OFFERING CIRCULAR SUPPLEMENT DATED MAY 11, 2006
(TO OFFERING CIRCULAR DATED MARCH 27, 2006)

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

This Offering Circular Supplement is supplemental to, and should be read in conjunction with, the Offering Circular and any other supplements to the Offering Circular that we may issue. Unless defined herein, terms included in this Offering Circular Supplement shall have the definitions ascribed to them in the Offering Circular.

See "Risk Factors" on page 1 of this Offering Circular Supplement and commencing on page 11 of the attached Offering Circular 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.

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 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 all applicable securities laws.

Citigroup **Deutsche Bank**

The date of this Offering Circular Supplement is May 11, 2006

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RISK FACTORS

Prior to making an investment in the Notes, prospective investors should consider carefully the following information, together with the information set out in the Offering Circular under the heading "Risk Factors" and elsewhere in this Offering Circular Supplement and in the Offering Circular.

Icelandic bankruptcy law may adversely affect funds set aside or held in trust for the Notes

The subordination provisions of the Subordinated Notes are governed by Icelandic law. Under certain circumstances, under Icelandic law, funds set aside or paid in trust to the Trustee or for the benefit of the Holders of Notes, pursuant to the subordination provisions of the Notes or otherwise, prior to the date that such amounts are due under the Notes would, upon the bankruptcy of the Company, be applied towards the satisfaction of Senior Obligations before being applied towards amounts due under the Notes.

RECENT DEVELOPMENTS

The following discussion and analysis should be read together with the financial statements, including the accompanying notes, included elsewhere in this Offering Circular Supplement and in the Offering Circular. The financial statements and the accompanying notes for the three months ended March 31, 2006 and 2005 have been prepared in accordance with IFRS. IFRS differ in some respects from U.S. GAAP. This discussion and analysis should also be read together with the information contained in "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Selected Statistical Data" in the Offering Circular.

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

To date, we continue to operate in an environment characterized by rising interest rates, the depreciation of the Icelandic krona and the decline of the value of the securities listed on the Iceland Stock Exchange.

Compared to interest rates at the end of 2005, the Central Bank of Iceland raised the policy interest rate by 1.00% as of May 8, 2006, to 11.50%. As of May 8, 2006, the Icelandic krona had depreciated 14.87% against the U.S. dollar to ISK 71.53 to $1.00 from its 2006 high of ISK 60.89 to $1.00 at January 12, 2006. As of the close of trading on May 8, 2006, the ICEX Main Index fell to 5,509.98, a 19.52% decrease since its high of 6,287.29 on February 15, 2006, and the ICEX-15 Index fell to 5,464.56, a 21.09% decrease since its high of 6,925.45 on February 15, 2006.

Our loan portfolio is denominated principally in currencies other than the Icelandic krona, while our shareholders' equity is denominated in Icelandic krona. Our management has taken measures to hedge our shareholders' equity in order to limit the effect that the depreciation of the krona 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 connection with these and other market conditions and other factors, in certain cases we may hedge all or a portion of our exposure on the investments in our proprietary investment portfolio. This portfolio is marked to market. As a result, we may recognize gains or losses on our investments in our income statement from time to time. We sold equity shares from our investment portfolio with a fair market value of €450 million for cash during the first quarter of 2006. The proceeds of these sales have been included as cash flow from operating activities. In addition, we have continuing on- and off-balance sheet exposure to market risk with respect to our holdings in equity shares amounting to a potential exposure of €275 million as of March 31, 2006 against which we have put up €150 million cash collateral, and may be required to put up additional collateral subject to margin calls. We include this cash collateral under cash and cash balances in our balance sheet.

We have reached an agreement with Glitnir Bank hf. ("Glitnir", formerly Íslandsbanki hf.) to acquire from Glitnir an 18.45% interest in Greidslumidlun hf., an Icelandic payment service company holding the VISA franchise in Iceland, principally in exchange for our 16.00% interest in Kreditkort hf., an Icelandic payment service company holding the MasterCard franchise in Iceland. Following the transactions described above, we will hold a 39.45% interest in Greidslumidlun hf. and a 4.0% interest in Kreditkort hf., and Glitnir will hold a 0.05% interest in Greidslumidlun hf. and a 51.0% interest in Kreditkort hf. This transaction is contingent on the approval of both the Icelandic Financial Supervisory Authority and the Icelandic Competition Authority. In addition, we have granted to Glitnir a call option with respect to almost all of our remaining interest in Kreditkort hf. We do not believe that this transaction will have a material effect on our financial condition or results of operations.

In line with our plans to increase our liquidity to fund our growing loan portfolio, in April 2006, we issued U.S.$ 500 million Senior Floating Rate Notes due 2011 under our US$10 billion Senior/Subordinated Medium Term Note Program. We have also issued two series of Inflation Linked Annuity Covered Bonds under our ISK 200 billion Covered Bond 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 a Aaa credit rating by Moody's Investors Service and are being sold to a European investor in a trade arranged by Deutsche Bank Securities AG.

These developments and others could have a material adverse effect on our business, financial condition and results of operations. You should carefully consider these developments and other risk factors set forth in the section entitled "Risk Factors" in the Offering Circular.

Factors Affecting Results of Operations and Financial Condition: First Quarter 2006

Our results of operations and financial condition for the three months ended March 31, 2006 were influenced by a number of factors. Compared to the first quarter of 2005, our results of operations and financial condition in the first quarter of 2006 were in particular affected by the results of the consolidation of Singer & Friedlander, which we acquired in July 2005. In addition, we sold our remaining 8.75% stake in Baugur Group hf. on March 7, 2006 to the investment company Gaumur and Eignarhaldsfélagid ISP, from which we realized capital gains of approximately ISK 3.3 billion. In general the equities markets in the Nordic countries, with the exception of Iceland, experienced gains, which helped to increase our results of operations and financial condition. An additional important factor affecting our results for the first quarter 2006 was the depreciation of the Icelandic krona during that period. As a substantial percentage of our income is denominated in currencies other than the Icelandic krona and we report our results in Icelandic krona, the depreciation of the Icelandic krona against such currencies had a positive effect on our results.

Results of Operations

The table below sets out our results of operations for the three months ended March 31, 2006 and 2005.

	Three Months ended March 31,		
	2006	2005	Change
	(ISK millions—IFRS)		(%)
Interest income	35,434	19,925	77.8
Interest expense	(24,950)	(12,879)	93.7
Net interest income	10,484	7,046	48.8
Fee and commission income	9,454	5,040	87.6
Fee and commission expense	(852)	(607)	(40.4)
Net fee and commission income	8,602	4,433	94.0
Dividend income	1,614	483	234.2
Net gain on financial assets/liabilities not at fair value	26	56	(53.6)
Net gain on financial assets/liabilities at fair value	11,440	6,246	83.2
Net foreign exchange difference	425	(9)	—
Net financial income	13,505	6,776	99.3
Share of profit of associates	1,038	40	2495.0
Other operating income	1,822	3,927	(53.6)
Other income	2,860	3,967	(27.9)
Operating income	35,451	22,222	59.5
Salaries and related expenses	(7,420)	(3,982)	86.3
Administration expenses	(3,749)	(2,336)	60.5
Depreciation and amortization	(1,293)	(287)	350.5
Other operating expenses	(90)	(397)	(77.3)
Operating expenses	(12,552)	(7,002)	79.3
Impairment on loans and advances	(710)	(894)	(20.6)
Profit before income tax	22,189	14,326	54.9
Income tax	(2,595)	(2,887)	(10.1)
Net earnings	19,594	11,439	71.3
Attributable to:			
Shareholders of Kaupthing Bank hf	18,798	11,093	69.5
Minority interest	796	346	130.1

During the three months ended March 31, 2006, operating income increased by 59.5% to ISK 35,451 million, compared to ISK 22,222 million for the three months ended March 31, 2005.

Net interest income for the first three months of 2006 amounted to ISK 10,484 million, a 48.8% increase from ISK 7,046 million for the corresponding period in 2005. This increase includes a ISK 3,557 million increase in net interest income from our Banking division, of which ISK 1,905 million was attributable to net interest income from Singer & Friedlander and an ISK 624 million increase in net interest income from our Treasury division, but was partially offset by increased interest expense incurred by our Capital Markets (ISK 229 million) and Investment Banking divisions (ISK 420 million). The net interest margin, or interest income less interest expense as a percentage of average total interest earning assets, was 1.41% in the first quarter of 2006, compared to 1.70% in the first quarter of 2005.

Net fee and commission income totaled ISK 8,602 million for the first three months of 2006, a 94.0% increase compared to ISK 4,433 million for the corresponding period in 2005. The increase in net fee and commission income was partly due to the net fee and commission income generated by Singer & Friedlander as well as due to depreciation of the Icelandic krona and increases in net fee and commission income across all our divisions, in particular in our Asset Management Private Banking division.

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 13,505 million for the first three months of 2006, a 99.3% increase over ISK 6,776 million for the corresponding period in 2005. The net financial income for the first quarter of 2006 reflects the ISK 3,441 million from the sale of our entire shareholding in, and dividends from, the Baugur Group hf. in March 2006, as well as better conditions in the Nordic financial markets, partially offset by a drop in the financial markets of Iceland, in the first quarter of 2006 compared to the first quarter of 2005.

Other income, which consists of share of profit of associates and other operating income, was ISK 2,860 million during the first three months of 2006, a 27.9% decrease compared to other operating income of ISK 3,967 million for the corresponding period in 2005. Other income for the first quarter of 2006 included ISK 1,038 million of earnings from associates and ISK 857 million of lease income from Singer & Friedlander's operating lease. Comparative figures for the first quarter of 2005 included earnings from associates amounting to ISK 40 million and a profit of ISK 3,093 million from the sale of the Icelandic leasing company Lýsing.

Operating expenses (which consist of salaries and related expenses, administration expenses, depreciation and amortization and other operating expenses) for the first three months of 2006 were ISK 12,552 million, a 79.3% increase from ISK 7,002 million for the first three months of 2005, primarily due to the inclusion of Singer & Friedlander's operating expenses in the first quarter of 2006. Excluding Singer & Friedlander's operating expenses, our operating expenses increased by 34.8% compared to the corresponding period in 2005. The cost to income ratio during the first quarter of 2006 was 35.4%, compared to 31.5% for the first quarter of 2005.

Salaries and related expenses were ISK 7,420 million for the first three months of 2006, a 86.3% increase compared to ISK 3,982 million for the corresponding period in 2005. This increase was attributable in part to an increase in full-time equivalent employees to 2,449 at the end of the first quarter of 2006, compared to 1,606 at the end of the first quarter of 2005, of which 519 of the new employees were from Singer & Friedlander's operations. In addition, performance-based bonus payments also increased in the first quarter of 2006 compared to the first quarter of 2005.

Administration expenses totaled ISK 3,749 million in the first three months of 2006, increasing by 60.5% from ISK 2,336 million for the corresponding period in 2005, primarily due to the inclusion of administrative expenses from Singer & Friedlander as well as to overall higher levels of operations.

Depreciation and amortization was ISK 1,293 million in the first three months of 2006, a 350.5% increase compared to ISK 287 million in the corresponding period in 2005. This increase is primarily attributable to the depreciation from Singer & Friedlander, principally related to that of its operating lease assets.

Impairment on loans and advances totaled ISK 710 million for the first three months of 2006, a 20.6% decrease compared to ISK 894 million for the corresponding period in 2005. This decrease reflects both the increased quality of our loan portfolio, notwithstanding an increase in the size of the loan portfolio.

We posted a pre-tax profit of ISK 22,189 million for the first quarter of 2006, a 54.9% increase over pre-tax profit of ISK 14,326 million for the first quarter of 2005.

Income tax for the first three months of 2006 was ISK 2,595 million (with an effective tax rate of 11.7%) compared to ISK 2,887 million (with an effective tax rate of 20.2%) for the first three months of 2005, reflecting a lower tax rate as a result of the increase in non-taxable dividend income and in permanently deferred taxes related to our investments in shares of subsidiaries in the first quarter of 2006 compared to the first quarter of 2005.

Net earnings amounted to ISK 19,594 million for the three months ended March 31, 2006, compared with ISK 11,439 million for the corresponding period in 2005, an increase of 71.3%. Net earnings attributable to shareholders amounted to ISK 18,798 million for the first quarter of 2006, compared to ISK 11,093 million for the first quarter of 2005, a 69.5% increase. Earnings per share for the first three months of 2006 were ISK 28.3 million, compared to ISK 17.0 million for the corresponding period in 2005.

Balance Sheet

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

	At March 31, 2006	At December 31, 2005	Change
	(ISK millions—IFRS)		(%)
Assets			
Cash and cash balances with central banks	7,587	34,877	(78.2)
Loans to credit institutions	329,588	195,594	68.5
Loans to customers	1,870,318	1,543,700	21.2
Bonds and debt instruments	384,446	390,575	(1.6)
Shares and equity instruments	104,133	114,188	(8.8)
Derivatives	49,263	21,047	134.1
Derivatives used for hedging	4,680	4,459	5.0
Hedged securities	123,325	82,098	50.2
Financial assets available-for-sale	192	167	15.0
Investments in associates	15,470	13,888	11.4
Intangible assets	61,857	54,943	12.6
Investment property	26,847	24,156	11.1
Property and equipment	25,610	22,433	14.2
Tax assets	6,250	5,004	24.9
Non-current assets and disposal groups classified as held-for-sale	2,229	2,302	(3.2)
Other assets	59,449	31,380	89.4
Total assets	3,071,244	2,540,811	20.9
Liabilities			
Due to credit institutions and central banks	97,625	69,643	40.2
Deposits	548,281	486,176	12.8
Borrowings	1,921,899	1,556,567	23.5
Subordinated loans	113,596	102,688	10.6
Financial liabilities measured at fair value	56,184	60,273	(6.8)
Provisions	3,409	3,271	4.2
Tax liabilities	21,980	18,458	19.1
Liabilities included in disposal groups classified as held-for-sale	1,160	1,161	(0.1)
Other liabilities	83,222	40,062	107.7
Total liabilities	2,847,356	2,338,299	21.8
Equity			
Share capital	6,636	6,638	(0.03)
Share premium	114,731	114,606	0.1
Reserves	5,973	(1,540)	--
Retained earnings	86,667	74,479	16.4
Total shareholders' equity	214,007	194,183	10.2
Minority interest	9,881	8,329	18.6
Total equity	223,888	202,512	10.6
Total liabilities and equity	3,071,244	2,540,811	20.9

Assets

Our total assets as of March 31, 2006 were ISK 3,071 billion, an increase of 20.9% from ISK 2,541 billion at December 31, 2005. This increase was in large part due to the 13.9% depreciation of the Icelandic krona during the first quarter of 2006. Excluding the effects of this depreciation, our total assets at March 31, 2006 reflected a 7% increase over our total assets at December 31, 2005, driven by organic growth. As of March 31, 2006, ISK 666,039 million, or 21.7% of our total assets were financial assets.

Loans to credit institutions increased from ISK 195,594 million to ISK 329,588 million, reflecting an increase of 68.5% (or an increase of 43% excluding the effects of the depreciation of the Icelandic krona), due to an increase in new loans to credit institutions. Loans to customers as of March 31, 2006 amounted to ISK 1,870 billion, an increase of 21.2% increase (or an increase of 8% excluding the effects of the depreciation of the Icelandic krona) compared to ISK 1,544 billion in loans to customers as of December 31, 2005.

Financial assets measured at fair value, which consists of bonds and debt instruments, shares and equity instruments, derivatives, derivatives used for hedging and hedged securities, totaled ISK 665,847 million as of March 31, 2006, reflecting an 8.8% increase (or an increase of 4% excluding the effects of the depreciation of the Icelandic krona) from ISK 612,367 million in financial assets measured at fair value as of December 31, 2005. Compared to the corresponding line items as at December 31, 2005, as of March 31, 2006, bonds and debt instruments decreased by 1.6% to ISK 384,446 million, shares and equity instruments decreased by 8.8% to ISK 104,133 million, derivatives increased by 134.1% to ISK 49,263 million, derivatives used for hedging increased by 5.0% to ISK 4,680 million and hedged securities increased by 50.2% to 123,325 million. Financial assets designated at fair value through profit or loss totaled ISK 266,814 million, an 3.1% increase compared to ISK 258,718 million at December 31, 2005. Mortgage loans at fair value increased by 5.4% to ISK 12,679 million at March 31, 2006 from ISK 12,033 million at December 31, 2005.

As of March 31, 2006, listed shares amounted to ISK 68,643 million and comprised 2.2% of our total assets. ISK 26.4 billion, or 38.4%, of these listed shares are listed on the ICEX. We reduced our holdings in unlisted shares to ISK 35,490 million (booked at fair market value), or 1.2% of our total assets, as of March 31, 2006, compared to ISK 41,592 million of unlisted shares as of December 31, 2005. Currently, our four largest unlisted positions are in Síminn hf., in which we hold a 29% interest, LD Equity, in which we hold a 23% interest, Exista, in which we hold a 19% interest, and Somerfield, in which we hold a 9% interest, and we are currently are considering further reducing our holdings in unlisted shares by distributing our stake in Exista to our shareholders through a payment of an extraordinary dividend, subject to certain conditions. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Recent Developments" in the Offering Circular.

Liabilities and Equity

Due to credit institutions and central banks totaled ISK 97,625 million as of March 31, 2006, an increase of 40.2% over ISK 69,643 million as of December 31, 2005 (or an increase of 24.4% excluding the effects of the depreciation of the Icelandic krona). Deposits were ISK 548,281 million as of December 31, 2006, an increase of 12.8% over ISK 486,176 million as of December 31, 2005. Of the ISK 62,105 million increase, ISK 46,609 million was attributable to currency fluctuations (primarily depreciation of the Icelandic krona), and ISK 15,495 was attributable to increases in customer deposits. Deposits represented 17.9% of our total funding as of March 31, 2006, compared with 19.1% as of December 31, 2005.

Borrowings increased 23.5% from ISK 1,557 billion as of December 31, 2005 to ISK 1,922 billion as of March 31, 2006, primarily due to the depreciation of the Icelandic krona, as well as to the increase in borrowings net of maturing debt during the first quarter of 2006.

Our total shareholder’s equity was ISK 214,007 million as of March 31, 2006, a 10.2% increase over total shareholder’s equity of ISK 194,183 million as of December 31, 2005. Our Capital Adequacy Directive ratio was 11.4% as of March 31, 2006, compared to 12.2% as of December 31, 2005. Tier I capital was 8.5% as of March 31, 2006, compared to 9.4% as of December 31, 2005.

Segment Analysis

The tables below set forth our profit before income tax by segment for the three months ended March 31, 2006 and 2005.

