 190 million (31.12.2006 ISK 642 million) with respect of interest income accrued on impairment on financial assets and ISK 49 million (31.12.2006 ISK 161 million) with respect to the unwind of the impairment provision discount.

Non-performing loans are classified as aggregated exposures of customers for which the Bank has made specific provisions in part or in full. Non-performing loans amounted at the end of March 2007 to ISK 26,331 million (31.12.2006 ISK 25,506 million), 1.03% of total loans to customers (31.12.2006 1.00%).

Financial assets

23. Financial assets are specified as follows:

31.3.2007	**Trading assets**	**Fin assets designated at fair value**	**Fin assets available for sale**	**Derivatives used for hedging**	**Total**
Bonds and debt instruments					
Listed	41,518	283,536	0	0	325,054
Unlisted	530	27,965	0	0	28,495
Mortgage loans	0	9,303	0	0	9,303
Bonds and debt instruments	**42,048**	**320,804**	**0**	**0**	**362,852**
Shares and instruments with variable income					
Listed	83,827	22,403	0	0	106,230
Unlisted	3,926	50,055	152	0	54,133
Bond fund with variable income	8,817	1,356	0	0	10,173
Shares and instruments with variable income	**96,570**	**73,814**	**152**	**0**	**170,536**
Derivatives					
OTC derivatives	44,112	0	0	0	44,112
Futures	12	0	0	0	12
Other trading derivatives	14,696	0	0	0	14,696
Derivatives	**58,820**	**0**	**0**	**0**	**58,820**
Derivatives used for hedging					
Fair value hedge	0	0	0	5,444	5,444
Portfolio hedge of interest rate risk	0	0	0	3,965	3,965

31.3.2007	Trading assets	Fin assets designated at fair value	Fin assets available for sale	Derivatives used for hedging	Total
Derivatives used for hedging	0	0	0	9,409	9,409
Securities used for hedging					
Bonds and debt instruments	81,358	0	0	0	81,358
Shares and equity instruments	153,628	0	0	0	153,628
Securities used for hedging	**234986**	**0**	**0**	**0**	**234,986**
Financial assets	**432,424**	**394,618**	**152**	**9,409**	**836,603**
Bonds and debt instruments					
Listed	26,208	246,620	0	0	272,828
Unlisted	3,559	31,369	0	0	34,928
Mortgage loans	0	10,508	0	0	10,508
Bonds and debt instruments	29,767	288,497	0	0	318,264
Shares and instruments with variable income					
Listed	77,638	33,931	0	0	111,569
Unlisted	2,471	34,559	164	0	37,194
Bond fund with variable income	8,835	1,422	0	0	10,257
Shares and instruments with variable income	**88,944**	**69,912**	**164**	**0**	**1 59,020**
Derivatives					
OTC derivatives	50,011	0	0	0	50,011
Futures	15	0	0	0	15
Other trading derivatives	15,428	0	0	0	15,428
Derivatives	65,454	0	0	0	65,454
Derivatives used for hedging					
Fair value hedge	0	0	0	2,953	2,953
Portfolio hedge of interest rate risk	0	0	0	3,500	3,500
Derivatives used for hedging	0	0	0	6,453	6,453
Securities used for hedging					
Bonds and debt instruments	66,732	0	0	0	66,732
Shares and equity instruments	47,011	2,195	0	0	49,206
Securities used for hedging	**113,743**	**2,195**	**0**	**0**	**115,938**
Financial assets	**297,908**	**360,604**	**164**	**6,453**	**665,129**

24. Bonds and debt instruments designated at fair value specified by issuer:

	31.3.2007	**31.12.2006**
Financial institutes	307,297	270,879
Government	1,513	1,032
Corporates	11,994	16,586
Bonds and debt instruments designated at fair value	**320,804**	**288,497**

Pledged assets

25. Pledged assets are specified as follows:

Mortgage loans in Kaupthing mortgages Fund	8 4,463	84, 165

In the ordinary course of business, the Bank enters into transactions that result in the transfer of financial assets to third parties or special entities. The Bank has transferred retail mortgage loans to the Kaupthing mortgages Fund, but has retained substantially all of the credit risk associated with the transferred assets, and continues to recognise these assets within loans to customers.

The Bank has entered into repurchase agreements that are conducted under terms usual and customary to standard lending, and stock borrowing and lending activities. Pledged assets according to these agreements amounted to ISK 101 billion at the end of March 2007 (31.12.2006 ISK 121 billion). Kaupthing Bank hf.. Interim Financial Statements 31 March 2007 16 Amounts are in ISK millions.