	Three Months Ended March 31, 2006						
	Capital Markets	Investment Banking	Treasury	Banking	Asset Mgmnt and Private Banking	Elimination and cost centers	Total
	(ISK millions—IFRS)						
Net interest income	(392)	(850)	1,636	10,208	162	(280)	10,484
Net fee and commission income	1,873	2,019	847	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	9,233	5,666	3,885	12,764	2,986	917	35,451
Operating expenses	(986)	(556)	(554)	(3,304)	(1,938)	(5,214)	(12,552)
Impairment	0	(1)	(6)	(705)	0	2	(710)
Total expenses	(986)	(557)	(560)	(4,009)	(1,938)	(5,212)	(13,262)
Gross profit	8,247	5,109	3,325	8,755	1,048	(4,295)	22,189
Allocated cost	(638)	(222)	(463)	(2,033)	(965)	4,321	0
Profit before income tax	7,609	4,887	2,862	6,722	83	26	22,189
Net segment revenue from external customers	10,477	6,188	(8,418)	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	9,233	5,666	3,885	12,764	2,986	917	35,451
Total assets	81,581	84,945	701,565	2,071,573	2,361	129,219	3,071,244
Depreciation and amortization	2	2	2	734	6	547	1,293

	Three Months Ended March 31, 2005						
	Capital Markets	Investment Banking	Treasury	Banking	Asset Mgmnt and Private Banking	Elimination and cost centers	Total
	(ISK millions—IFRS)						
Net interest income	(163)	(430)	1,012	6,651	93	(117)	7,046
Net fee and commission income	1,094	1,501	274	751	729	84	4,433
Net financial income	2,183	4,024	409	59	0	101	6,776
Other income	0	29	0	193	0	3,745	3,967
Operating income	3,114	5,124	1,695	7,654	822	3,813	22,222
Operating expenses	(678)	(351)	(248)	(1,611)	(568)	(3,546)	(7,002)
Impairment	0	0	(31)	(859)	0	(4)	(894)
Total expenses	(678)	(351)	(279)	(2,470)	(568)	(3,550)	(7,896)
Gross profit	2,436	4,773	1,416	5,184	254	263	14,326
Allocated cost	(372)	(133)	(190)	(1,046)	(214)	1,955	0
Profit before income tax	2,064	4,640	1,226	4,138	40	2,219	14,326
Net segment revenue from external Customers	4,101	4,344	(9,423)	18,084	565	4,551	22,222
Net segment revenue from other segments	(987)	780	11,118	(10,430)	257	(738)	0
Operating income	3,114	5,124	1,695	7,654	822	3,813	22,222
Total assets	69,753	55,957	224,469	1,262,220	745	62,502	1,675,646
Depreciation and amortization	5	4	0	48	2	228	287

Capital Markets

Operating income in our Capital Markets division was ISK 9,233 million for the first three months of 2006, a 196.5% increase over operating income of ISK 3,114 million for the corresponding period in 2005. This increase was driven by an increase of ISK 779 million in net fee and commission income, an increase of ISK 5,569 million in net financial income, largely due to trading gains attributable to the positive performance of the Nordic equity markets during the first quarter of 2006, and offset by an ISK 229 million decrease in net interest income.

Total expenses increased to ISK 986 million in the first three months of 2006, a 45.4% increase over total expenses of ISK 678 million in the first three months of 2005. This increase reflects increased salary expenses and overall higher levels of operations.

Pre-tax profit in our Capital Markets division increased by 268.7% to ISK 7,609 million in the first three months of 2006, compared to ISK 2,064 million for the first three months of 2005, as the increase in operating income outpaced the increase in operating expenses. The acquisition of Singer & Friedlander did not have a material impact on the results of our Capital Markets division.

Investment Banking

Operating income in Investment Banking was ISK 5,666 million for the three months ended March 31, 2006, a 10.6% increase over ISK 5,124 million for the corresponding period in 2005.

Net financial income increased by ISK 211 million to ISK 4,235 million, ISK 3,441 million of which was attributable to the sale of our entire shareholding in, and dividends from, the Baugur Group hf. and ISK 794 million of which was attributable to increases in our investment portfolio, reflecting both the realization of certain gains and the marking-to-market of the portfolio. Net fee and commission income increased ISK 518 million to ISK 2,019 million, due to increased M&A advisory and capital markets transactions. Net interest income decreased by ISK 420 million to (ISK 850 million) as interest expense increased due to growth in our balance sheet. Other income increased by ISK 233 million to ISK 262 million due to increase in profits from associated companies.

Total expenses in the Investment Banking division increased by 58.7%, from ISK 351 million in the first quarter of 2005 to ISK 557 million in the first quarter of 2006, primarily due to increased salary expenses and overall higher levels of operations.

Pre-tax profit increased 5.3% from ISK 4,640 million in the first quarter of 2005 to ISK 4,887 million in the first quarter of 2006. The acquisition of Singer & Friedlander did not have a material impact on the results of our Investment Banking division.

Treasury

Operating income in our Treasury division was ISK 3,885 million for the first three months of 2006, a 129.2% increase over operating income of ISK 1,695 million for the corresponding period in 2005. This increase was driven by an increase of ISK 624 million in net interest income, an increase of ISK 573 million in net fee and commission income, principally due to an increase in gains on derivatives contracts, and an increase of ISK 993 million in net financial income, also principally due to an increase in gains on derivatives contracts.

Total expenses increased to ISK 560 million in the first three months of 2006, a 100.7% increase over total expenses of ISK 279 million in the first three months of 2005. This increase reflects increased salary expenses and overall higher levels of operations.

Pre-tax profit in our Treasury division increased by 133.4% to ISK 2,862 million in the first three months of 2006, compared to ISK 1,226 million for the first three months of 2005, as the increase in operating income outpaced the increase in operating expenses. The acquisition of Singer & Friedlander did not have a material impact on the results of our Treasury division.

Banking

Operating income in our Banking division was ISK 12,764 million for the first three months of 2006, a 66.8% increase over operating income of ISK 7,654 million for the corresponding period in 2005. This increase was driven by an ISK 3,557 million increase in net interest income, an ISK 382 million increase in net fee and commission income, an ISK 144 million increase in net financial income and an ISK 1,027 million increase in other income, almost entirely attributable to income generated by Singer & Friedlander's operating lease contracts.

Total expenses increased to ISK 4,009 million in the first three months of 2006, a 62.3% increase over total expenses of ISK 2,470 million in the first three months of 2005. This increase reflects increased salary expenses and overall higher levels of operations, in part due to our acquisition of Singer & Friedlander, and was offset by a decrease of ISK 154 million in impairment of loans due to improvement in the quality of our loan portfolio.

Pre-tax profit in our Banking division increased by 62.4% to ISK 6,722 million in the first three months of 2006, compared to ISK 4,138 million for the first three months of 2005, as the increase in operating income outpaced the increase in operating expenses.

Asset Management and Private Banking

Operating income in our Asset Management and Private Banking division was ISK 2,986 million for the first three months of 2006, a 263.3% increase over operating income of ISK 822 million for the corresponding period in 2005. This increase was driven by an increase of ISK 69 million in net interest income, an increase of ISK 1,899 million in net fee and commission income and an increase of ISK 196 million in net financial income, reflecting the acquisition of Singer & Friedlander.

Total expenses increased to ISK 1,938 million in the first three months of 2006, a 241.2% increase over total expenses of ISK 568 million in the first three months of 2005. This increase reflects increased salary expenses and overall higher levels of operations, in part due to our acquisition of Singer & Friedlander.

Pre-tax profit in our Asset Management and Private Banking division increased by 107.5% to ISK 83 million in the first three months of 2006, compared to ISK 40 million for the first three months of 2005, as the increase in operating income outpaced the increase in operating expenses.

Assets in custody totaled ISK 1,490 billion as of March 31, 2006, an increase of 4.5% from December 31, 2005. Assets under management increased by 25.6%, to ISK 1,348 billion at the end of March 31, 2006, of which ISK 465 billion was attributable to assets under management at Singer & Friedlander.

Liquidity

The table below sets out the amount of our long term obligations that will mature in 2006 and 2007:

Maturity of long term funding:	**Year ended December 31,**	
	2006	**2007**
Kaupthing	€1.3 billion	€3.6 billion
FIH	€1.9 billion	€1.4 billion
Group	€3.2 billion	€5.0 billion

To date in 2006, we have raised approximately €2.6 billion (€1.8 billion at Kaupthing and €0.8 billion at FIH) to meet the €3.2 billion that will mature in 2006, satisfying approximately 81% of the group's financing needs for the year. The source of these funds include a €500 million issue of covered bonds and a U.S.$500 million issue of Senor Notes under the Program, both of which represent inaugural deals in debt markets we had previously not tapped. In addition, we continued to access our established funding markets, closing a €500 million syndicated loan and raising €400 million in structured private placements. In addition, FIH issued €500 million of Eurobonds during the first quarter of 2006. We believe our sources of funding will allow us to meet our obligations on a consolidated basis as they come due although we cannot assure you of the availability or cost of funding in the future.

In the course of our ordinary business we have and expect to continue to support our subsidiaries, among other things by granting them advances in order to ensure their continuing competitiveness in their respective markets and for liquidity and capital purposes. As of April 31, 2006, total advances to our banking subsidiaries, including to FIH, amounted to ISK 194,352 million.

The table below sets out the liquid assets of the group at March 31, 2006:

	At March 31, 2006
	(€ millions)
Cash and cash balances with central banks	88
Loans to credit institutions	3,840
Bonds	5,215
Total liquid assets	**9,143**
Listed equities	1,354
Liquid assets and listed equities	10,497

ANNEX A

KAUPTHING BANK

Consolidated Interim Financial Statements

1 January - 31 March 2006

Kaupthing Bank hf.
Borgartun 19
105 Reykjavik

Reg. no. 560882-0419

Contents

Endorsement and Signatures of the Board of Directors and the CEO

The Consolidated Interim Financial Statements of Kaupthing Bank hf. for the three months ended 31 March 2006, have been prepared in accordance with International Financial Reporting Standards (IFRS). The Consolidated Interim Financial Statements includes the Interim Financial Statements of Kaupthing Bank hf. and its subsidiaries, together referred to as "the Bank".

Net earnings, according to the Income Statement, amounted to ISK 19,594 million for the period 1 January to 31 March 2006. Total equity, according to the Balance Sheet, amounted to ISK 223,888 million at the end of the period, including share capital amounting to ISK 6,636 million. The equity ratio of the Bank, calculated according to the Act on Financial Undertakings, was 11.4% for the Bank. This ratio may not be lower than 8.0%.

The Board of Directors and the CEO of Kaupthing Bank hf. hereby confirm the Consolidated Interim Financial Statements for the period 1 January to 31 March 2006.

Reykjavik, 26 April 2006

Board of Directors

Sigurdur Einarsson
Chairman

Ásgeir Thoroddsen

Brynja Halldórsdóttir

Gunnar Páll Pálsson

Niels de Coninck-Smith

Bjarnfredur Ólafsson

Finnur Ingólfsson

Hjörleifur Thór Jakobsson

Tommy Persson

CEO

Hreidar Már Sigurdsson

Auditors' Review Report

To the Board of Directors

Introduction
We have reviewed the accompanying consolidated condensed Balance Sheet of Kaupthing Bank hf. as of March 31, 2006 and the related Consolidated Condensed Statements of Income, Changes in Equity and Cash Flows for the three-months period then ended. Management is responsible for the preparation and 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 consolidated interim financial information is not prepared, in all material respects, in accordance with IAS 34, Interim Financial Reporting.

Reykjavik, 26 April 2006

Sigurdur Jónsson

Reynir Stefán Gylfason

KPMG Endurskodun hf.

Consolidated Interim Income Statement
for the Period from 1 January to 31 March 2006

	Notes	2006 1.1.-31.3.	2005 1.1.-31.3.
Interest income		35,434	19,925
Interest expenses		(24,950)	(12,879)
Net interest income		10,484	7,046
Fee and commission income		9,454	5,040
Fee and commission expenses		(852)	(607)
Net fee and commission income		8,602	4,433
Dividend income		1,614	483
Net gain on financial assets / liabilities not at fair value		26	56
Net gain on financial assets / liabilities at fair value	7	11,440	6,246
Net foreign exchange difference		425	(9)
Share of profit of associates		1,038	40
Other operating income	10	1,822	3,927
Operating income		35,451	22,222
Salaries and related expenses		(7,420)	(3,982)
Administration expenses		(3,749)	(2,336)
Depreciation and amortisation		(1,293)	(287)
Other operating expenses		(90)	(397)
Impairment on loans and advances	20	(710)	(894)
Profit before income tax		22,189	14,326
Income tax		(2,595)	(2,887)
Net earnings		19,594	11,439
Attributable to:			
Shareholders of Kaupthing Bank hf.		18,798	11,093
Minority interest		796	346
		19,594	11,439
Earnings per share	11	28.3	17.0
Diluted earnings per share	11	27.8	16.8

Interim Financial Statements, Kaupthing Bank hf. 31 March 2006 5 Amounts are in ISK millions

Consolidated Interim Balance Sheet
as at 31 March 2006

	Notes	31.3.2006	31.12.2005
Assets			
Cash and cash balances with central banks	13	7,587	34,877
Loans to credit institutions	14-15	329,588	195,594
Loans to customers	16-20	1,870,318	1,543,700
Bonds and debt instruments	21	384,446	390,575
Shares and equity instruments	21	104,133	114,188
Derivatives	21	49,263	21,047
Derivatives used for hedging	21	4,680	4,459
Hedged securities	21	123,325	82,098
Financial assets available-for-sale	26	192	167
Investments in associates		15,470	13,888
Intangible assets	27	61,857	54,943
Investment property	28	26,847	24,156
Property and equipment		25,610	22,433
Tax assets		6,250	5,004
Non-current assets and disposal groups classified as held-for-sale	29	2,229	2,302
Other assets	30	59,449	31,380
Total Assets		3,071,244	2,540,811
Liabilities			
Due to credit institutions and central banks	32	97,625	69,643
Deposits	33	548,281	486,176
Borrowings	34-35	1,921,899	1,556,567
Subordinated loans	36	113,596	102,688
Financial liabilities measured at fair value	37	56,184	60,273
Provisions		3,409	3,271
Tax liabilities		21,980	18,458
Liabilities included in disposal groups classified as held-for-sale	39	1,160	1,161
Other liabilities	40	83,222	40,062
Total Liabilities		2,847,356	2,338,299
Equity			
Share capital		6,636	6,638
Share premium		114,731	114,606
Reserves		5,973	(1,540)
Retained earnings		86,667	74,479
Total Shareholders' Equity		214,007	194,183
Minority interest		9,881	8,329
Total Equity		223,888	202,512
Total Liabilities and Equity		3,071,244	2,540,811
Off Balance Sheet Items:			
Obligations	44		

Interim Financial Statements, Kaupthing Bank hf. 31 March 2006 6 Amounts are in ISK millions

Consolidated Interim Statement of Changes in Equity
for the period from 1 January to 31 March 2006

Shareholders' equity

	Share capital and premium	Reserves	Retained earnings	**Total**	Minority interest	**Total equity**
Changes in equity in Q1 2006:						
Equity 1 January 2006	121,244	(1,540)	74,479	194,183	8,329	202,512
Translation difference		7,354		7,354		7,354
Fair value changes in AFS financial assets		2		2		2
Net earnings not posted in Income Statement		7,356		7,356		7,356
Net earnings according to the Income Statement			18,798	18,798	796	19,594
Total earnings for the period				26,154	796	26,950
Dividends paid			(6,610)	(6,610)		(6,610)
Purchases and sales of treasury stock	19			19		19
Changes in minority interest				0	756	756
Exercised stock options	104			104		104
Other reserves		157		157		157
Equity 31 March 2006	121,367	5,973	86,667	214,007	9,881	223,888
Changes in equity in Q1 2005:						
Equity 31 December 2004	117,080	(670)	34,039	150,449	9,543	159,992
Changes due to conversion 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		(502)		(502)		(502)
Net earnings not posted in Income Statement		(502)		(502)		(502)
Net earnings according to the Income Statement			11,093	11,093	346	11,439
Total earnings for the period				10,591	346	10,937
Dividends paid			(3,300)	(3,300)		(3,300)
Purchases and sales of treasury stock	559			559		559
Changes in minority interest				0	323	323
Exercised stock options	61			61		61
Equity 31 March 2005	117,700	(1,172)	40,753	157,281	10,208	167,489

Interim Financial Statements, Kaupthing Bank hf. 31 March 2006 7 Amounts are in ISK millions

Condensed Consolidated Interim Statement of Cash Flows
for the Period from 1 January to 31 March 2006

	2006 1.1.-31.3.	2005 1.1.-31.3.
Net cash provided by operating activities	8,859	13,482
Net cash flow used in investing activities	(5,623)	(49,330)
Net cash flow from financing activities	4,634	89,963
Net increase in cash equivalents	7,870	54,115
Cash and cash equivalents, beginning of the year	81,758	23,336
Cash and cash equivalents, end of the period	89,628	77,451

Interim Financial Statements, Kaupthing Bank hf. 31 March 2006 8 Amounts are in ISK millions

Notes to the Consolidated Interim Financial Statements

Accounting policies

General information

Kaupthing Bank hf. is a company incorporated and domiciled in Iceland. The Condensed Consolidated Interim Financial Statements for the three months ended 31 March 2006 comprise Kaupthing Bank hf. (the parent) and its subsidiaries (together referred to as "the Bank"). The Condensed Interim Financial Statements were authorised for issue by the Board of Directors of Kaupthing Bank hf. on 26 April 2006.

The Consolidated Financial Statements of the Bank as at and for the year ended 31 December 2005 are available upon request from the Company´s registered office at Borgartun 19, Reykjavik or at www.kaupthing.net or www.icex.is.

The Condensed Consolidated Interim Financial Statements are presented in Icelandic krona (ISK), rounded to the nearest million.

1. Statement of compliance

These Condensed 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

2. Significant accounting policies

The accounting policies applied by the Bank in these Condensed 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 2005.

Notes to the Income Statement

Segment Reporting

3. 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: 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 centres are: Overhead, Back office, Risk Management, Finance, Legal department, Information Technology and Human Resources.

4. Summary of the Bank's profit centres' operations:

Q1 2006	Capital Markets	Investment Banking	Treasury	Banking	Asset Managem. and Private Banking	Elimination and cost centres	Total
Net interest income	(392)	(850)	1,636	10,208	162	(280)	10,484
Net fee and commission income	1,873	2,019	847	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	9,233	5,666	3,885	12,764	2,986	917	35,451
Operating expenses	(986)	(556)	(554)	(3,304)	(1,938)	(5,214)	(12,552)
Impairment	0	(1)	(6)	(705)	0	2	(710)
Total expenses	(986)	(557)	(560)	(4,009)	(1,938)	(5,212)	(13,262)
Gross profit	8,247	5,109	3,325	8,755	1,048	(4,295)	22,189
Allocated cost	(638)	(222)	(463)	(2,033)	(965)	4,321	0
Profit before income tax	7,609	4,887	2,862	6,722	83	26	22,189
Net segment revenue from external customers	10,477	6,188	(8,418)	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	9,233	5,666	3,885	12,764	2,986	917	35,451
Total assets	81,581	84,945	701,565	2,071,573	2,361	129,219	3,071,244
Depreciation and amortisation	2	2	2	734	6	547	1,293

Q1 2005	Capital Markets	Investment Banking	Treasury	Banking	Asset Managem. and Private Banking	Elimination and cost centres	Total
Net interest income	(163)	(430)	1,012	6,651	93	(117)	7,046
Net fee and commission income	1,094	1,501	274	751	729	84	4,433
Net financial income	2,183	4,024	409	59	0	101	6,776
Other income	0	29	0	193	0	3,745	3,967
Operating income	3,114	5,124	1,695	7,654	822	3,813	22,222
Operating expenses	(678)	(351)	(248)	(1,611)	(568)	(3,546)	(7,002)
Impairment	0	0	(31)	(859)	0	(4)	(894)
Total expenses	(678)	(351)	(279)	(2,470)	(568)	(3,550)	(7,896)
Gross profit	2,436	4,773	1,416	5,184	254	263	14,326
Allocated cost	(372)	(133)	(190)	(1,046)	(214)	1,955	0
Profit before income tax	2,064	4,640	1,226	4,138	40	2,219	14,326
Net segment revenue from external customers	4,101	4,344	(9,423)	18,084	565	4,551	22,222
Net segment revenue from other segments	(987)	780	11,118	(10,430)	257	(738)	0
Operating income	3,114	5,124	1,695	7,654	822	3,813	22,222
Total assets	69,753	55,957	224,469	1,262,220	745	62,502	1,675,646
Depreciation and amortisation	5	4	0	48	2	228	287

Interim Financial Statements, Kaupthing Bank hf. 31 March 2006 10 Amounts are in ISK millions

Notes to the Consolidated Interim Financial Statements

Geographic 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.

Q1 2006	Iceland	Scandi-navia	UK	Luxem-bourg	Other	Total
Net interest income	2,627	3,452	2,987	1,158	260	10,484
Net fee and commission income	3,157	1,614	2,218	1,393	220	8,602
Net financial income	1,647	7,983	2,154	1,009	711	13,505
Other income	1,628	401	833	(1)	0	2,860
Operating income	9,059	13,450	8,192	3,559	1,191	35,451

Q1 2005	Iceland	Scandi-navia	UK	Luxem-bourg	Other	Total
Net interest income	1,959	2,717	998	1,242	130	7,046
Net fee and commission income	1,659	770	1,380	493	131	4,433
Net financial income	1,518	1,157	4,162	17	(78)	6,776
Other income	3,588	363	3	10	3	3,967
Operating income	8,724	5,007	6,543	1,762	186	22,222

Quarterly Statements

6. Summary of the Bank's operating results by quarters:

	2006 Q1	2005 Q4	2005 Q3	2005 Q2	2005 Q1
Net interest income	10,484	9,529	9,487	6,647	7,046
Net fee and commission income	8,602	6,203	6,862	4,930	4,433
Net financial income	13,505	13,960	4,772	11,773	6,776
Other income	2,860	2,855	1,788	771	3,967
Operating income	35,451	32,547	22,909	24,121	22,222
Operating expenses	(12,552)	(11,277)	(9,511)	(7,335)	(7,002)
Impairment	(710)	(1,789)	(928)	(779)	(894)
Profit before income tax	22,189	19,481	12,470	16,007	14,326
Income tax	(2,595)	(4,018)	(2,429)	(1,894)	(2,887)
Net earnings	19,594	15,463	10,041	14,113	11,439
Attributable to:					
Shareholders of Kaupthing Bank hf.	18,798	14,786	9,708	13,673	11,093
Minority interest	796	677	333	440	346
Net earnings	19,594	15,463	10,041	14,113	11,439

Net gain on financial assets and liabilities at fair value

7. Net gain on financial assets and liabilities at fair value	Q1 2006	Q1 2005
Net gain on trading portfolio	7,412	1,923
Net gain on assets designated at fair value through profit and loss	3,816	3,990
Fair value adjustments on hedge accounting	212	333
Net gain on financial assets and liabilities at fair value	11,440	6,246

Interim Financial Statements, Kaupthing Bank hf. 31 March 2006 11 Amounts are in ISK millions

8. Net gain on trading portfolio are specified as follows:

	Q1 2006	Q1 2005
Gain on equity instruments and related derivatives	7,032	1,807
(Loss) gain on interest rate instruments and related derivatives	(343)	152
Gain (loss) on foreign exchange trading	303	(36)
Gain on credit derivatives	420	0
Net gain on trading portfolio	7,412	1,923

9. Net gain on assets at fair value designated through profit and loss are specified as follows:

(Loss) gain on interest rate instruments designated at fair value	(380)	3,192
Gain on equity instruments designated at fair value	4,196	798
Net gain on assets at fair value through profit and loss	3,816	3,990

Other operating income

10. Other operating income is specified as follows:

Gain on disposals of assets other than held for sale	10	3,095
Fair value adjustments on investment properties	399	(51)
Realised gain on investment properties	94	35
Insurance premium	101	152
Income from operating lease	857	0
Other operating income	361	696
Other operating income	1,822	3,927

Earnings per Share

11. Earnings per share are specified as follows:

Net earnings attributable to the shareholders of Kaupthing Bank hf.	18,798	11,093
Weighted average share capital:		
Weighted average of outstanding shares for the period	663.7	652.8
Effects of stock options	11.7	6.8
Weighted average of outstanding shares for the period diluted	675.4	659.6
Earnings per share	28.3	17.0
Diluted earnings per share	27.8	16.8
Numbers of shares at the end of the period, million	663.6	653.6
Numbers of shares at the end of the period diluted, million	675.2	660.4
Average numbers of own shares, million	4.1	5.6
Numbers of own shares, end of period, million	1.0	4.7

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 period.

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.

Interim Financial Statements, Kaupthing Bank hf. 31 March 2006 12 Amounts are in ISK millions

Notes to the Balance Sheet

12. Assets specified by location of its markets and customers.

31.3.2006	Iceland	Scandi-navia	UK	Luxem-bourg	Other	Total
Cash and cash balances with central banks	965	3,475	127	2,837	183	7,587
Loans and advances	680,075	900,329	347,093	161,349	111,060	2,199,906
Financial assets measured at fair value	287,120	204,970	152,675	6,678	14,403	665,846
Financial assets available-for-sale	0	192	0	0	0	192
Other assets	57,644	74,011	64,601	391	1,066	197,713
Assets	1,025,804	1,182,977	564,496	171,255	126,712	3,071,244

Cash and cash balances with central banks

13. Cash and cash balances with central banks are specified as follows:

	31.3.2006	31.12.2005
Cash and cash balances	7,526	16,869
Cash equivalent	61	18,008
Cash and cash balances with central banks	7,587	34,877

Loans to credit instituitons

14. Loans to credit institutions specified by types of loans:

Bank accounts	81,971	46,881
Overdraft	3,238	1,733
Money market loans	179,793	97,544
Other loans	64,586	49,436
Loans to credit institutions	329,588	195,594

15. Loans to credit institutions specified by maturity:

On demand	78,398	42,860
Up to 3 months	204,417	110,644
Over 3 months and up to a year	15,273	12,483
Over 1 year and up to 5 years	25,180	26,074
Over 5 years	6,320	3,533
Loans to credit institutions	329,588	195,594

Loans to customers

16. Loans to customers specified by types of loans:

Overdrafts	115,513	82,787
Subordinated loans	14,992	7,647
Other loans	1,511,533	1,257,506
Advances	147,804	125,882
Finance lease	59,145	51,212
Finance lease - Current assets	21,331	18,666
Loans to customers	1,870,318	1,543,700

Interim Financial Statements, Kaupthing Bank hf. 31 March 2006 13 Amounts are in ISK millions

17. Loans to customers specified by sectors:

	31.3.2006	31.12.2005
Municipalities	2.7%	2.8%
Business enterprises:		
Agriculture	0.6%	0.6%
Fishing industry	1.5%	0.8%
Industry	11.5%	11.0%
Commerce	22.7%	23.7%
Service	42.7%	43.6%
Individuals	18.3%	17.5%
Loans to customers	100.0%	100.0%

18. Loans to customers specified by maturity:

On demand	116,215	68,712
Up to 3 months	333,836	293,260
Over 3 months and up to a year	174,270	159,786
Over 1 year and up to 5 years	616,610	511,101
Over 5 years	629,387	510,841
Loans to customers	1,870,318	1,543,700

19. Specifications of subordinated loans:

Loans to customers	9,152	5,796
Bonds and other fixed income securities	5,840	1,851
Subordinated loans	14,992	7,647

20. Changes in the provision on loans and advances are specified as follows:

	Q1 2006	Q1 2005
Balance at the beginning of the year	12,953	11,627
Impairment on loans and advances during the period	710	894
Exchange rate difference on translation	864	2
Write offs during the period	(992)	(837)
Payment of loans previously written off	82	55
Provision on loans and advances	13,617	11,741

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Financial assets measured at fair value

21. Financial assets measured at fair value are specified as follows:

31.3.2006	Trading assets	Fin. assets designated at fair value	Mortgage loans at fair value	Derivatives used for hedging	Total
Bonds and debt instruments:					
Listed	137,038	75,377	0	0	212,415
Unlisted	13,661	145,691	0	0	159,352
Mortgage loans	0	0	12,679	0	12,679
Bonds and debt instruments	150,699	221,068	12,679	0	384,446
Shares and equity instruments					
Listed	49,594	19,049	0	0	68,643
Unlisted	8,793	26,697	0	0	35,490
Shares and equity instruments	58,387	45,746	0	0	104,133
Derivatives					
OTC derivatives	39,304	0	0	0	39,304
Other trading derivatives	9,959	0	0	0	9,959
Derivatives	49,263	0	0	0	49,263
Derivatives used for hedging					
Fair value hedge	0	0	0	1,344	1,344
Portfolio hedge of interest rate risk	0	0	0	3,336	3,336
Derivatives used for hedging	0	0	0	4,680	4,680
Hedged securities					
Bonds and debt instruments	75,796	0	0	0	75,796
Shares and equity instruments	47,529	0	0	0	47,529
Hedged securities	123,325	0	0	0	123,325
Financial assets measured at fair value	381,674	266,814	12,679	4,680	665,847
31.12.2005					
Bonds and debt instruments:					
Listed	169,714	78,730	0	0	248,444
Unlisted	0	130,098	0	0	130,098
Mortgage loans	0	0	12,033	0	12,033
Bonds and debt instruments	169,714	208,828	12,033	0	390,575
Shares and equity instruments					
Listed	54,273	18,323	0	0	72,596
Unlisted	10,025	31,567	0	0	41,592
Shares and equity instruments	64,298	49,890	0	0	114,188
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
Hedged securities					
Bonds and debt instruments	28,710	0	0	0	28,710
Shares and equity instruments	53,388	0	0	0	53,388
Hedged securities	82,098	0	0	0	82,098
Financial assets measured at fair value	337,157	258,718	12,033	4,459	612,367

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22. Bond and debt instruments measured at fair value specified by maturity:

	31.3.2006	31.12.2005
On demand	19	0
Up to 3 months	1,859	3,839
Over 3 months and up to a year	113,367	118,188
Over 1 year and up to 5 years	40,244	38,118
Over 5 years	65,579	48,683
Bonds and debt instruments measured at fair value	221,068	208,828

23. Bond and debt instruments measured at fair value specified by issuer:

Financial institutes	128,912	117,979
Government	56,298	69,633
Corporates	35,844	21,213
Individuals	14	3
Bonds and debt instruments measured at fair value	221,068	208,828

24. Mortgage loans measured at fair value specified by sectors:

Municipalities	2.1%	1.9%
Business enterprises:		
Agriculture	0.2%	0.2%
Industry	22.4%	22.6%
Commerce	36.3%	36.3%
Construction	4.2%	4.5%
Transportation	0.4%	0.4%
Service	34.4%	34.1%
Mortgage loans measured at fair value	100.0%	100.0%

25. Mortgage loans measured at fair value specified by maturity:

Up to 3 months	300	232
Over 3 months and up to a year	569	543
Over 1 year and up to 5 years	2,827	2,676
Over 5 years	8,983	8,582
Mortgage loans measured at fair value	12,679	12,033

Financial assets available-for-sale

26. Financial assets available-for-sale are specified as follows:

Equity instruments	192	167
Financial assets available-for-sale	192	167

Intangible assets

27. Intangible assets are specified as follows:

	Goodwill	Other intangible assets	Total
Book value 1 January	50,481	4,462	54,943
Exchange rate difference	6,448	410	6,858
Additions during the period	0	299	299
Amortisation	0	(243)	(243)
Intangible assets	56,929	4,928	61,857

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Investment properties

28. Investment properties for renting are specified as follows:

	31.3.2006	31.12.2005
Book value 1 January	24,156	19,155
Exchange rate difference	1,647	5
Additions during the period	645	4,839
Disposals during the period	0	(208)
Revaluation during the period	399	365
Investment properties for renting	26,847	24,156

Non-current assets and disposal groups classified as held for sale

29. Non-current assets and disposal groups classified as held for sale are specified as follows:

Mortgages foreclosed - tangible assets held for sale	462	572
Mortgages foreclosed - total assets of legal entities held for sale	1,767	1,730
Non-current assets and disposal groups classified as held for sale	2,229	2,302

Other assets

30. Other assets are specified as follows:

Unsettled securities trading	35,579	16,091
Reinsurers' share in insurance fund	161	136
Accounts receivables	9,651	6,997
Sundry assets	7,253	401
Prepaid expenses	1,984	2,887
Accrued income	4,821	4,868
Other assets	59,449	31,380

Unsettled securities trading was settled in less than three days from the accounting date.

31. Reinsurers' share in insurance fund are specified as follows:

Premium reserve for reinsurers' share in insurance fund	39	30
Claims reserve for reinsurers' share in insurance fund	122	106
Reinsurers' share in insurance fund	161	136

Due to credit institutions and central banks

32. Due to credit institutions and central banks mature as follows:

On demand	7,294	11,176
Up to 3 months	82,257	52,820
Over 3 months and up to a year	6,056	3,890
Over 1 year and up to 5 years	0	0
Over 5 years	2,018	1,757
Due to credit institutions and central banks	97,625	69,643

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Deposits

33. Deposits mature as follows:

	31.3.2006	31.12.2005
On demand	186,263	163,426
Up to 3 months	280,197	253,963
Over 3 months and up to a year	52,229	18,156
Over 1 year and up to 5 years	23,893	39,834
Over 5 years	5,699	10,797
Deposits	548,281	486,176

Borrowings

34. Borrowings are specified as follows:

Bonds issued	1,381,185	1,158,806
Bills issued	161,587	164,910
Money market loans	344,034	200,581
Other loans	35,093	32,270
Borrowings	1,921,899	1,556,567

35. Borrowings mature as follows:

On demand	4,279	10,684
Up to 3 months	457,594	300,885
Over 3 months and up to a year	297,665	214,935
Over 1 year and up to 5 years	959,287	862,240
Over 5 years	203,074	167,823
Borrowings	1,921,899	1,556,567

Included in up to 3 months are Repurchase agreements with banks amounting ISK 81,089 million at the end of March compared to ISK 14,376 millon at year end 2005.

Subordinated loans

36. Subordinated loans are specified as follows:

Tier I capital	46,160	41,201
Tier II capital	67,436	61,487
Subordinated loans	113,596	102,688

Financial liabilities measured at fair values

37. Financial liabilities measured at fair value through profit and loss are specified as follows:

Trading liabilities	33,584	32,003
Derivatives used for hedging - portfolio hedge of interest rate risk	8,998	13,276
Mortgage funding measured at fair value	13,602	14,994
Financial liabilities measured at fair value through profit and loss	56,184	60,273

38. Trading liabilities are specified as follows:

Short position in equity instruments held for trading	3,598	3,765
Derivatives held for trading	29,986	27,942
Other liabilities held for trading	0	296
Trading liabilities	33,584	32,003

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Liabilities included in disposal groups classified as held for sale

39. Liabilities included in disposal groups classified as held for sale are specified as follows:

	31.3.2006	31.12.2005
Loans on mortgages foreclosed	10	14
Loans on mortgages foreclosed - total liabilities of legal entities held for sale	1,150	1,147
Liabilities included in disposal groups classified as held for sale	1,160	1,161

Other liabilities

40. Other liabilities are specified as follows:

Insurance liabilities	6,920	5,965
Unsettled securities trading	44,746	8,478
Accounts payable	5,371	3,573
Other liabilities	26,185	22,046
Other liabilities	83,222	40,062

Unsettled securities trading was settled in less than three days from the accounting date.

41. Insurance liabilities are specified as follows:

Provision for unearned premiums	373	297
Claims outstanding	266	227
Provision for bonuses	21	21
Life insurance provision due to unit linked policies	6,260	5,420
Insurance liabilities	6,920	5,965

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Equity

Shareholders' equity

42. Equity at the end of the period amounts to ISK 223,888 million. The equity ratio, calculated in accordance to Article 84 of the Act on Financial Undertakings, was 11.4%. According to the law the ratio may not go below 8.0%.

The ratio is calculated as follows:

	31.3.2006		31.12.2005	
	Book value	Weighted value	Book value	Weighted value
Risk I:				
Assets recorded in the Financial Statements	3,071,244	2,225,041	2,540,811	1,841,833
Assets deducted from equity		(70,023)		(62,590)
Guarantees and other items not included in the Balance Sheet		198,022		166,028
		2,353,040		1,945,271
Equity:				
Tier I capital:				
Equity		223,888		202,512
Intangible assets		(61,857)		(54,943)
Assets subtracted from equity		(7,150)		(6,741)
Subordinated loans		46,160		41,201
Tier II capital:				
Subordinated loans		67,436		61,285
Investment in credit institutions		(1,016)		(6,451)
		267,461		236,863
Equity ratio		11.4%		12.2%
Thereof Tier I ratio		8.5%		9.4%

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Derivatives

43. Derivatives remaining maturity date of principal and book value are specified as follows:

31.3.2006	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	834,116	103,049	2,730	939,895	15,586	8,643
Interest rate and exchange rate agreements	54,775	268,173	1,054,142	1,377,090	27,490	20,861
Options - purchased agreements	32,810	49,348	19,933	102,091	3,737	0
Options - sold agreements	24,183	54,380	20,198	98,761	100	5,206
	945,885	474,951	1,097,003	2,517,837	46,913	34,710
Equity derivatives:						
Equity swaps, agreements unlisted	38,036	14,302	10	52,348	2,186	2,606
Equity options, purchased, agreements unlisted	2,861	0	2,000	4,861	70	0
Equity options, sold, agreements unlisted	3,198	0	2,000	5,198	217	153
Futures, agreements listed	1,715	0	0	1,715	0	1
Contracts for differences	1,003	0	0	1,003	1,747	0
	46,814	14,302	4,010	65,125	4,219	2,760
Bond derivatives:						
Bond swaps, agreements unlisted	100,598	2,737	24,955	128,289	2,334	474
Derivatives total	1,093,296	491,990	1,125,968	2,711,252	53,467	37,943

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 33,631 million when calculating the capital ratio of the Bank.

31.12.2005	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	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	21,505	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, 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	35,716	71	1,154
Derivatives total	682,485	244,771	854,791	1,782,046	24,026	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.

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Off Balance Sheet information

Obligations

44. The Bank has granted its customers guarantees, overdraft permissions, loan commitments, assets under management and custody agreements. These items are specified as follows:

	31.3.2006	31.12.2005
Guarantees	282,374	196,793
Credit default swaps average rate A	203,221	179,147
Unused overdrafts	42,393	42,558
Loan commitments	213,073	165,066

The credit risk is valued at ISK 175 billion for Guarantees, Credit default swaps, Unused overdrafts and Loan commitments when calculating the capital ratio of the Bank.

Assets under management	1,348,324	1,073,651
Assets under custody	1,490,139	1,426,448

Additional information

Deposit Insurance Fund

45. 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

46. The Bank sold equity shares with a fair value of EUR 450 millions 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 275 millions against which the Bank has placed EUR 150 m cash collateral, subject to a requirement for additional collateral based on changes in the market price of the equity shares. This cash collateral is included within the caption cash and cash balances shown on the Balance Sheet.