Intangible assets

26. Intangible assets are specified as follows:

	Goodwill	Other Intangible assets	31.3.2007 Total	31.12.2006 Total
Balance at the beginning of the year	63,118	5,183	68,301	54,943
Exchange rate difference	(4,396)	(208)	(4,604)	13,880
Additions during the period	0	388	388	1,810
Impairment during the period	000	(1,270)		
Amortisation during the period	0	(133)	(133)	(1,062)
Intangible assets	**58,722**	**5,230**	**63,952**	**68,301**

Investment property

27. Investment property are specified as follows:

	31.3.2007	31.12.2006
Balance at the beginning of the year	31,584	24,156
Exchange rate difference	(1,227)	3,426
Additions during the period	390	3,475
Disposals during the period	0	(2,347)
Revaluation during the period	(122)	96
Transfers	0	2,778
Investment property at the end of the period	**30,625**	**31,584**

28. Other assets are specified as follows:

Unsettled securities trading	45,641	90,427
Accounts receivables	6,618	8,617
Accrued income	9,885	8,004
Prepaid expenses	3,553	2,846
Non-current assets and disposal groups classified as held for sale	2,348	2,334
Sundry assets	12,238	5,646
Other assets	80,283	117,874

Unsettled securities trading was settled in less than three days from the reporting date.

Financial liabilities measured at fair value

29. Financial liabilities measured at fair value are specified as follows:

Trading liabilities	61,130	51,095
Derivatives used for hedging - portfolio hedge of interest rate risk	8,565	8,768
Mortgage funding measured at fair value	9,720	11,401
Financial liabilities measured at fair value	79,415	71,264

30. Trading liabilities are specified as follows:

	31.3.2007	31.12.2006
Short position in equity instruments held for trading	3,702	2,122
Derivatives held for trading	57,428	48,788
Other liabilities held for trading	0	185

Trading liabilities	**61,130**	**51,095**

31. Derivatives used for hedging are specified as follows:

Fair value hedge	331	1,070
Portfolio hedge of interest rate risk	8,234	7,698
Derivatives used for hedging	**8,565**	**8,768**

Borrowings

32. Borrowings are specified as follows:

Bonds issued	1,735,629	1,762,483
Bills issued	236,702	156,203
Money market loans	326,137	373,285
Other loans	136,633	107,968
Borrowings	2,435,101	2,399,939

Included are Repurchase agreements with banks amounting to ISK 30,471 million at the end of the period compared to ISK 94,913 millon at year end 2006.

Subordinated loans

33. Subordinated loans are specified as follows:

	31.3, 2007	**31,12 ,2006**
Tier 1 capital	48,727	51,817
Tier II capital	170,129	164,213
Subordinated loans	**218,856**	**216,030**

Other liabilities

34. Other liabilities are specified as follows:

Unsettled securities trading	49,361	91,661
Provisions	2,784	4,666
Accounts payable	5,989	4,410
Sundry liabilities	46,926	48,211
Other liabilities	**105,060**	**148,948**

Unsettled securities trading was settled in less than three days from the reporting date.

Equity

35. Equity at the end of the period amounts to ISK 324,140 million. The equity ratio, calculated in accordance to Article 84 of the Act on Financial Undertakings, was 13.8%. According to the law the ratio may not be lower than 80%.

The ratio is calculated as follows:

	31.3.2007		**31.12.2006**	
	Book value	**Weighted value**	**Book value**	**Weighted value**
Risk base:				
Assets recorded in the Financial Statements	4,198,385	3,076,766	4,055,396	2,875,539
Assets deducted from equity		(62,403)		(66,922)
Guarantees and other items not included in the Balance Sheet		226,844		259,023
		3,241,207		**3,067,640**

Equity

	31.3.2007		31.12.2006	
	Book value	Weighted value	Book value	Weighted value
Tier I capital:				
Equity		324,140		334,892
Intangible assets		(60,830)		(65,276)
Subordinated loans		48,727		51,817
Tier II capital:				
Subordinated loans		156,019		160,717
Investment in credit institutions		(22,044)		(21,324)
		446,012		**460,826**
Equity ratio		138%		150%
Thereof Tier I ratio		96%		105%