Related parties

47. 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 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 Vátryggingafélag Íslands hf. (4.0%). This definition is based on IAS 24. Information regarding related parties are as follows:

Significant related companies:	31.3.2006	31.12.2005
Loans:		
Balance at the beginning of the year	3,063	3,128
Additions	3,433	15,604
Reductions	(3,015)	(15,669)
Balance at the end of the period	3,481	3,063

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 8,940 million at 31 March 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 first quarter of 2006.

Transactions with related parties have been conducted on arm's length basis.

Interim Financial Statements, Kaupthing Bank hf. 31 March 2006 22 Amounts are in ISK millions

Events after the Balance Sheet date

48. There have been no material post Balance Sheet events which would require disclosure or adjustment to the 31 March 2006 Interim Financial Statements. On 26 April 2006 the Board of Directors reviewed the Interim Financial Statements and authorised them for publication.

Monitoring and controlling liquidity risk

49. The breakdown by contractual maturity of financial assets and liabilities.

31.3.2006	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years
Cash and central banks balances	7,587	0	0	0	0
Loans and advances	194,613	538,253	189,543	641,790	635,707
Financial assets measured at fair value	332,430	70,731	123,462	56,651	82,572
Financial assets available-for-sale	192	0	0	0	0
Total financial assets	534,822	608,984	313,005	698,441	718,279
Due to credit institutions and central banks	7,294	82,257	6,056	0	2,018
Deposits	186,263	280,197	52,229	23,893	5,698
Borrowings	4,279	457,594	297,665	959,287	203,074
Financial liabilities measured at fair value	4,270	18,200	4,544	11,930	17,240
Total financial liabilities	202,106	838,249	360,494	995,111	228,030
Assets - liabilities	332,716	(229,265)	(47,490)	(296,670)	490,249

31.12.2005	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years
Cash and central banks balances	34,877	0	0	0	0
Loans and advances	111,572	403,904	172,269	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	0	0	0	0
Total financial assets	484,756	575,861	175,227	598,613	552,247
Due to credit institutions and central banks	11,176	52,820	3,890	0	1,757
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 financial liabilities	189,965	616,530	242,727	921,039	202,397
Assets - liabilities	294,791	(40,669)	(67,500)	(322,426)	349,850

Interim Financial Statements, Kaupthing Bank hf. 31 March 2006 23 Amounts are in ISK millions

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 and filed with the *Commission de Surveillance du Secteur Financier* (the "CSSF"). 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:** 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 Note 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 11 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".

Citigroup

Deutsche Bank

Credit Suisse

Merrill Lynch & Co.

Morgan Stanley

The date of this Offering Circular is March 27, 2006

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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 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 on a confidential basis 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 (or any document incorporated by reference therein). 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, "Kaupthing" and "the Issuer" refer to Kaupthing Bank hf., and "we", "our", "us" and "the group" refer to Kaupthing together with its subsidiaries.

We present our financial statements in Icelandic krona and references in this Offering Circular to "Icelandic krona", "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, and references to "Danish krone" or "DKK" are to the currency of Denmark. For your convenience, we have translated certain Icelandic krona amounts in 2005 at ISK 63.13=$1.00, the mid rate for the U.S. dollar quoted by the Central Bank of Iceland at December 30, 2005. No representation is made that the amounts in Icelandic krona have been, could have been or could be converted into U.S. dollars at the mid rate or at any other rate. At March 24, 2006, such mid rate was ISK 73.47 per $1.00.

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.

We have included financial statements in this Offering Circular as at, and for the years ended December 31, 2004 and 2003, prepared in accordance with accounting principles generally accepted in Iceland ("Icelandic GAAP"). We have also included financial statements in this Offering Circular as at, and for the years ended December 31, 2005 and 2004, prepared in accordance with International Financial Reporting Standards ("IFRS"). Note 123 to our IFRS consolidated financial statements 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") 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" are to Denmark, the Faeroe 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" are to Denmark, 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.

This Offering Circular includes certain statistics and market share data. We believe that the statistics and market share data 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", and "plans" and similar expressions 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. These factors include those set forth in the section of this Offering Circular entitled "Risk Factors" beginning on page 11, as well as more generally:

- 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. 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.

OFFERING OF MEDIUM-TERM NOTES

Citigroup Global Markets Inc., Deutsche Bank Securities Inc., Credit Suisse Securities (USA) LLC, 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 with any other document incorporated by reference herein 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 Iceland Stock Exchange ("ICEX") and the Stockholm Stock Exchange. 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 six countries: Iceland, the United Kingdom, Denmark, Sweden, Finland and Luxembourg. In the United States, we operate through our subsidiary Kaupthing Securities Inc., a licensed broker-dealer. The United Kingdom, Iceland and Scandinavia currently are our most important markets, generating 34%, 30% and 26%, respectively, of our net operating income in 2005.

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 eight 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 2005 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. We expect this percentage to increase in 2006, as we seek to expand our activities in Finland, Luxembourg and the United Kingdom. We currently have senior long-term debt ratings of 'A1' from Moody's and 'A' from Fitch. As of December 31, 2005, our total assets were ISK 2,540,811 million, our Tier 1 ratio was at 9.4% and our Capital Adequacy Directive ("CAD") ratio was 12.2%. Our net earnings for 2005 were ISK 49,260 million ($780 million), an increase of 178% from 2004.

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

Our goal is to become a leading provider of integrated financial services for medium-sized companies and high net worth individuals in Northern Europe and to expand our investment business. We believe we have established a strong platform through a combination of organic growth and strategic acquisitions in all of the Nordic countries, the United Kingdom and Luxembourg. As a provider of comprehensive services to growing companies, we have been able to grow with our clients and develop our business relationships with them. At the same time, we believe we have established strong relationships with our private clients which form the basis of our successful asset management and private banking services.

We intend to achieve this goal through the following measures:

- ***Cross-selling our products.*** We continually seek to build on synergies in our client base by cross-selling products of our different divisions and business units.
- ***Aggressively managing risk.*** We seek to minimize our potential for loss by continually improving the quality of our loan portfolio and carefully monitoring the exposures in our trading portfolio.
- ***Rapid and efficient integration of acquisitions.*** We look to maximize the benefits available to us from businesses we have acquired by quickly and efficiently integrating their operations within our group.
- ***Increasing the maturity profile of our loan portfolio.*** We seek to achieve a stable asset base by increasing the maturity profile of our loan portfolio.
- ***Expanding our investment activities.*** We intend to continue to acquire minority interests in certain businesses on a strategic basis with the intention of realizing a gain on these investments.

Competitive Strengths

We believe that we have a number of competitive strengths that will allow us to build on our position as a leading Nordic bank. These strengths include:

- ***Focused strategy.*** We maintain both a geographic and product focus, concentrating on Northern Europe and in particular on investment and corporate banking. We seek to exploit our market niche as an integrated financial service provider for medium-sized companies.
- ***Strong risk management culture.*** 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.
- ***Multi-product approach to clients.*** We have a strong culture of cross-selling products to our clients to reap maximum benefit from our client relationships. In particular, we have the ability to support investment banking advisory products with capital markets solutions.
- ***Track record in integrating acquisitions.*** We have a history of expanding through acquisitions in our target markets. This has resulted in increased profitability, better asset quality and further diversification of our business.
- ***High efficiency.*** We have a low cost/income ratio and high income per employee compared to our peer group.
- ***Clear and direct lines of communication.*** We have a relatively flat organizational and management structure that provides us with clear and direct lines of communication. We believe this structure enables us to make rapid, thorough and high-quality decisions, which is valued by our customers.
- ***Experienced management team.*** We have an experienced management team with an average of 15 years working in the industry and who have worked with us for an average of seven years.

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 11 below and include, among other things, the impact of changes in interest rates, the concentration of our loan portfolio, our ability to access funding sources, our exposure to adverse changes in the Nordic economy and the risk of increased competition. 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., Deutsche Bank Securities Inc., Credit Suisse Securities (USA) LLC, 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 Notes will mature in nine months or longer as specified in the applicable Pricing Supplement.
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.	A1	A2	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: Application has been made to the Luxembourg Stock Exchange for Notes issued under the Program to be admitted to trading on the Luxembourg Stock Exchange's Euro MTF market.

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.

Each Series of Notes may be listed on the Luxembourg Stock Exchange and/or 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.

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 (i) summary consolidated financial information for the group as at, and for the year ended December 31, 2005, prepared in accordance with IFRS, and comparison figures as at and for the year ended December 31, 2004, restated in accordance with IFRS and (ii) summary consolidated financial information for the group as at, and for the years ended December 31, 2004 and 2003, prepared in accordance with Icelandic GAAP. We have not prepared financial information in accordance with Icelandic GAAP for any periods subsequent to December 31, 2004. Note 123 to our consolidated IFRS financial statements for the year ended December 31, 2005 included elsewhere in this Offering Circular contains an explanation of how the transition to IFRS has affected our reported financial condition and results of operations. This note includes reconciliations of equity and profit or loss for comparative periods as at and for the year ended December 31, 2004 reported under Icelandic GAAP. 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 krona amounts in 2005 have been translated, solely for your convenience, at ISK 63.13 per $1.00, the mid rate quoted by the Central Bank of Iceland on December 30, 2005.

	As at and for the year ended December 31,				
	2005 ($)	**2005 (ISK)**	**2004 (ISK)[(1)]**	**2004 (ISK)**	**2003 (ISK)**
	(IFRS)	**(IFRS)**	**(IFRS)**	**(Icelandic GAAP)**	**(Icelandic GAAP)**
	(in millions, except percentages)				
Income Statement items					
Net interest income	518	32,710	18,259	18,900	10,124
Net fee and commission income	355	22,428	13,308	13,297	9,683
Net financial income	591	37,282	16,326	11,290	10,044
Other income	142	8,984	2,052	5,082	1,929
Operating income	**1,606**	**101,404**[(2)]	**49,945**[(2)]	**48,569**[(3)]	**31,780**[(3)]
Salaries and related expenses	(322)	(20,317)	(12,851)	(12,652)	(10,110)
Other operating expenses	(228)	(14,414)	(10,774)	(11,750)	(8,383)
Operating expenses	**(550)**	**(34,731)**	**(23,625)**	**(24,402)**	**(18,493)**
Impairment	(70)	(4,389)	(3,825)	(3,819)	(3,894)
Profit before income tax	**986**	**62,284**	**22,495**	**20,348**	**9,393**
Income tax	(178)	(11,228)	(4,236)	(4,040)	(1,486)
Net earnings	**808**	**51,056**	**18,259**	**16,308**	**7,907**
Minority interest	(28)	(1,796)	(552)	(548)	(387)
Shareholders' net earnings	**780**	**49,260**	**17,707**	**15,760**	**7,520**
Balance Sheet items					
Loans and advances	27,551	1,739,294	1,154,416	1,088,346	350,995
Financial assets measured at fair value	9,700	612,366	304,454	256,618	134,085
Assets other than mentioned above	2,996	189,151	95,583	189,056	73,489
Total assets	**40,247**	**2,540,811**	**1,554,453**	**1,534,020**	**558,569**
Deposits from credit institutions and central banks	1,103	69,643	32,488	147,455	79,267
Other deposits	7,701	486,176	202,193	202,038	182,497
Borrowings	24,657	1,556,567	968,512	884,219	210,645
Subordinated loans	1,627	102,688	57,623	57,627	10,704
Liabilities other than mentioned above	1,951	123,225	134,728	83,932	18,924
Total liabilities	**37,039**	**2,338,299**	**1,395,544**	**1,375,271**	**502,037**

	As at and for the year ended December 31,				
	2005 ($)	2005 (ISK)	2004 (ISK)(1)	2004 (ISK)	2003 (ISK)
	(IFRS)	(IFRS)	(IFRS)	(Icelandic GAAP)	(Icelandic GAAP)
	(in millions, except percentages)				
Minority interest	132	8,329	9,539	9,306	10,603
Shareholders' equity	3,076	194,183	149,370	149,443	45,929
Total liabilities and equity	**40,247**	**2,540,811**	**1,554,453**	**1,534,020**	**558,569**
Financial ratios					
Return on average assets(4)	2.34%	2.34%	—	1.46%	1.42%
Return on average equity(4)	28.36%	28.36%	—	18.39%	19.46%
Net interest margin	1.62%	1.62%	—	1.92%	2.08%
Net interest spread	1.43%	1.43%	—	1.87%	2.08%
Cost to income ratio(5)	34.09%	34.09%	—	47.30%	58.17%
Asset quality ratios					
Non-performing loans as a percentage of loans to customers	0.97%	0.97%	—	1.97%	3.68%
Non-performing assets as a percentage of loans to customers	1.12%	1.12%	—	2.21%	4.28%
Provision for loans as a percentage of loans to customers	0.83%	0.83%	—	1.66%	2.54%
Net charge-offs as a percentage of average loans to customers outstanding	0.24%	0.24%	—	0.85%	0.48%
Capital ratios					
CAD ratio	12.2%	12.2%	—	14.2%	14.2%
Tier 1 capital ratio	9.4%	9.4%	—	11.5%	12.2%
Ratio of earnings to fixed charges	128.9%	128.9%	—	66.5%	42.8%

(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) 2003 and 2004 amounts are net operating income.
(4) Average on quarter-end balances.
(5) Operating expenses divided by net 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

In recent years, our results of operations have depended to a great extent on earnings attributable to net interest income. Net interest income represented approximately 32% of our operating income in 2005, approximately 37% in 2004 and approximately 32% of net operating income in 2003.

Our financial operations are dependent on interest rate and other monetary policies of governments and central banks in the jurisdictions in which we operate as well as changes to such policies. For example, loans with fixed rates will become less profitable if interest rates rise. 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. We currently are operating in an increasing interest rate environment. A significant portion of our liabilities are short to medium term and we may have to refinance these obligations at higher rates. At December 31, 2005, ISK 921,039 million or 42.4% of our total financial liabilities matured in one to five years while ISK 598,613 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%, and once to date in 2006, on March 8, to 3.50%. 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 once to date in 2006, on January 26, to 10.75%.

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. A significant fall in our average interest rates charged on loans to customers that is not fully matched by a decrease in interest rates on our funding sources, or a significant rise in interest rates on our funding sources that is not fully matched by a rise in our interest rates charged, could have a material adverse effect on our business, financial condition and results of operations.

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. Inflation has increased to 4.0% for 2005 from 3.2% in 2004 and 2.1% in 2003. In addition, Iceland's current account deficit at December 31, 2005 was almost 16% of gross domestic product for 2005, impacting the value of the Icelandic krona, which has fallen in value against the U.S. dollar. At March 24, 2006, the krona had depreciated 17.1% against the U.S. dollar to ISK 73.47 to $1.00 from its high of ISK 60.89 to $1.00 at January 12, 2006. These developments and others may have a material adverse effect on our business, financial condition and results of operations.

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

Our loan portfolio is exposed to relatively high concentration in certain market sectors. As of December 31, 2005, 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 27%, 19% and 17% respectively, of our loan portfolio (excluding loans to banks and off-balance sheet credit related commitments). Furthermore, as of that date, our ten largest borrowers represented 12.1% of our loan portfolio and our 20 largest borrowers represented 18.2% of our portfolio (in each case excluding loans to banks and off-balance sheet credit related commitments), and loans to our single largest borrower represented 1.9% of our total loan portfolio (excluding loans to banks and off-balance sheet credit-related commitments). 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. Our total exposure to non-ISK denominated loans comprised approximately 85% of our loan portfolio (excluding loans to banks and off-balance sheet credit related commitments). 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 krona also could have a material adverse effect on our business, financial condition and results of operations.

After the merger with Búnadarbanki Islands hf. ("Búnadarbanki") in 2003, we wrote off approximately ISK 1.4 billion in non-performing loans in 2003, and have 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 FIH and Singer & Friedlander, which we acquired in 2004 and 2005, respectively, or other 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 65% and 17%, respectively, of our total loan portfolio as of December 31, 2005. 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.

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, 2005 our equity and debt investment portfolios totaled ISK 114,209 million and ISK 407,230 million, respectively, and accounted for 4.5% and 16%, 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.

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. 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 corporate and individual borrowers are secured by collateral such as 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 the United Kingdom, Iceland, 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. 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 retail 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.

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.

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

For the year ended December 31, 2005, we derived approximately 24% of our net operating income from our investment banking activities. 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. We also could be adversely affected by a decline in the value or the illiquid nature of this 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.

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.

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

Our reporting currency is the Icelandic krona. As of December 31, 2005, approximately 85% of our loan portfolio was comprised of non-ISK-denominated loans. 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 krona. 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. As a result, fluctuations in exchange rates could have a material adverse effect on our business, financial condition and results of operations.

We may be unable to continue to grow through acquisitions

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

We continue to evaluate potential acquisition and investment opportunities that could further expand our international banking operations 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.

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 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, 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 Bankaktiebolag JP Nordiska, 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. 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 corporate customers 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 the Nordic region and to target these corporate customers will succeed. If we are unable to further expand our loan portfolio in general and our corporate 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

The risk-adjusted capital guidelines promulgated by the Basel Committee on Banking Supervision, which include guidelines for capital adequacy and implementation, will take effect on January 1, 2007. At this time, we are unable to quantify how the revised guidelines will affect our requirements for capital and the impact these changes will have on our capital position. However, it is possible that our deployment and use of capital may have to be altered 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

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 corporate 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 is 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.

Our banking businesses entail operational risks

We are exposed to many types of operational risk, including the risk of fraud by employees or others, operational errors, including clerical or record keeping errors or errors resulting from faulty computer or telecommunications systems, or from external events that may affect our operations and reputation. Our business activities require us to record and process a large number of transactions accurately on a daily basis. The recording and processing of these transactions are potentially exposed to the risk of human and technological errors or a breakdown in internal controls relating to the due authorization of transactions. A failure or delay in recording or processing transactions, or any other material breakdown in internal controls, could subject us to claims for losses and regulatory fines and penalties. Consequently, we could suffer reputational or financial harm, which could have a material adverse affect on our financial condition and results of operations. 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 are exposed to unidentified and unanticipated risks

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. A failure of our risk management techniques could have a material adverse effect on our business, financial condition and results of operations.

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

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

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 integration of the IT systems of Singer & Friedlander with our systems and cannot assure you 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.

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

We may be unable to recruit or retain experienced and qualified personnel

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. Further, a loss of key employees with institutional and client knowledge could have a material adverse effect on our reputation and our business, financial condition and results of operations.

We rely on certain key members of management

We are highly dependent on our chief executive officer and senior management. The loss of the services of key members of our senior management or staff may significantly delay our business objectives and could have a material adverse effect on our business, financial condition and results of operations. In addition, competition in Iceland to hire qualified personnel could have a material adverse affect on our ability to recruit new senior managers.

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. 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 krona based on the mid rate quoted by the Central Bank of Iceland expressed in Icelandic krona per $1.00. No representation is made that amounts in Icelandic krona have been, could have been, or could be converted into U.S. dollars at the mid rate or at any other rate. At March 24, 2006, the mid rate was ISK 73.47 per $1.00.

	High	Low	Average[1]	Period End
	(krona per dollar)			
Recent Monthly Exchange Rate Data				
January, 2006	62.79	60.89	61.50	62.43
February, 2006	68.84	62.56	64.04	65.47
March, 2006 (through March 24)	73.47	64.71	69.12	73.47
Historical Annual Exchange Rate Data				
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
2001	110.39	83.87	97.76	103.2

(1) The average rate for each year from 2001 to 2005 is the average of the mid rates on the last business day of each month during the relevant period.

Source: Central Bank of Iceland

CAPITALIZATION

The following table sets forth our capitalization as at December 31, 2005.

	At December 31, 2005	Percentage of total capitalization
	(ISK millions— IFRS)	(%)
Borrowings		
Issued bonds	1,323,716	54.8
Loans	232,851	9.7
Total borrowings	1,556,567	64.5
Deposits		
Deposits from credit institutions and central banks	69,643	2.9
Other deposits	486,176	20.2
Total deposits	555,819	23.1
Subordinated loans		
Tier I	41,201	1.7
Tier II	61,487	2.6
Total subordinated loans	102,688	4.3
Equity		
Share capital	6,638	0.3
Other equity	187,545	7.8
Total shareholders' equity	194,183	8.1
Total capitalization	2,409,257	100.0

SELECTED CONSOLIDATED FINANCIAL INFORMATION

Set forth below is (i) selected consolidated financial information for the group as at, and for the year ended December 31, 2005, prepared in accordance with IFRS, and comparison figures as at and for the year ended December 31, 2004, restated in accordance with IFRS and (ii) selected consolidated financial information for the group as at, and for the years ended December 31, 2004 and 2003, prepared in accordance with Icelandic GAAP. We have not prepared financial information in accordance with Icelandic GAAP for any periods subsequent to December 31, 2004. Note 123 to our consolidated IFRS financial statements for the year ended December 31, 2005 included elsewhere in this Offering Circular contains an explanation of how the transition to IFRS has affected our reported financial condition and results of operations. This note includes reconciliations of equity and profit or loss for comparative periods as at and for the year ended December 31, 2004 reported under Icelandic GAAP. 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 krona amounts in 2005 have been translated, solely for your convenience, at ISK 63.13 per $1.00, the mid rate quoted by the Central Bank of Iceland on December 30, 2005.

	As at and for the year ended December 31,				
	2005 ($)	**2005 (ISK)**	**2004 (ISK)[1]**	**2004 (ISK)**	**2003 (ISK)**
	(IFRS)	**(IFRS)**	**(IFRS)**	**(Icelandic GAAP)**	**(Icelandic GAAP)**
	(in millions, except percentages)				
Income Statement items					
Net interest income	518	32,710	18,259	18,900	10,124
Net fee and commission income	355	22,428	13,308	13,297	9,683
Net financial income	591	37,282	16,326	11,290	10,044
Other income	142	8,984	2,052	5,082	1,929
Operating income	**1,606**	**101,404**[2]	**49,945**[2]	**48,569**[3]	**31,780**[3]
Salaries and related expenses	(322)	(20,317)	(12,851)	(12,652)	(10,110)
Other operating expenses	(228)	(14,414)	(10,774)	(11,750)	(8,383)
Operating expenses	**(550)**	**(34,731)**	**(23,625)**	**(24,402)**	**(18,493)**
Impairment	(70)	(4,389)	(3,825)	(3,819)	(3,894)
Profit before income tax	**986**	**62,284**	**22,495**	**20,348**	**9,393**
Income tax	(178)	(11,228)	(4,236)	(4,040)	(1,486)
Net earnings	**808**	**51,056**	**18,259**	**16,308**	**7,907**
Minority interest	(28)	(1,796)	(552)	(548)	(387)
Shareholders' net earnings	**780**	**49,260**	**17,707**	**15,760**	**7,520**
Balance Sheet items					
Loans and advances	27,551	1,739,294	1,154,416	1,088,346	350,995
Financial assets measured at fair value	9,700	612,366	304,454	256,618	134,085
Assets other than mentioned above	2,996	189,151	95,583	189,056	73,489
Total assets	**40,247**	**2,540,811**	**1,554,453**	**1,534,020**	**558,569**
Deposits from credit institutions and central banks	1,103	69,643	32,488	147,455	79,267
Other deposits	7,701	486,176	202,193	202,038	182,497
Borrowings	24,657	1,556,567	968,512	884,219	210,645
Subordinated loans	1,627	102,688	57,623	57,627	10,704
Liabilities other than mentioned above	1,951	123,225	134,728	83,932	18,924
Total liabilities	**37,039**	**2,338,299**	**1,395,544**	**1,375,271**	**502,037**
Minority interest	132	8,329	9,539	9,306	10,603
Shareholders' equity	3,076	194,183	149,370	149,443	45,929
Total liabilities and equity	**40,247**	**2,540,811**	**1,554,453**	**1,534,020**	**558,569**

	As at and for the year ended December 31,				
	2005 ($) (IFRS)	2005 (ISK) (IFRS)	2004 (ISK)(1) (IFRS)	2004 (ISK) (Icelandic GAAP)	2003 (ISK) (Icelandic GAAP)
Financial ratios					
Return on average assets (4)	2.34%	2.34%	—	1.46%	1.42%
Return on average equity(4)	28.36%	28.36%	—	18.39%	19.46%
Net interest margin	1.62%	1.62%	—	1.92%	2.08%
Net interest spread	1.43%	1.43%	—	1.87%	2.08%
Cost to income ratio (5)	34.09%	34.09%	—	47.30%	58.17%
Asset quality ratios					
Non-performing loans as a percentage of loans to customers	0.97%	0.97%	—	1.97%	3.68%
Non-performing assets as a percentage of loans to customers	1.12%	1.12%	—	2.21%	4.28%
Provision for loans as a percentage of loans to customers	0.83%	0.83%	—	1.66%	2.54%
Net charge-offs as a percentage of loans to customers outstanding	0.24%	0.24%	—	0.85%	0.48%
Capital ratios					
CAD ratio	12.2%	12.2%	—	14.2%	14.2%
Tier 1 capital ratio	9.4%	9.4%	—	11.5%	12.2%
Ratio of earnings to fixed charges	128.9%	128.9%	—	66.5%	42.8%

(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) 2003 and 2004 amounts are net operating income.
(4) Average on quarter-end balances.
(5) Operating expenses divided by net 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 year ended December 31, 2005 and 2004 have been prepared in accordance with IFRS. The financial statements and the accompanying notes for the years ended December 31, 2004 and 2003 have been prepared in accordance with Icelandic GAAP. IFRS and Icelandic GAAP differ in some respects from 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.

Transition to IFRS; Comparability of Information

We prepare our consolidated financial statements in accordance with IFRS as of January 1, 2005, as a basis for preparation of our consolidated results for periods ending after that date. Comparative data for the corresponding periods in 2004 originally presented in accordance with Icelandic GAAP have been recalculated and presented in accordance with IFRS, which differ in significant respects from those used to prepare our Icelandic GAAP financial statements. Note 123 to our consolidated IFRS financial statements for the year ended December 31, 2005 included elsewhere in this Offering Circular contains an explanation of how the transition to IFRS has affected our reported financial condition and results of operations. This note includes reconciliations to IFRS of equity and profit or loss for comparative periods as at and for the year ended December 31, 2004 reported under Icelandic GAAP.

The preparation of the consolidated financial information in accordance with IFRS resulted in changes to the accounting policies as compared with the most recent annual financial statements prepared under Icelandic GAAP. We 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 the comparative figures as at and for the year ended December 31, 2004 to comply with IAS 32 *Financial Instruments: Disclosure and Presentation* and IAS 39 *Financial Instruments: Recognition and Measurement*. Specifically, we applied Icelandic GAAP to the comparative figures as at and for the year ended December 31, 2004 to financial instruments within the scope of IAS 32 and IAS 39, except for the comparative figures as at December 31, 2004 presented in the balance sheet data, which have been adjusted in accordance with IAS 32 and IAS 39 as adopted on January 1, 2005, as explained in note 123.

The presentation of our results and the line items reported in our IFRS financial statements are different from those in our Icelandic GAAP financial statements. For example, under IFRS, the Icelandic GAAP item entitled "bonds, shares and other securities" now is classified as three separate items: "financial assets held for trading", "financial assets designated at fair value through profit or loss" and "financial assets available-for-sale". Further, under Icelandic GAAP we took both provisions for loan losses in respect of specific loans where we have identified a risk of loss, as well as a general provision against our entire loan portfolio. 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. In addition, prior to 2005, we presented our Corporate Banking and Retail Banking units as separate business divisions. Commencing with our 2005 IFRS financial statements, we have combined these together as the Banking division.

As a result, our financial statements prepared under IFRS will not be directly comparable to our financial statements prepared under Icelandic GAAP for the same or prior periods.

Overview

In July 2004, we acquired FIH in Denmark. As a result of the acquisition, net operating income increased during 2004 by ISK 5,853 million, or 12.1% of operating income, principally impacting our Banking division's net operating income. As a result of the acquisition, our total assets grew by ISK 756,817 million and as at January 1, 2005, FIH constituted 48.7% of our total assets.

In July 2005, we acquired Singer & Friedlander in the UK. As a result of the acquisition, net operating income increased during 2005 by ISK 7,804 million, or 7.7% of operating income, principally impacting both our Banking and Asset Management and Private Banking divisions' net operating income. As a result of the acquisition, our total assets grew by ISK 376,054 million and as at December 31, 2005, Singer & Friedlander constituted 14.8% of our total assets.

Introduction

We are a Northern European bank with shares listed on the ICEX and the Stockholm Stock Exchange. 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 six countries: Iceland, the United Kingdom, Denmark, Sweden, Finland and Luxembourg. In the United States, we operate through our subsidiary Kaupthing Securities Inc., a licensed broker-dealer. The United Kingdom, Iceland and Scandinavia currently are our most important markets, generating 34%, 30% and 26%, respectively, of our net operating income in 2005.

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 eight 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 2005 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 2006, as we seek to expand our activities in Finland, Luxembourg and the United Kingdom. We currently have senior long-term debt ratings of 'A1' from Moody's and 'A' from Fitch. As of December 31, 2005, our total assets were ISK 2,540,811 million, our Tier 1 ratio was at 9.4% and our CAD ratio was 12.2%. Our net earnings for 2005 were ISK 49,260 million, an increase of 178% from 2004.

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 Developments

We sold our remaining 8.75% stake in Baugur Group hf. on March 7, 2006 to the investment company Gaumur and Eignarhaldsfélagid ISP, from which we realized capital gains of approximately ISK 3.3 billion. The sale ended an investment project which began in 2003 with the acquisition and delisting of Baugur Group hf. from the ICEX and that entity's subsequent division into the investment company Baugur Group hf. and the retail company Hagar hf. We originally advised on, provided financing for and acquired almost 20% of Baugur Group hf.

We currently are considering disposing of our ownership interest in Exista ehf. through a payment of extraordinary dividends to our shareholders in the form of Exista ehf. shares, provided that Exista ehf. lists its shares prior to the end of this year. However, any such disposition would be subject to various conditions, including approval by Exista ehf.'s existing shareholders, and we cannot guarantee that any such disposition will take place.

We have been taking steps to increase our liquidity. Excluding FIH, we currently have €1.1 billion of long term debt maturing in 2006 and €3.5 billion of long term debt maturing in 2007, which includes €500 million of extendible notes which mature in 2010 but may be called earlier by investors with 12 months' notice. See "Risk Factors—Liquidity risk may impair our ability to fund our operations and adversely affect our financial condition." In March 2006, we signed a €500 million syndicated loan agreement and have raised approximately €400 million in structured private placements in 2006 to date. We currently have in place a covered bond program and are working to launch a "Samurai" bond issue in Japan.

Factors Affecting Results of Operations

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. Under Icelandic GAAP, loan origination fees are recognized when they are incurred by the borrower.

Net fee and commission income. We provide various services to our clients from which we earn income. Fee and commission income depends in large part on the volume and value of services we provide to clients, which in turn depends on conditions in the markets in which we operate and 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 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 gain on disposals of assets other than assets held for sale, fair value adjustments on investment properties and insurance premiums.

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, 2005.

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.

Allowance for loan losses and impairment on loans and advances

For our financial information as at December 31, 2004 and 2003 prepared under Icelandic GAAP, the allowance for loan losses is based upon management's ongoing assessments of the probable estimated losses inherent in our loan portfolio. Assessments are conducted by members of management responsible for various types of loans employing a methodology and following guidelines which are continually monitored. We also record an unallocated allowance to account for inherent uncertainties, factors which are difficult to measure and inaccuracies in the process of estimating allowances. As the process for determining the adequacy of an allowance requires subjective and complex judgments by management about the effect of matters that are inherently uncertain, subsequent evaluations of the loan portfolio, in light of factors then prevailing, may result in significant changes in the allowance for loan losses.

For our financial information as at December 31, 2005 and January 1, 2005 prepared under IFRS, our allowance for loan losses is based on our review 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

We regularly review goodwill and equity method investments for possible indications of impairment. 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.

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 techniques such as 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 estimates. Changes in assumptions about 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.

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	51.9
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 at fair value	147	492	(70.1)
Net gain on financial assets/liabilities not at fair value	33,920	12,755	165.9
Net foreign exchange difference	1,407	(892)	—
Net financial income	37,282	16,326	128.3
Share of profit of associates	1,396	240	481.7
Other operating income	8,069	1,834	340.0
Net operating income(1)	101,884	49,968	103.9
Salaries and related expenses	(20,317)	(12,851)	58.1
Administrative expenses	(11,594)	(9,428)	23.0
Depreciation and amortization	(2,818)	(1,347)	109.2
Operating expenses	(34,731)	(23,625)	47.0
Impairment on loans and advances	(2,450)	(3,825)	(36.0)
Impairment on other assets	(1,939)	0	—
Net loss on non-current assets held for sale	(483)	(22)	—
Profit 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)	225.4
Shareholders' net earnings	49,260	17,707	178.2

(1) Net operating income is operating income excluding net loss on non-current assets held for sale.

Operating Income

Net operating income in 2005 amounted to ISK 101,884 million, an increase of 103.9% compared to ISK 49,968 million in 2004.

Net interest income in 2005 amounted to ISK 32,710 million, compared with ISK 18,259 million in 2004, representing an increase of 79.1%. This increase reflects a ISK 14,180 million increase in net interest income from our Banking division, driven by our acquisition of Singer & Friedlander, which contributed ISK 4,693 million of net interest income during the year, as well as by a ISK 2,693 million increase from our Treasury division, which increase was principally due to our acquisition of Singer & Friedlander. The net interest margin, or interest income less interest expense as a percentage of average total interest earning assets, was 1.62% in 2005, compared with an estimated 1.92% in 2004. This lower net interest margin reflects interest expense rising faster than interest income.

Net fee and commission income totaled ISK 22,428 million during 2005, compared with ISK 13,308 million in 2004, an increase of 68.5%. This increase was driven principally by a ISK 4,849 million increase in fees and commissions generated by our Investment Banking division, reflecting the acquisition of Singer & Friedlander, which contributed ISK 1,335 million of net fee and commission income during the year, as well as an increase in Asset Management and Private Banking.

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 128.4%. This increase was driven principally by a ISK 9,967 million increase in our Investment Banking division and a ISK 9,763 million increase in Capital Markets, reflecting more favorable conditions in the Nordic financial markets.

Other operating income totaled ISK 8,069 million in 2005, compared with ISK 1,834 million in 2004, of which ISK 1,679 million was due to our acquisition of Singer & Friedlander. This increase is due largely to a profit of ISK 3,093 million from the sale of our leasing subsidiary Lysing hf., as well as to lease income from Singer & Friedlander.

Expenses

Operating expenses consists of salaries and related expenses, administrative expenses and depreciation and amortization. Operating expenses totaled ISK 34,731 million in 2005, compared with ISK 23,625 million in 2004, an increase of 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 cost to income ratio in 2005 was 34.1%, a decrease from 47.3% in 2004.

Salaries and related expenses totaled ISK 20,317 million in 2005 and increased by 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, as well as an increase in performance-related bonuses. Salaries and related expenses attributable to Singer & Friedlander during the year amounted to ISK 3,390 million. 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 totaled 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 Singer & Friedlander.

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 to depreciation of operating lease assets of Singer & Friedlander.

Impairment on loans and advances totaled ISK 2,450 million in 2005, compared with ISK 3,825 million in 2004, a decrease of 36.0%. This reflects the increased quality of our loan portfolio, notwithstanding an increase in the size of the portfolio. Impairment of other assets was ISK 1,939 million on 2005 compared with ISK 0 in 2004, driven by impairment related to the sale of Neomarkka in Finland, impairment related to our operations in Norway, where a restructuring has taken place, and impairment in respect of Singer & Friedlander in London.

Tax and Net Earnings

We posted a pre-tax profit of ISK 62,284 million in 2005, an increase of 176.9% over ISK 22,495 million the previous year. This increase occured notwithstanding a net loss of ISK 241 million attributable to Singer & Friedlander.

Income tax in 2005 totaled ISK 11,228 million, compared with ISK 4,236 million the previous year, reflecting our higher profitability during the year. Of this, ISK 144 million was attributable to 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 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 178.2%. Earnings per share were ISK 75.2 in 2005, compared with ISK 35.6 in 2004.

Balance Sheet Data

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 and advances	1,739,294	1,154,416	50.7
Financial assets measured at fair value[(1)]	612,366	304,454	101.1
Financial assets available-for-sale	167	1,507	88.9
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			
Deposits from credit institutions and central banks	69,643	32,488	114.4
Other 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

(1) Financial assets measured at fair value are comprised of:

	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

Assets

Our total assets as of December 31, 2005 were ISK 2,541 billion, an increase of 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.

In accordance with IFRS, the item previously categorized under Icelandic GAAP as "loans" now is divided into two categories: "loans and advances" and "mortgage loans measured at fair value". "Mortgage loans measured at fair value" only refers to specific mortgage loans in Denmark. These are now included as a category of "Financial assets measured at fair value". Mortgage loans in other countries are categorized under "loans and advances". Loans and advances 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. Loans to customers increased 56.9% from ISK 992 billion to ISK 1,556,653 million in 2005, due to the acquisition of Singer & Friedlander as well as increased loans to corporate customers and increased Icelandic mortgage loans. Loans due from credit institutions increased 12.2% from ISK 174,310 million to ISK 195,594 million.

In accordance with IFRS, the item previously categorized under Icelandic GAAP as "bonds, shares and other securities" now is classified as three separate items: "financial assets held for trading", "financial assets designated at fair value through profit or loss" and "financial assets available-for-sale". 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 increase of financial assets designated at fair value at Singer & Friedlander. Trading assets amounted to ISK 337,157 million as of December 31, increasing by 64.3% from ISK 205,185 million at January 1, 2005. Financial assets designated at fair value through profit or loss were ISK 258,717 million as of December 31, increasing by 306.2% from ISK 63,695 million at January 1, 2005. Derivatives used for hedging amounted to ISK 4,459 million as of December 31, compared with ISK 3,820 million at the beginning of the year, an increase of 16.7%.

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 have entered into derivatives contracts amounting to ISK 53,388 million against our investment in shares and other equity instruments. 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.

In accordance with the implementation of IFRS at the beginning of 2005, our unlisted securities are measured at fair value. Previously, our holdings in unlisted shares were measured at the lower of cost or fair value. Notwithstanding this, under IFRS when we calculate the fair value of our 19.2% holding in Exista ehf., the parent of Exista B.V., Exista B.V.'s 21.1% share in Kaupthing Bank is calculated at cost.

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 totaled ISK 1,521 million. This impairment mainly is 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 36.6% from ISK 3,631 million at the beginning of the year.