Derivatives

36. Derivatives remaining maturity date of principal and book value are specified as follows:

31.3.2007	**Principal**				**Book value**	
	Up to 3 months	**Over 3 months and up to a year**	**Over 1 year**	**Total**	**Assets**	**Liabilities**
Currency and interests rate derivatives, agreements unlisted:						
Forward exchange rate agreements	1,651,908	141,565	3,569	1,797,042	12,694	13,852
Interest rate and exchange rate agreements	214,339	601,371	1,924,485	2,740,195	31,255	34,384
Options - purchased agreements	8,355	73,943	51,762	134,060	2,061	94
Options - sold agreements	10,928	75,727	48,458	135,113	84	2,196
	1,885,530	892,606	2,028,274	4,806,410	46,094	50,526
Equity derivatives:						
Equity swaps, agreements unlisted	113,541	40,357	4,873	158,771	10,540	7,986
Equity options, purchased unlisted agreements	3,309	2,732	0	6,041	196	31
Equity options, sold unlisted agreements	1,017	2,918	0	3,935	86	377
Futures, agreements listed	5,607	88	0	5,695	7	18
Contracts for differences	0	2	0	2	119	0
	123,474	46,097	4,873	1 74,444	10,948	8,412
Credit derivative contracts:						
Credit default swaps	0	0	186,753	186,753	31	3
Total rate of return swaps	0	0	50,888	50,888	1,620	0
	0	0	237,641	237,641	1,651	3
Bond derivatives:						
Bond swaps, agreements unlisted	46,716	1,338	23,703	71,757	3,339	483
Options - purchased agreements	161	204	13,843	14,208	6,197	0
Options - sold agreements	161	204	13,843	14,208	0	6,569
	47,038	1,746	51,389	100,173	9,536	7,052
Derivatives	**2,056,042**	**940,449**	**2,322,177**	**5,318,668**	**68,229**	**65,993**

Currency and interests rate derivatives, agreements unlisted:

Forward exchange rate agreements	1,428,174	137,042	4,879	1,570,095	13,178	12,575
Interest rate and exchange rate agreements	117,595	364,708	1,942,931	2,425,234	37,976	30,529
Options - purchased agreements	53,139	22,730	62,242	138,111	2,870	63
Options - sold agreements	48,438	24,876	40,738	114,052	93	2,452
	1,647,346	549,356	2,050,790	4,247,492	54,117	45,619
Equity derivatives:						
Equity swaps, agreements unlisted	35,888	9,076	4,886	49,850	8,430	3,369
Equity options, purchased unlisted agreements	4,308	0	2,700	7,008	90	73
Equity options, sold unlisted agreements	338	0	2,700	3,038	151	10
Futures, agreements listed	1,527	0	0	1,527	15	0
Contracts for differences	3,959	0	0	3,959	32	0
	46,020	9,076	10,286	65,382	8,718	3,452
Credit derivative contracts:						
Credit default swaps	4,257	0	212,928	217,185	36	8
Total rate of return swaps	0	0	45,999	45,999	0	1,733
	4,257	0	258,927	263,184	36	1,741
Bond derivatives:						
Bond swaps, agreements unlisted	22,360	2,939	25,471	50,770	2,307	102
Options - purchased agreements	0	401	13,931	14,332	6,729	0
Options - sold agreements	0	401	13,931	14,332	0	6,717
	22,360	3,741	53,333	79,434	9,036	6,819
Derivatives	**1,719,983**	**562,173**	**2,373,336**	**4,655,492**	**71,907**	**57,631**

The objective of the above-mentioned agreements is to control currency and interest rate risk of the Bank. The credit risk is valued at ISK 36,626 million when calculating the capital ratio of the Bank at 31 March 2007 and ISK 30,575 million at 31 December 2006.

OFF BALANCE SHEET INFORMATION

Obligations

37. The Bank has granted its customers guarantees, overdraft permissions and loan commitments. These items are specified as follows:

	31.3.2007	**31.12.2006**
Guarantees	266,864	324,929
Credit default swaps, investment grade	187,081	324,929
Unused overdrafts	48,939	50,927
Loan commitments	299,243	317,689

The credit risk is valued at ISK 189 billion at the end of the period (31.12.2006 ISK 226 billion) for guarantees, credit default swaps, unused overdrafts and loan commitments when calculating the capital ratio of the Bank.

ADDITIONAL INFORMATION

Assets under management and under custody

38. Assets under management and assets under custody are specified as follows: **31.3.2007** **31.12.2006**

Assets under management	1,443,681	1,403,376
Assets under custody	2,181,270	1,952,813

The Bank provides asset custody, asset management, investment management and advisory services to its clients. These services require the Bank to make decisions on the treatment, acquisition or disposal of financial instruments. Assets in the Bank's custody are not reported in its accounts.