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

Liabilities and Equity

Deposits from credit institutions and the central bank (previously "Amounts owed to credit institutions") totaled ISK 69,643 million as of December 31, 2005, an increase of 114.4% over ISK 32,488 million at the beginning of the year. Other deposits (previously "Deposits") amounted to ISK 486,176 million as of December 31, 2005, an increase of 140.5% over ISK 202,193 million at the beginning of the year. This increase principally reflects the consolidation of Singer & Friedlander into the group. 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 60.7%, reflecting increasing funding needs due to the growth of our balance sheet, as well as the acquisition of Singer & Friedlander. Subordinated loans, partially to fund the acquisition of Singer & Friedlander, increased 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 30.0% during the year. The Capital Adequacy Directive ratio was 12.2% at December 31, 2005, compared with 14.2% as at the end of 2004. Tier 1 capital was 9.4% as of December 31, 2005, compared with 11.5% at the beginning of the year.

Segment Analysis

The tables below set out our profit before income tax by segment for 2005 and 2004.

	Year Ended December 31, 2005						
	Investment Banking	Banking	Capital Markets	Treasury	Asset Mgmnt and Private Banking	Elimination and cost centers	Total
	(ISK millions—IFRS)						
Net interest income	(2,322)	32,076	(1,120)	4,733	632	(1,289)	32,710
Net fee and commission income	7,592	3,165	4,730	1,364	5,256	322	22,428
Net financial income	18,416	232	16,008	2,637	100	(112)	37,282
Other operating income	163	2,739	35	0	0	6,047	8,984
Operating income	23,849	38,212	19,653	8,734	5,988	4,968	101,404
Operating expenses	(1,808)	(10,011)	(3,113)	(1,481)	(4,186)	(14,131)	(34,731)
Impairment	(22)	(2,395)	0	6	0	(1,978)	(4,389)
Total expenses	(1,830)	(12,406)	(3,113)	(1,475)	(4,186)	(16,109)	(39,120)
Gross profit	22,019	25,806	16,540	7,259	1,802	(11,141)	62,284
Allocated cost	(706)	(5,356)	(1,751)	(877)	(1,758)	10,448	0
Profit before income tax	21,313	20,450	14,789	6,382	44	(693)	62,284
Net segment revenue from external customers	25,620	77,801	22,830	(33,915)	4,482	4,586	101,404
Net segment revenue from other segments	(1,771)	(39,589)	(3,177)	42,649	1,506	382	0
Operating income	23,849	38,212	19,653	8,734	5,988	4,968	101,404
Total assets	80,433	1,849,845	70,277	428,027	1,823	110,406	2,540,811
Depreciation and amortization	22	1,475	19	4	15	1,283	2,818

	Year Ended December 31, 2004						
	Investment Banking	Banking	Capital Markets	Treasury	Asset Mgmnt and Private Banking	Elimination and cost centers	Total
	(ISK millions—IFRS)						
Net interest income	(802)	17,896	(182)	2,040	(188)	(505)	18,259
Net fee and commission income	2,743	2,883	2,808	1,353	2,954	567	13,308
Net financial income	8,449	76	6,245	651	0	906	16,326
Other operating income	33	61	0	0	0	1,958	2,052
Operating income	10,423	20,916	8,871	4,044	2,766	2,926	49,945
Operating expenses	(1,150)	(4,830)	(2,483)	(922)	(1,527)	(12,713)	(23,625)
Impairment	0	(3,795)	0	(24)	0	(6)	(3,825)
Total expenses	(1,150)	(8,625)	(2,483)	(946)	(1,527)	(12,719)	(27,450)
Gross profit	9,273	12,291	6,388	3,098	1,239	(9,793)	22,495
Allocated cost	(887)	(3,974)	(1,399)	(678)	(1,122)	(8,097)	0
Profit before income tax	8,386	8,317	4,989	2,420	117	(17,890)	22,495
Net segment revenue from external Customers	12,092	29,499	11,481	(7,510)	1,644	2,740	49,945
Net segment revenue from other segments	(1,669)	(8,583)	(2,610)	11,554	1,122	186	0
Operating income	10,423	20,916	8,871	4,044	2,766	2,926	49,945
Total assets	51,732	1,151,079	64,667	223,310	589	63,076	1,554,453
Depreciation and amortization	12	223	29	3	1	1,079	1,347

Investment Banking

Operating income in Investment Banking was ISK 23,849 million in 2005, a 128.8% increase over ISK 10,423 million in 2004. This increase was driven principally by a ISK 9,967 million increase in net financial income, largely due to the increase in value of certain of our principal investments and a ISK 4,849 million increase in net fee and commission income, driven by increased M&A advisory and capital markets transactions, partially offset by a ISK 1,520 million decrease in net interest income, as interest expense grew more quickly than interest income. Operating expenses in Investment Banking increased 57.2%, from ISK 1,150 million to ISK 1,808 million, due to increased salary expenses and overall higher levels of operations, in part related to our acquisitions. Profit before income tax in Investment Banking in 2005 increased 154.2% to ISK 21,313 million from ISK 8,386 million in 2004, as the increase in operating income significantly outpaced the increase in operating expenses.

Banking

Operating income in Banking was ISK 38,212 million in 2005, an 82.7% increase over ISK 20,916 million in 2004. This increase was driven principally by a ISK 14,180 million increase in net interest income, due to the acquisition of Singer & Friedlander, as well as increased growth in lending both to retail clients in Iceland and to corporate clients across the group. Other operating income increased by ISK 2,678 million, due to operating lease contracts generated by Singer & Friedlander. Operating expenses in Banking increased 107.3%, from ISK 4,830 million to ISK 10,011 million, due to increased salary expenses and overall higher levels of operations, in part related to our acquisitions. Profit before income tax in Banking increased 145.9% to ISK 20,450 million, from ISK 8,317 million in 2004, as the increase in operating income significantly outpaced the increase in operating expenses.

Capital Markets

Operating income in Capital Markets was ISK 19,653 million in 2005, a 121.5% increase over ISK 8,871 million in 2004. This increase was driven principally by a ISK 9,763 million increase in net financial income and a ISK 1,922 million increase in net fee and commission income, driven by more favorable conditions in the Nordic financial markets, partially offset by a ISK 938 million decrease in net interest income, reflecting a higher cost of financing of proprietary trading positions. Operating expenses increased 25.4%, from ISK 2,483 million to ISK 3,113 million, due to increased salary expenses and overall higher levels of operations. Profit before income tax in Capital Markets increased 196.4%, from ISK 4,989 million to ISK 14,789 million, as the increase in operating income significantly outpaced the increase in operating expenses.

Treasury

Operating income in Treasury was ISK 8,734 million in 2005, a 116.0% increase over ISK 4,044 million in 2004. This increase was driven principally by a ISK 2,693 million increase in net interest income, reflecting higher levels of operations and a 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 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. Profit before income tax in Treasury increased 163.7% to ISK 6,382 million in 2005 from ISK 2,420 million in 2004, as the increase in operating income significantly outpaced the increase in operating expenses.

Asset Management and Private Banking

Operating income in Asset Management and Private Banking was ISK 5,988 million in 2005, a 116.5% increase over ISK 2,766 million in 2004. Net commission income was ISK 5,256 million in 2005, an increase of 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 a loss of ISK 188 million in 2004. Operating expenses in Asset Management and Private Banking increased 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. Profit before income tax in Asset Management and Private Banking decreased 62.4% to ISK 44 million in 2005 from ISK 117 million in 2004, as the increase in operating expenses outpaced the increase in operating income.

Years Ended December 31, 2004 and 2003 (Icelandic GAAP)

Results of Operations

The table below sets out our results of operations under Icelandic GAAP for 2004 and 2003.

	Year ended December 31,		
	2004	2003	Change
	(ISK millions—Icelandic GAAP)		(%)
Interest from credit institutions	1,804	2,173	(16.9)
Interest on loans	44,076	22,245	98.1
Interest on bonds	3,832	1,861	105.9
Other interest income	3,605	3,369	7.0
Interest income	53,317	29,648	79.8
Interest to credit institutions	(3,119)	(5,724)	(45.5)
Interest on deposits	(8,374)	(7,221)	16.0
Interest on borrowings	(20,158)	(5,435)	270.9
Interest on subordinated loans	(2,419)	(938)	157.9
Other interest expenses	(347)	(206)	68.4
Interest expense	(34,417)	(19,524)	76.3
Net interest income	18,900	10,124	86.7
Fees, commissions and other service charges	15,645	11,125	40.6
Fees, commissions and other service charges, paid	(2,348)	(1,442)	62.8
Net fee and commission income	13,297	9,683	37.3
Dividends from shares and other holdings	4,216	1,101	282.9
Trading gains	11,290	10,044	12.4
Other operating income	866	828	4.6
Total other operating income	29,669	21,656	37.0
Net operating income	48,569	31,780	52.8
Salaries and salary-related expenses	(12,652)	(10,110)	25.1
Other administrative expenses	(9,108)	(7,028)	29.6
Depreciation and amortization	(2,642)	(1,355)	95.0
Other operating expenses	(24,402)	(18,493)	32.0
Provision for losses	(3,819)	(3,894)	(1.9)
Pre-tax profit	20,348	9,393	116.6
Income tax	(4,040)	(1,486)	171.9
Profit before minority interest	16,308	7,907	106.3
Minority interest	(548)	(387)	41.6
Net earnings	15,760	7,520	109.6

Income

Net operating income in 2004 amounted to ISK 48,569 million, an increase of 52.8% compared to ISK 31,780 million in 2003.

Net interest income in 2004 amounted to ISK 18,900 million, compared with ISK 10,124 million in 2003, representing an increase of 86.7%. This increase is a result largely of FIH joining the group in 2004, which contributed ISK 5,045 million of net interest income during the year. The net interest margin, or interest income less interest expense as a percentage of average total interest earning assets, was 1.92% in 2004, compared with 2.08% in 2003. The lower interest margin primarily is the result of changes in the composition of our loan portfolio after the acquisition of FIH.

Net fee and commission income was ISK 13,297 million during the year, compared with ISK 9,683 million in 2003, an increase of 37.3%, driven by a ISK 1,224 million increase in Corporate Banking and a ISK 925 million increase in Asset Management and Private Banking. Trading gains in 2004 was ISK 11,290 million, compared with ISK 10,044 million in 2003, an increase of 12.4%. Of this amount in 2004, ISK 7,735 million represents trading gains from equities, ISK 2,948 million from bonds and ISK 607 million from foreign exchange.

Dividends from shares and other holdings amounted to ISK 4,216 million and other operating income was ISK 866 million in 2004, totaling ISK 5,082 million, compared with ISK 1,929 million in 2003. This 163.5% increase is due largely to dividend payments to us during the second quarter from our 19.2 ownership interest in Singer & Friedlander and profit from the sale of Kaupthing Bank A/S, our subsidiary in Denmark.

Expenses

Other operating expenses totaled ISK 24,402 million in 2004, compared with ISK 18,493 million in 2003, an increase of 32.0%. The cost to income ratio in 2004 was 50.2%, a decrease from 58.2% in 2003.

Salaries and related expenses totaled ISK 12,652 million in 2004, an increase of 25.1% from ISK 10,110 million in 2003, driven principally by an increase in the number of employees following our acquisition of FIH. At the end of 2004, the total number of full-time equivalent employees was 1,606, compared with 1,237 at the beginning of the year.

Other administrative expenses totaled ISK 9,108 million in 2004, increasing by 29.6% from ISK 7,028 million in 2003.

Depreciation of fixed assets and amortization of goodwill was ISK 2,642 million in 2004, a 95.0% increase over ISK 1,355 million in 2003. This increase is attributable to an increase in amortization of goodwill in connection with the acquisition of FIH.

Provision for losses totaled ISK 3,819 million in 2004, compared with ISK 3,894 million in 2003, a decrease of 1.9%. Provision for losses decreased despite a growth in the loan portfolio because our asset quality has improved.

Income Tax and Net Earnings

We posted a pre-tax profit of ISK 20,348 million in 2004, compared with ISK 9,393 million the previous year. Income tax in 2004 totaled ISK 4,040 million, which represents an increase of 171.9% from ISK 1,486 million the previous year. Our effective tax rate in 2004 was 19.9%, compared with 15.8% in 2003. Net earnings amounted to ISK 15,760 million in 2004, compared with ISK 7,520 million in 2003, representing an increase of 109.6%.

Balance Sheet Data

The table below sets forth our balance sheet under Icelandic GAAP at December 31, 2004 and 2003.

	At December 31,		
	2004	2003	Change
	(ISK millions—Icelandic GAAP)		(%)
Assets			
Cash and amounts due from credit institutions	113,543	50,545	124.6
Loans	1,088,346	350,995	210.1
Bonds and other fixed-income securities	169,666	80,832	109.9
Shares and other variable-yield securities	78,686	50,327	56.4
Shares in associated companies	7,066	2,070	241.4
Shares in subsidiaries	1,200	856	40.2
Goodwill	34,208	5,948	475.1
Fixed assets	6,467	5,441	18.9
Other assets	14,614	8,638	69.2
Prepaid expenses and accrued income	19,185	2,086	819.7
Deferred tax assets	1,039	831	25.1
Total assets	1,534,020	558,569	174.6
Liabilities			
Amounts owed to credit institutions	147,455	79,267	86.0
Savings deposits	202,038	182,497	10.7
Borrowings	884,219	210,645	319.8
Other liabilities	74,767	17,278	332.7
Provision for deferred income tax liability	9,165	1,646	456.8
Total liabilities	1,317,644	491,333	168.2
Subordinated loans	57,627	10,704	438.4
Total liabilities and subordinated loans	1,375,271	502,037	173.9
Minority interest in subsidiaries' equity	9,306	10,603	(12.2)
Equity			
Share capital	6,521	4,384	48.8
Share premium	110,402	23,304	373.8
Accrued stock options	157	316	(50.3)
Retained earnings	32,363	17,925	80.6
Equity	149,443	45,929	225.4
Total liabilities and equity	1,534,020	558,569	174.6

Assets

Our total assets on December 31, 2004 were ISK 1,534,020 million, an increase of ISK 975,451 million or 174.6% from ISK 558,569 million at year-end 2003. Loans on December 31, 2004 amounted to ISK 1,088,346 million, an increase of ISK 737,351 million or 210.1% from ISK 350,995 million at the end of 2003. The increase is mainly due to the acquisition of FIH. Loans represented 70.9% of our total assets on December 31, 2004, compared with 62.8% of total assets at the end of 2003. Total provision for loans on December 31, 2004 was ISK 16,492 million, which represented 1.4% of loans and guarantees compared to 2.4% at the end of 2003. The decrease is due mainly to the acquisition of FIH.

Holdings in bonds and other fixed income securities were valued at ISK 169,666 million on December 31, 2004, an increase of ISK 88,834 million or 109.1% from ISK 80,832 million at the end of 2003. This increase is attributable largely to FIH's holdings in bonds. Taking derivatives into account, we were exposed to market risk of ISK 72,456 million at December 31, 2004. Our holdings in shares and other variable yield securities amounted to ISK 78,686 million at the end of 2004, an increase of 56.4% from ISK 50,327 million at the end of 2003. We had entered into derivatives agreements against these assets to a total of ISK 13,138 million. As at December 31, 2004, Kaupthing owned 300,000 unlisted A shares and 1,249,617 listed B shares representing 54.4% of voting rights and 30.4% of the nominal value of total share capital in Norvestia. Norvestia is a fully consolidated subsidiary, with the shares not owned by us reported as minority interests, which we recognize using the equity method. Accordingly, we are not exposed to market risk of ISK 11 billion attributable to minority interests in Norvestia in Finland, and our exposure to market risk with respect to our stake in Norvestia amounts to approximately ISK 5.5 billion. Listed shares comprised ISK 65,651 million, or 4.3% of our total assets. Unlisted shares comprised ISK 13,035 million, or 0.8% of our total assets. Our four largest positions in unlisted shares represented approximately 91% of total assets in unlisted shares. Under Icelandic GAAP, all of our securities are entered at market value, with the exception of unlisted securities, which are entered at the lower of cost and estimated market value. Other assets (consisting of goodwill, fixed assets, other assets, prepaid expenses and accrued income and deferred tax assets) increased by 229% during the year, from ISK 22,944 million to ISK 75,513 million. A large part of the increase relates to goodwill and prepaid expenses from the acquisition of FIH.

Liabilities and Equity

Amounts owed to credit institutions at December 31, 2004 totaled ISK 147,455 million, an increase of 86.0% from ISK 79,267 million outstanding at year-end 2003. Savings deposits totaled ISK 202,038 million at the end of the year, which represents an increase of ISK 19,541 million or 10.7% from ISK 182,497 million at year-end 2003. Deposits represented 13.2% of our total financing at December 31, 2004, compared with 32.7% at December 31, 2003. Borrowings increased 319.8% from ISK 210,645 million at year-end 2003 to ISK 884,219 million at year-end 2004 and represented 67.1% of our total liabilities.

Our equity totaled ISK 149,443 million at December 31, 2004, compared with ISK 45,929 million at the end of 2003, which represents an increase of 225.4% during the year. This increase is due largely to the issue of share capital to finance the acquisition of FIH, first in a pre-emptive rights issue in August, and then in a private placement of new shares to institutional investors in October. The sales value of these new shares totaled ISK 92,443 million. The CAD ratio was 14.2%, the same as at the end of 2003. Tier 1 capital was 11.5% on December 31, 2004, compared with 12.2% at the end of 2003.

Segment Analysis

The tables below set out our gross margin by segment for 2004 and 2003.

	Year Ended December 31, 2004						
	Investment Banking	Corporate Banking	Retail Banking	Capital Markets	Treasury	Asset Mgmnt and Private Banking	Total
	(ISK millions—Icelandic GAAP)						
Net interest income	(802)	11,225	6,671	(182)	2,040	(188)	18,764
Net commission income	2,743	1,531	1,352	2,808	1,353	2,954	12,741
Trading gains	8,449	72	4	6,245	651	—	15,421
Other operating income	33	—	61	—	—	—	94
Total income	10,423	12,828	8,088	8,871	4,044	2,766	47,020
Operating expenses	(1,150)	(961)	(3,869)	(2,483)	(922)	(1,527)	(10,912)
Provision for losses	—	(1,293)	(2,502)	—	(24)	—	(3,819)
Total expenses	(1,150)	(2,254)	(6,371)	(2,483)	(946)	(1,527)	(14,731)
Gross margin	**9,273**	**10,574**	**1,717**	**6,388**	**3,098**	**1,239**	**32,289**

	Year Ended December 31, 2003						
	Investment Banking	Corporate Banking	Retail Banking	Capital Markets	Treasury	Asset Mgmnt and Private Banking	Total
	(ISK millions—Icelandic GAAP)						
Net interest income	(684)	4,055	5,447	(759)	2,018	47	10,124
Net commission income	2,854	308	1,517	2,061	598	2,029	9,367
Trading gains	3,168	63	56	6,093	900	—	10,280
Other operating income	97	72	62	216	76	6	529
Total income	5,435	4,498	7,082	7,611	3,592	2,082	30,300
Operating expenses	(939)	(444)	(3,474)	(2,080)	(821)	(1,417)	(9,175)
Provision for losses	—	(2,415)	(1,361)	—	(118)	—	(3,894)
Total expenses	(939)	(2,859)	(4,835)	(2,080)	(939)	(1,417)	(13,069)
Gross margin	**4,446**	**1,639**	**2,247**	**5,531**	**2,653**	**665**	**17,231**

Investment Banking

Total income in Investment Banking was ISK 10,423 million in 2004, a 91.8% increase over ISK 5,435 million in 2003. This increase was driven principally by a ISK 5,281 million increase in trading gains, due to profits from the sale of principal investments, including our holdings in the Icelandic oil distributor Skeljungur, the fashion retailer Karen Millen, the Icelandic CocaCola bottler Vífilfell and approximately half of our holdings in the investment company Baugur Group hf. Our remaining interest in Baugur Group hf. was sold on March 7, 2006. Operating expenses in Investment Banking increased 22.5%, from ISK 939 million to ISK 1,150 million, due to higher salary costs and administrative costs due to higher levels of activity in the division. Gross margin in Investment Banking increased 108.6% to ISK 9,273 million from ISK 4,446 million, as the increase in total income significantly outpaced the increase in operating expenses.

Corporate Banking

Total income in Corporate Banking was ISK 12,828 million in 2004, a 185.2% increase over ISK 4,498 million in 2003. This increase was driven principally by a ISK 7,170 million increase in net interest income, largely due to the acquisition of FIH and a ISK 1,223 million increase in net commission income. Operating expenses in Corporate Banking increased 116.4%, from ISK 444 million to ISK 961 million, due to the acquisition of FIH. Provisions for losses decreased ISK 1,122 million or 46.5% from ISK 2,415 million to ISK 1,293 million due to improved asset quality. Gross margin in Corporate Banking increased 545.2% to ISK 10,574 million from ISK 1,639 million, as the increase in total income significantly outpaced the increase in operating expenses.

Retail Banking

Total income in Retail Banking was ISK 8,088 million in 2004, a 14.2% increase over ISK 7,082 million in 2003. This increase was driven principally by a ISK 1,224 million increase in net interest income, due to increased volume in lending, especially in mortgage financing, partially offset by an ISK 165 million reduction in net commission income principally due to service charge discounts to retail customers. Operating expenses in Retail Banking increased 11.4%, from ISK 3,474 million to ISK 3,869 million, due to increased activity in mortgage lending. Provision for losses increased 83.8% from ISK 1,361 million to ISK 2,502 million due to write-offs of bad loans after our merger with Búnadarbanki. Gross margin in Retail Banking decreased 23.6% from ISK 2,247 million to ISK 1,717 million, due largely to the higher level of provisions.

Capital Markets

Total income in Capital Markets was ISK 8,871 million in 2004, a 16.6% increase over ISK 7,611 million in 2003. This increase was driven principally by a ISK 747 million increase in net commission income, reflecting increased trading volume. The contribution of net interest income to net operating income improved ISK 577 million as negative net interest income was reduced from ISK 759 million to ISK 182 million. Operating expenses increased 19.4%, from ISK 2,080 million to ISK 2,483 million, due to higher levels of activity in the division. Gross margin in Capital Markets increased 15.5%, from ISK 5,531 million to ISK 6,388 million, as the increase in total income outpaced the increase in operating expenses.

Treasury

Total income in Treasury was ISK 4,044 million in 2004, a 12.6% increase over ISK 3,592 million in 2003. This increase was driven principally by a ISK 755 million increase in net commission income, reflecting increased derivatives and foreign exchange trading, partially offset by an ISK 249 million reduction in trading gains principally due to losses on Icelandic fixed income swaps. Operating expenses in Treasury remained largely constant, at ISK 946 million in 2004 compared with ISK 939 million in 2003, as the ISK 101 million increase in net operating expenses was almost completely offset by an ISK 94 million reduction in provisions. Gross margin in Treasury increased 16.8% to ISK 3,098 million from ISK 2,653 million, as the increase in total income outpaced the increase in operating expenses.

Asset Management and Private Banking

Total income in Asset Management and Private Banking was ISK 2,766 million in 2004, a 32.9% increase over ISK 2,082 million in 2003. This increase was driven principally by a ISK 925 million increase in net commission income, due to an increase in assets under management, an increase in performance-based commission income and the launch of new products. Operating expenses in Asset Management and Private Banking increased 7.8%, from ISK 1,417 million to ISK 1,527 million, due to higher salary costs and administrative costs due to higher levels of activity in the division. Gross margin in Asset Management and Private Banking increased 86.3% from ISK 665 million to ISK 1,239 million, as the increase in total income outpaced the increase in operating expenses.

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".

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 year ended December 31, 2005 under IFRS and for the years ended December 31, 2004 and 2003 under Icelandic GAAP, 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.

	For the 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 and advances	1,501,870	82,672	5.50
Financial 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			
Deposits from credit institutions and central banks	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	1.62

(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

	For the year ended December 31,					
	2004			2003		
	Average balance[(1)]	Interest	Average rate %	Average balance[(1)]	Interest	Average rate %
	(ISK millions, except percentages—Icelandic GAAP)					
Assets						
Cash and amounts due from credit institutions	91,931	1,804	1.96	48,068	2,173	4.52
Loans	737,492	44,076	5.98	329,305	22,245	6.76
Bonds and other fixed income securities	130,987	3,832	2.93	96,807	1,861	1.92
Other assets	26,095	3,605	13.81	12,433	3,369	27.10
Total interest earning assets	**986,505**	**53,317**	**5.40**	**486,613**	**29,648**	**6.09**
Provisions for losses	(13,314)	—	—	(7,521)	—	—
Total non-interest earning assets	103,357	—	—	51,837	—	—
Total assets	**1,076,548**	—	—	**530,929**	—	—
Liabilities						
Amounts owed to credit institutions	111,033	3,119	2.81	112,126	5,724	5.10
Savings deposits	194,894	8,374	4.30	187,311	7,221	3.86
Borrowings	573,110	20,158	3.52	158,129	5,435	3.44
Subordinated loans	47,397	2,419	5.10	11,255	938	8.33
Other liabilities	48,886	347	0.71	18,091	206	1.14
Total interest bearing liabilities	**975,320**	**34,417**	**3.53**	**486,912**	**19,524**	**4.01**
Total non-interest bearing liabilities	5,360	—	—	1,405	—	—
Total liabilities	980,680	—	—	488,317	—	—
Total shareholders' equity	85,721	—	—	38,642	—	—
Minority interest	10,147			3,970		
Total liabilities and equity	**1,076,548**	—	—	**530,929**	—	—
Net interest spread[(2)]	—	—	1.87	—	—	2.08
Net interest income and net interest margin[(3)]	—	18,900	1.92	—	10,124	2.08

(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.

	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
Financial 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)	(14,052)
Net interest income	14,451	17,458	(3,007)

	2004 v 2003		
	Total interest change	**Due to change in volume**	**Due to change in interest rate**
	(ISK millions—Icelandic GAAP)		
Interest income			
Cash and amounts due from credit institutions	(369)	861	(1,230)
Loans	21,831	24,395	(2,564)
Bonds and other fixed income securities	1,971	1,000	971
Other interest income	236	1,887	(1,651)
Total interest income	23,669	28,143	(4,474)
Interest expense			
Amounts owed to credit institutions	2,605	31	2,574
Savings deposits	(1,153)	(326)	(827)
Borrowings	(14,723)	(14,596)	(127)
Subordinated loans	(1,481)	(1,845)	364
Other liabilities	(141)	(219)	78
Total interest expense	(14,893)	(16,955)	2,062
Net interest income	8,776	11,188	(2,412)

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

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, 2005 and 2004 and under Icelandic GAAP at December 31, 2004 and 2003.

	At December 31, 2005	At January 1, 2005
	(ISK millions—IFRS)	
Trading assets		
Bonds	197,116	142,864
Other debt instruments	1,286	—
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
Financial assets designated at fair value		
Bonds	88,730	28,316
Debt instruments	120,098	—
Shares	46,583	26,224
Other equity instruments	3,306	9,155
Mortgage loans measured at fair value		
Municipalities	229	635
Business enterprises	11,804	31,119
Derivatives used for hedging		
Fair value hedge	982	370
Portfolio hedge of interest rate risk	3,477	3,450
Financial assets measured at fair value	**612,366**	**304,454**

	At December 31,	
	2004	2003
	(ISK millions—Icelandic GAAP)	
Trading bonds		
Listed bonds	142,754	68,526
Unlisted bonds	17,002	10,932
Investment bonds		
Listed bonds	9,854	1,116
Unlisted bonds	56	258
Trading shares		
Listed shares	65,651	33,663
Unlisted shares	11,376	16,526
Investment shares		
Unlisted shares	1,659	138
Financial assets other than loans and advances	**248,352**	**131,159**

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

	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	—	171,048	2,404	58,103	27,162	258,717
Mortgage loans measured at fair value	—	232	543	2,676	8,582	12,033
Derivatives used for hedging	983	677	11	659	2,129	4,459
Financial assets measured at fair value	**338,140**	**171,957**	**2,958**	**61,438**	**37,873**	**612,366**

Loan Portfolio

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

	At December 31, 2005	At January 1, 2005
	(ISK millions—IFRS)	
Iceland		
Loans to credit institutions		
Bank accounts	16,739	4,183
Overdraft	—	—
Money market loans	7,433	47,989
Other loans	29,064	10,289
Total loans to credit institutions	**53,236**	**62,461**
Loans to customers		
Overdrafts	37,027	18,108
Subordinated loans	3,474	5,238
Other loans	444,784	276,274
Advances	—	—
Finance lease	—	25,840
Finance lease—current assets	—	—
Total loans to customers	**485,285**	**325,460**
Total loans (Iceland)	538,521	387,921
Provision for losses	(6,778)	(8,116)
Total Iceland loans	**531,743**	**379,805**
Foreign		
Loans to credit institutions		
Bank accounts	30,142	11,124
Overdraft	1,733	1,739
Money market loans	90,111	92,890
Other loans	20,372	6,096
Total loans to credit institutions	**142,358**	**111,849**
Loans to customers		
Overdrafts	45,760	22,995
Subordinated loans	4,173	1,785
Other loans	825,675	586,170
Advances	125,882	—
Finance lease	51,212	32,879
Finance lease—current assets	18,666	23,111
Total loans to customers	**1,071,368**	**666,940**
Total loans (foreign)	1,213,726	778,789
Provision for losses	(6,175)	(4,178)
Total foreign loans	**1,207,551**	**774,611**
Total loans and advances	**1,739,294**	**1,154,416**

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

	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 credit institutions						
Bank accounts	16,648	82	—	—	9	16,739
Overdraft	—	—	—	—	—	—
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 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
Advances	—	—	—	—	—	—
Finance lease	—	—	—	—	—	—
Finance lease—current assets	—	—	—	—	—	—
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 Iceland loans	**20,960**	**86,559**	**55,944**	**202,040**	**166,240**	**531,743**
Foreign						
Loans to 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**
Loans to customers						
Overdrafts	983	38,945	5,832	—	—	45,760
Subordinated loans	—	—	—	—	4,173	4,173
Other loans	63,717	114,021	60,529	269,503	317,905	825,675
Advances	—	46,096	12,651	42,348	24,787	125,882
Finance lease	—	14,718	24,119	12,375	—	51,212
Finance lease—current assets	—	3,294	9,005	6,367	—	18,666
Provisions for losses	(260)	(1,955)	(499)	(1,254)	(2,207)	(6,175)
Total loans to foreign customers	**64,440**	**215,119**	**111,637**	**329,339**	**344,658**	**1,065,193**
Total foreign loans	**90,612**	**317,345**	**116,325**	**335,135**	**348,134**	**1,207,551**
Total loans and advances	**111,572**	**403,904**	**172,269**	**537,175**	**514,374**	**1,739,294**

The following table provides details of loans to customers by sector at the dates indicated.

	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
Business enterprises		
Agriculture	3,403	4,105
Fishing industry	12,492	10,023
Industry	49,175	50,624
Commerce	22,759	36,407
Service	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
Business enterprises		
Agriculture	6,207	1,543
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 and advances	**1,739,294**	**1,154,416**

Characteristics of our 20 Largest Loans

The group's 20 largest loans amounted to ISK 280.3 billion, or 18.2% of customer loans at the end of 2005, our 10 largest loans amounted to 12.1% of customer loans and the largest loan represented 1.9% of our customer loan portfolio. Loans to Danish, Icelandic and British customers represented 42%, 38%, and 20%, respectively, of these 20 largest loans. The group's 20 largest loans include loans across a range of industries, including Industry, Retail and Investments. Our largest exposure to a single industry at the end of 2005 was ISK 91 billion, or approximately 32% of the total of these 20 loans.

Loan Loss Allowances

Under Icelandic GAAP, we took both provisions for loan losses in respect of specific loans where we have identified a risk of loss, as well as a general provision against our entire loan portfolio. 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. As a result, our impairments under IFRS are less than our total provisions for loan losses under Icelandic GAAP at the end of 2004. In addition, under IFRS at the beginning of 2005, certain mortgage loans in Denmark are no longer categorized as "Loans" but as "Mortgage loans measured at fair value" and are included in our balance sheet under "Financial assets measured at fair value". As a result, no impairment is assessed against these mortgage loans, which further reduces impairments under IFRS compared to provisions for loans losses under Icelandic GAAP.

The following table sets forth the impairments or loan loss allowances and changes in loans, charge-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.

	Total 2005	Specific 2004	General 2004	Total 2004	Total 2003
	(IFRS)	(Icelandic GAAP)			
	(ISK millions, except percentages)				
Balance at the beginning of the year	12,294	5,465	2,836	8,301	5,764
Acquisition through business combination	1,765	9,990	405	10,395	—
Impairment/provision for losses on loans and advances during the year	2,450	2,989	830	3,819	3,894
Exchange rate differences on translation	(518)	(378)	(65)	(443)	25
Write offs during the year	(3,212)	(5,566)	(35)	(5,601)	(1,402)
Payment of loans previously written off	174	21	—	21	20
Balance at end of year	12,953	12,521	3,971	16,492	8,301
Restatement according to IFRS	—	—	—	12,294	—
Average outstanding loans to customers for the period indicated	1,268,050	—	—	659,056	288,649
Outstanding loans to customers at end of the period indicated	1,543,700	—	—	991,093	327,019
Provisions/outstanding loans to customers at the end of the period indicated	0.84%	—	—	1.66%	2.54%
Net write-offs/average outstanding loans to customers for the period indicated	0.24%	—	—	0.85%	0.48%

The following table sets forth by sector write-offs of loans over the years indicated.

	Year ended December 31,		
	2005	2004	2003
		(ISK millions)	
Write-offs during the year			
Agriculture	133	113	4
Fishing industry	39	416	—
Industry	1,010	1,770	113
Commerce	413	397	91
Service	562	1,684	725
Individuals	1,055	1,221	469
Total	3,212	5,601	1,402

Allocation of Provisions for Losses on Loans and Advances

The table below details the allocation of provisions for losses on loans and advances to customers by sector under IFRS as at December 31, 2005 and January 1, 2005.

	At December 31, 2005			At January 1, 2005		
	Iceland	Foreign	Total	Iceland	Foreign	Total
	(ISK millions—IFRS)					
Municipalities	—	—	—	—	—	—
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	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**

Assets

The table below shows assets as at December 31, 2005 by each country where such assets exceed 3% of the group's total assets.

	At December 31, 2005					
	Iceland	Denmark	UK	Sweden	Other	Total
	(ISK millions—IFRS)					
Cash and cash balances with central banks	811	27,757	59	9	6,241	34,877
Loans and advances	531,743	670,380	297,642	77,249	162,280	1,739,294
Financial assets measured at fair value	247,669	139,605	160,956	8,333	55,803	612,366
Financial assets available-for-sale	—	—	—	—	167	167
Other assets	69,362	26,647	45,389	6,005	6,704	154,107
Total	**849,585**	**864,389**	**504,046**	**91,596**	**231,195**	**2,540,811**

Non-performing Assets

The following table sets forth our non-performing assets as at December 31, 2005, 2004 and 2003.

	At December 31,		
	2005	2004	2003
	(IFRS)	(Icelandic GAAP)	(Icelandic GAAP)
	(ISK millions, except percentages)		
Loans with specific provisions for losses	—	16,561	7,149
Other non-performing loans	—	2,973	4,900
Total non-performing loans	15,078	19,534	12,049
Mortgages foreclosed:			
Tangible assets held for sale	572	—	—
Total assets of legal entities held for sale	1,730	—	—
Total mortgages foreclosed	2,302	2,402	1,962
Total non-performing assets	17,380	21,936	14,011
Non-performing loans as a percentage of loans to customers	0.98%	1.97%	3.68%
Non-performing assets as a percentage of loans to customers	1.13%	2.21%	4.28%
Provision for loans as a percentage of loans to customers	0.84%	1.66%	2.54%
Net charge-offs as a percentage of average loans to customers outstanding	0.24%	0.85%	0.48%

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, 2005 and 2004 under IFRS and for the years ended December 31, 2004 and 2003 under Icelandic GAAP.

	At December 31, 2005	At January 1, 2005
	(ISK millions—IFRS)	
Icelandic operations		
Deposits from credit institutions and central banks	10,126	8,875
Other deposits	149,300	112,941
Total Iceland deposits	159,426	121,816
Deposits in foreign banking offices		
Deposits from credit institutions and central banks	59,517	23,613
Other deposits	336,876	89,252
Total foreign deposits	396,393	112,865
Total deposits	**555,819**	**234,681**
Interest expense	18,856	8,374

	At December 31,	
	2004	2003
	(ISK millions—Icelandic GAAP)	
Liabilities to credit institutions	147,455	79,267
Savings deposits		
Demand deposits	79,929	103,432
Time deposits	122,109	79,065
Total savings deposits	202,038	182,497
Total deposits and liabilities owed to credit institutions	**349,493**	**261,764**

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, 2005					
	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	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 5 years	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

	At December 31, 2004					
	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	Total
	(ISK millions—Icelandic GAAP)					
Savings deposits	79,929	82,980	8,773	23,922	6,434	202,038
Liabilities owed to credit institutions	9,270	93,705	1,826	9,763	32,891	147,455
Total deposits and liabilities owed to credit institution	89,199	176,685	10,599	33,685	39,325	349,493

	At December 31, 2003					
	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	Total
	(ISK millions—Icelandic GAAP)					
Savings deposits	103,432	36,274	20,999	16,797	4,995	182,497
Liabilities owed to credit institutions	3,249	71,151	2,444	1,944	479	79,267
Total deposits and liabilities owed to credit institution	106,681	107,425	23,443	18,741	5,474	261,764

Borrowings

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

	At December 31, 2005		At January 1, 2005	
	(IFRS)			
	(ISK millions)	(%)	(ISK millions)	(%)
Borrowings				
Bonds issued	1,158,806	74.4	779,931	80.5
Bills issued	164,910	10.6	35,726	3.7
Money market loans	200,581	12.9	111,901	11.6
Other loans	32,270	2.1	40,954	4.2
Total borrowings	1,556,567	100.0	968,512	100.0
Borrowings mature				
On demand	10,684	0.7	9,685	1.0
Up to 3 months	300,885	19.3	145,277	15.0
Over 3 months and up to a year	214,935	13.8	125,907	13.0
Total short-term borrowings	526,504	33.8	280,869	29.0
Over 1 year and up to 5 years	862,240	55.4	581,107	60.0
Over 5 years	167,823	10.8	106,536	11.0
Total borrowings	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 two years ended December 31, 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, 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 shows details of the types of the group's borrowings and also shows the amounts of short-term borrowings outstanding as at December 31, 2004 and 2003.