Related parties

39. The Bank has a related party relationship with its subsidiaries, associates, the Board of Directors of the parent company, the Managing Directors of the Bank, the Managing Directors of the largest subsidiaries, close family members of individuals referred to above and entities with significant influence as the largest shareholders of the Bank which are Exista and related companies (23.0%) and Kjalar Investmens hf. (9.7%). Information regarding related parties are as follows:

Significant related companies:

Loans:	**31.3.2007**	**31.12.2006**
Balance at the beginning of the year	109,556	36,888
Additions	71	91,274
Reductions	(5,096)	(18,606)
Balance at the end of the period	104,531	109,556

Lysing, which is a financial institution, supervised by FSA in Iceland, had ISK 38,717 million of the total loans to related parties at 31 March 2007 (31.12.2006 ISK 39,380 million).

The Bank has issued a contingent guarantee to a related party regarding exposure to a market price of equity shares with a maximum potential exposure of EUR 300 million. At the end of the period the condition for the guarantee was not met. The related party has also issued a guarantee to Kaupthing Bank for the same maximum potential amount.

The Bank has granted loans to the board members and its key management. The outstanding balance of loans to the board members, management and close family members amounted to ISK 14,644 million at 31 March 2007 and ISK 17,716 million at 31 December 2006. The terms and conditions are similar for the board members and key management as loans granted to other customers of the Bank. The aforementioned amounts do not include loans related to the business activities of the board members and key management.

No unusual transactions took place with related parties in the first quarter of 2007.

Transactions with related parties have been conducted on arm's length basis.

Maturity of assets and liabilities

40. The breakdown by contractual maturity of assets and liabilities.

Assets	**On demand**	**Up to 3 months**	**3-12 months**	**1-5 Years**	**Over 5 years**	**Total**
Cash and balances with central banks	133,901	0	0	0	0	133,901
Loans to credit institutions	56,682	301,268	25,414	41,100	27,895	452,359
Loans to customers	235,189	437,773	354,237	795,091	736,831	2,559,121
Bonds and debt instruments	44,268	91,138	127,354	5,439	94,653	362,852
Shares and equity instruments	96,570	73,814	0	152	0	170,536
Derivatives	40	18,184	14,003	24,937	1,656	58,820
Derivatives used for hedging	0	1,311	218	2,165	5,715	9,409
Securities used for hedging	234,986	0	0	0	0	234,986
Investments in associates	0	0	0	0	5,369	5,369
Intangible assets	0	0	0	0	63,952	63,952
Investment property	0	0	0	0	30,625	30,625
Property and equipment	0	0	0	0	29,127	29,127
Tax assets	0	0	1,987	5,058	0	7,045
Other assets	45,641	0	34,642	0	0	80,283
Total Assets 31.3.2007	**847,277**	**923,488**	**557,855**	**873,942**	**995,823**	**4,198,385**

Total Assets 31.12.2006	693,178	900,669	394,934	1,033,881	1,032,734	4,055,396
Liabilities						
Due to credit institutions and central banks	12,290	87,138	18,498	0	1,945	119,871
Deposits	242,808	309,504	272,118	53,486	14,254	892,170
Financial liabilities measured at fair value	3,706	19,213	14,645	24,850	17,001	79,415
Borrowings	1,797	538,027	342,990	1,286,249	266,038	2,435,101
Subordinated loans	0	0	142	20,479	198,235	218,856
Tax liabilities	0	0	11,942	11,830	0	23,772
Other liabilities	49,359	0	55,701	0	0	105,060
Total Liabilities 31.3.2007	**309,960**	**953,882**	**716,036**	**1,396,894**	**497,473**	**3,874,245**
Total Liabilities 31.12.2006	336,083	1,004,574	608,811	1,179,243	591,793	3,720,504
Assets -liabilities 31.3.2007	**537,317**	**(30,394)**	**(158,181)**	**(522,952)**	**498,350**	**324,140**
Assets- liabilities 31.12.2006	357,095	(103,905)	(213,877)	(145,362)	440,941	334,892

Events after the Balance Sheet date

41. Kaupthing Bank completed the sale of wholly owned subsidiary, Eik Fasteignafélag hf.. at the beginning of April 2007. The sale of the subsidiary resulted in a profit before income tax of approximately ISK 4,000 million, which will be booked in the second quarter of 2007.

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