	At December 31,			
	2004		2003	
	(Icelandic GAAP)			
	(ISK millions)	(%)	(ISK millions)	(%)
Borrowings				
Bonds issued	850,159	96.1	150,424	71.4
Loans	34,060	3.9	60,221	28.6
Total borrowings	884,219	100.0	210,645	100.0
Borrowings maturing within one year	307,941	—	70,000	—
Percentage of total borrowings	—	34.8	—	33.2

Capital

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

Equity as at December 31, 2005 was ISK 202,512 million. The equity ratio, calculated in accordance with Article 84 of the Icelandic Act on Financial Undertakings, was 12.2%. Under applicable Icelandic law, we are required to maintain an equity ratio of at least 8.0%.

The ratio is calculated as follows.

	At December 31,					
	2005		2004		2003	
	Book value	Weighted value	Book value	Weighted value	Book value	Weighted value
	(IFRS)		(Icelandic GAAP)			
	(ISK millions, except percentages)					
Risk I						
Assets recorded in the financial statements	2,540,811	1,841,833	1,534,020	1,166,377	558,569	408,910
Assets deducted from equity	—	(62,590)	—	(50,335)	—	(8,543)
Guarantees and other items not included in the balance sheet	—	166,029	—	73,129	—	13,988
Total Risk I capital	—	1,945,272	—	1,189,171	—	414,355
Equity						
Tier I capital						
Equity	—	202,512	—	158,749	—	45,929
Intangible assets	—	(54,943)	—	(34,208)	—	4,655
Assets subtracted from equity	—	(6,741)	—	(1,232)	—	(1,398)
Subordinated loans	—	41,201	—	13,947	—	1,151
Total Tier I capital	—	182,029	—	137,256	—	50,337
Tier II capital:						
Subordinated loans	—	61,285	—	43,108	—	9,532
Investment in credit institutions	—	(6,451)	—	(11,598)	—	(1,197)
Total capital	—	236,862	—	168,766	—	58,672
Equity ratio	—	12.2%	—	14.2%	—	14.2%
Tier I ratio	—	9.4%	—	11.5%	—	12.2%

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, 2005.

	At December 31, 2005				
	On demand	**Up to 3 months**	**3-12 months**	**1-5 years**	**Over 5 years**
	(ISK millions—IFRS)				
Cash and central banks balances	34,877	—	—	—	—
Loans and advances	111,572	403,904	172,269	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	—	—	—	—
Total	484,756	575,861	175,227	598,613	552,247
Deposits from credit institutions and central banks	11,176	52,820	3,890	—	1,757
Other deposits	163,426	253,963	18,156	39,834	10,797
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	189,965	616,530	242,727	921,039	202,398
Periodic interest-sensitive gap	294,791	(40,669)	(67,500)	(322,426)	349,849
Cumulative interest-sensitive gap	294,791	254,122	186,622	(135,804)	214,045

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

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 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 the 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.

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 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 units within risk management concentrate on different aspects of the credit portfolio: credit control focuses on the distressed client process, monitoring defaults, following up on legal proceedings and overseeing specific provisions and write-offs. Credit risk analysis is dedicated to, but financially independent from, the credit process in general and the loan application phase in particular. This unit 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.

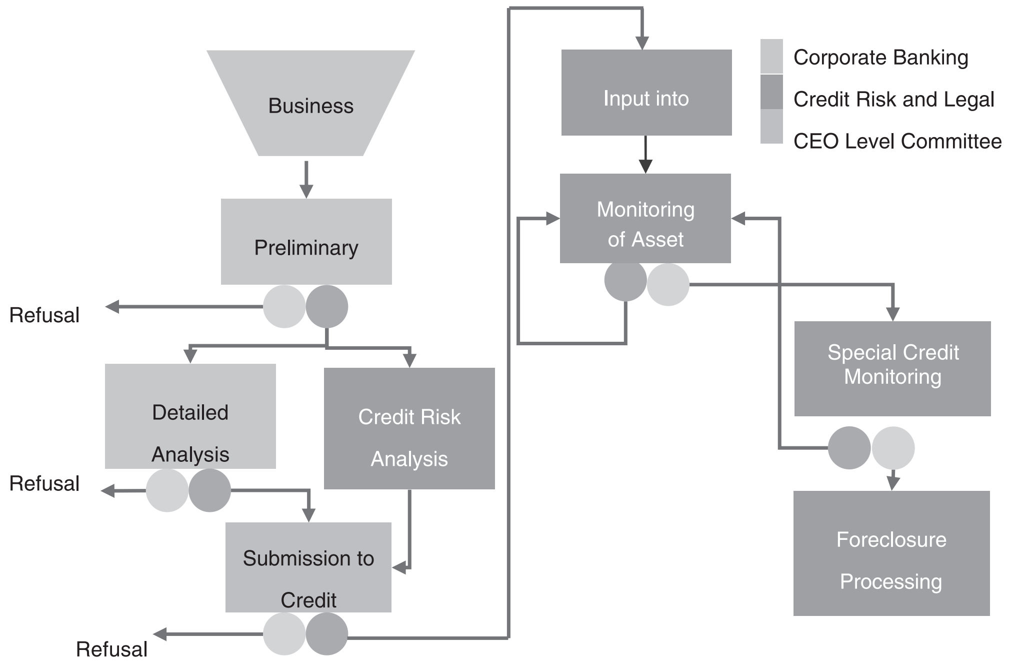
Our Corporate Banking and Risk Management units work together to analyze larger exposures and the manner in which different related entities are intertwined. This process provides us with a comprehensive overview of our outstanding exposure and the potential risks that can arise from interlinked ownership. Furthermore, specific procedures are in place to monitor the aggregate exposure of a single counterparty across subsidiaries.

Credit Application Process

We have strengthened our credit application process in recent years and we continually rationalize and develop both the specific tools as well as the overall process that we use. Our board of directors' credit committee oversees the credit process and has final authority in all matters related to credit. Moreover, our board of directors' credit committee covers all large credit proposals, limits the lending authority of personnel, and restricts exposures to different types of entities and reviews loans granted outside of committee meetings.

In order to make use of our local expertise, a large part of our credit and collateral risk is evaluated on a local level in our subsidiaries. However, to maintain a group-wide overview, our chief executive officer or his deputy is a member of all local credit committees. In each committee, the same or similar credit rules apply, as well as any further requirements stipulated by local regulations. This structure allows us to benefit from local expertise while monitoring risk on a global level. In this manner, local credit committees of our subsidiaries are able to grant credit, but the aggregate exposure of the lender and financially related counterparties is limited, most commonly to a percentage of the subsidiary's capital. Any credit applications that would lead to exposures exceeding the set limit are referred to the credit committee of the board of directors.

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



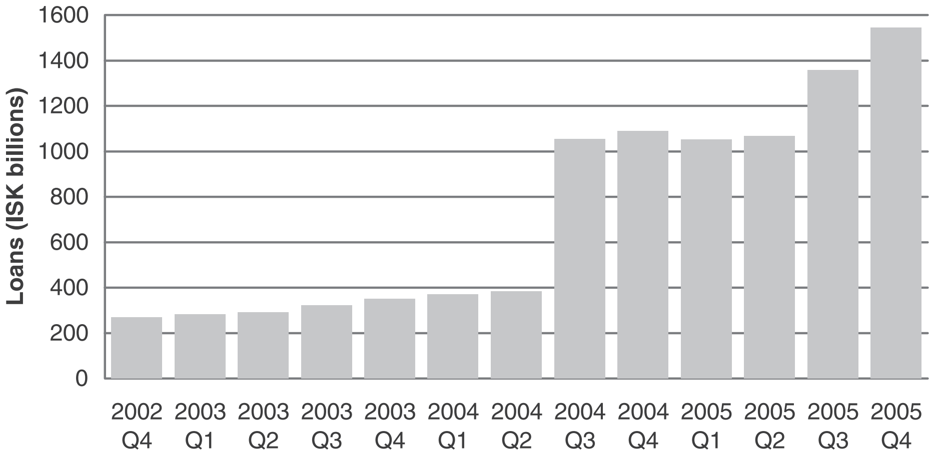
An effective and precise credit rating system is essential for analyzing and pricing risk accurately. Recently, we have emphasized improving our credit risk modeling on a group wide scale. Where applicable, and together with our internal credit rating system, we use the services of external credit rating 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.

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.

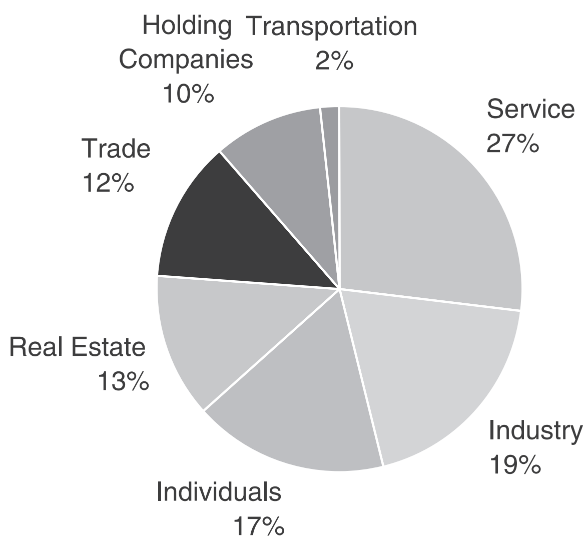
Credit Exposure

At 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 the year-end of 2005, corporate loans totaled ISK 1,275 billion, up from ISK 860 billion in 2004, and loans to individuals totaled ISK 268 billion, up from ISK 120 billion in 2004, largely due to new mortgage loans introduced in Iceland during the latter half of 2004 and the addition of clients of Singer & Friedlander. We believe that our portfolio is well diversified. Our largest exposures are to companies within the service sector, which constitute around 27% of our portfolio, followed by the industry sector at approximately 19% and loans to individuals at approximately 17%. Other significant sectors are real estate and trade. Combined, these sectors represent approximately one quarter of our portfolio.

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



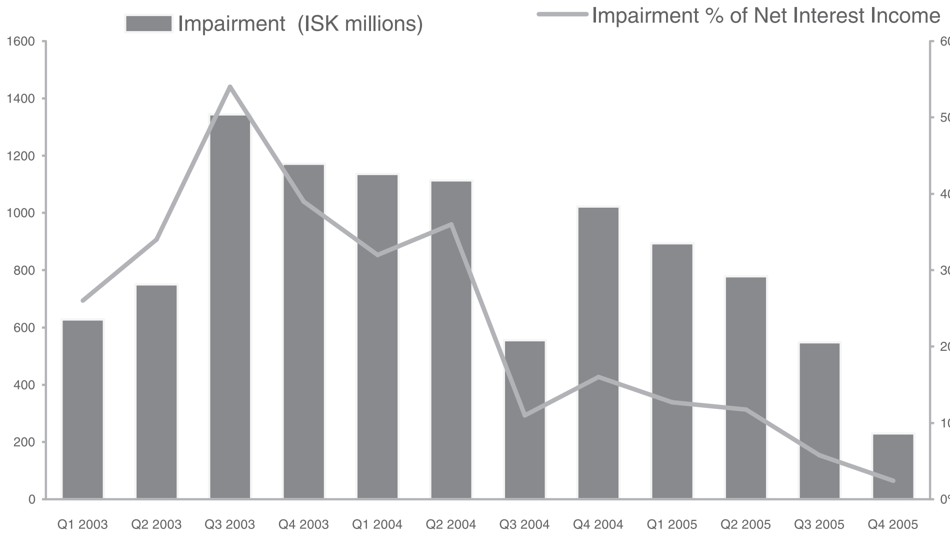
The table below illustrates the distribution of our loan portfolio to customers, net of loan loss provisions, by sector at December 31, 2005, which totaled ISK 1,544 billion.



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.

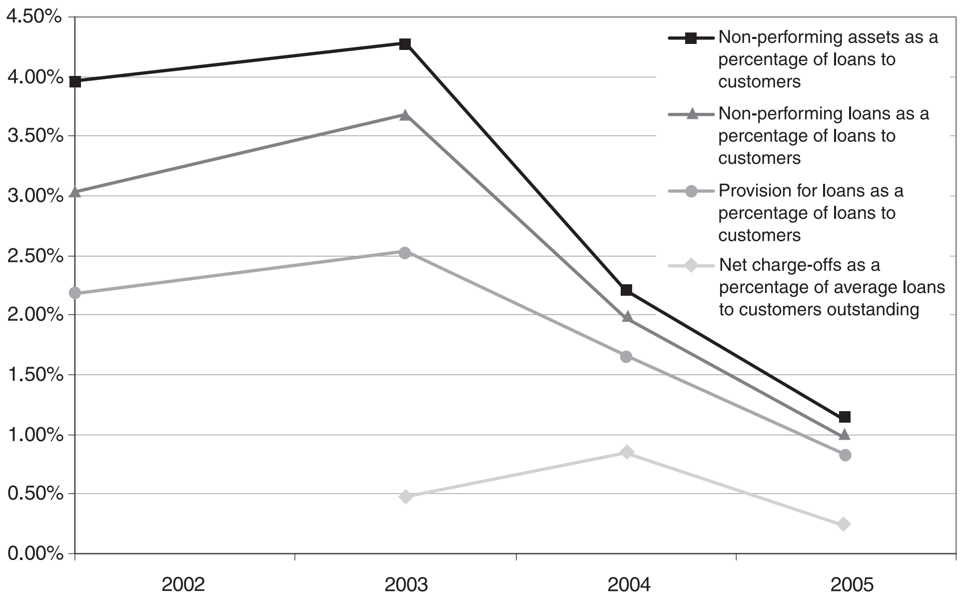
The table below illustrates the development of our provisions on a quarterly basis since 2003, both in absolute amounts and as a percentage of net interest income.



We believe that our efforts have improved the quality of our loan portfolio. As a result, during 2005, provisions continued to decline, both in absolute terms and as a percentage of net interest income. During the last quarter of 2005, provisions were approximately 2.5% of net interest income, down from over 50% in the third quarter of 2003.

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 table 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 charge-offs as a percentage of average loans to customers outstanding.



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

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 posed by the relevant authorities.

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 Risk Management through a position monitoring system. The head of Risk Management 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 Risk Management if any deviations or exceptions are observed.

Our Risk Management unit sends a daily report on profit and loss and turnover to the head of Risk Management, the head of Trading 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.

Market Risk Analysis

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 Value at Risk of our security portfolio, which helps to identify all major contributing factors of market risk.

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.

We have three key liquidity targets. First we seek to have enough available secured liquidity (including deposits, bonds available-for-sale under repurchase agreements and the unused portion of revolving credit facilities) to enable us to serve and repay maturing debt for at least 180 days without accessing the capital markets. Second, we seek 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 (our "available credit")) to cover our liabilities over that period. Finally, we seek to cover short-term liabilities for 390 days with unsecured liquidity together with liquid assets (listed and liquid securities). 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 short-term liquidity (maturing assets in excess of maturing liabilities) at December 31, 2005.

	At December 31, 2005				
	Up to 1 month	1-3 months	3-6 months	6-12 months	1-2 years
	(ISK billions—IFRS)				
Secured liquidity	247	18	(82)	(241)	(548)
Secured liquidity and available credit	464	236	136	(23)	(329)
Unsecured liquidity and liquid assets	574	345	246	86	(220)

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, 2005. Risk is measured by assuming a 1% simultaneous increase in all yield curves in the relevant maturity band. 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, 2005					
		Up to 1 month	1-3 months	3–12 months	1-5 years	Over 5 years	Total
		(ISK millions—IFRS)					
Currency							
Icelandic Krona	Trading	—	(1)	(1)	(94)	(578)	(674)
	Banking	10	19	2	22	(13,447)	(13,394)
Danish Krone	Trading	162	43	(106)	(865)	(769)	(1,535)
	Banking	(28)	(171)	(367)	(418)	(455)	(1,439)
Euro	Trading	(175)	(156)	(23)	(59)	20	(393)
	Banking	233	358	(25)	261	398	1,225
Great British Pound	Trading	(29)	(33)	(1)	(6)	12	(57)
	Banking	41	251	(146)	(25)	(139)	(18)
United States Dollar	Trading	(1)	(33)	(16)	(1)	(1)	(52)
	Banking	39	55	(35)	(123)	(866)	(930)
Swiss Franc	Trading	7	2	(2)	—	—	7
	Banking	4	35	(87)	(6)	17	(37)
Other	Trading	—	(13)	(10)	(57)	28	(52)
	Banking	25	26	(27)	5	40	69
	Total	288	382	(844)	(1,366)	(15,740)	(17,280)

At the end of 2005, the total amount of our ISK-denominated inflation-linked assets was ISK 237,218 million and the total amount of our ISK-denominated inflation-linked liabilities was ISK 129,917 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 table below shows the effect that the indicated changes in interest rates would have on net interest income as projected for the next twelve months beginning January 1, 2006 using a static balance sheet for each set of interest rate scenarios, as compared to the flat interest rate scenario.

Net Interest Income at Risk Analysis

Interest rate scenario	Annualized hypothetical percentage change in net operating income
1.00%	(17)%
Flat	—
(1.00)%	17%

The overall net interest income profile demonstrates the symmetry in our interest rate risk, as an upward shift in the yield curve would have a negative effect on our earnings proportionate to the positive effect on our earnings created by a downward shift of the same magnitude.

The table above assumes an instantaneous shift in all yield curves. This table also assumes a static balance sheet 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 charges 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 affect on our share price. Strategic risk, reputational 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.

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.

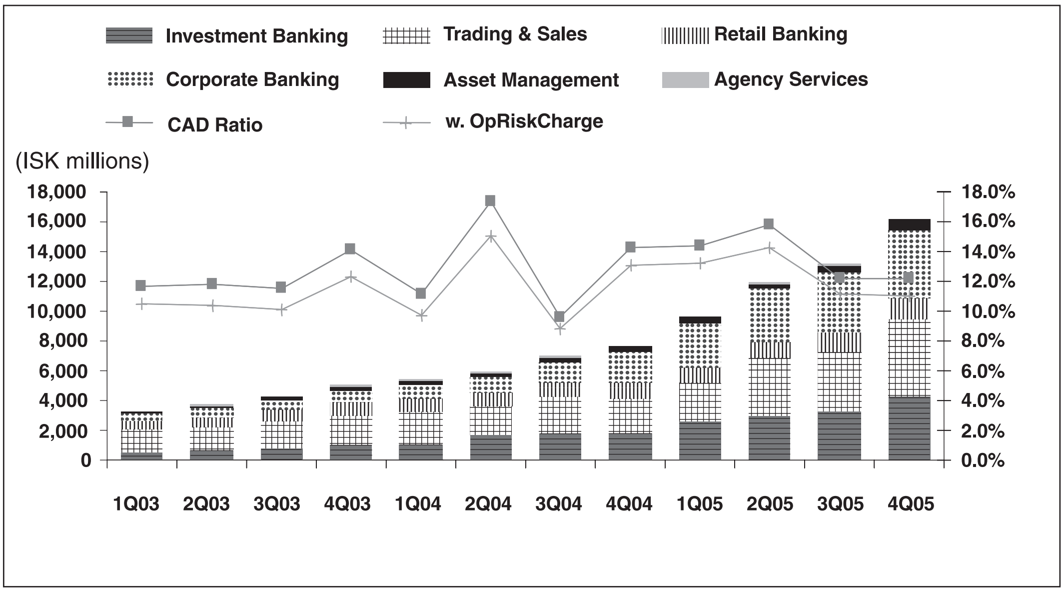
We have also taken out various insurance policies to cover major operational risk events.

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. For estimation of the operational risk capital charge our business units are mapped into the following business lines: Investment Banking, Trading and Sales, Agency Services, Asset Management, and Banking, which is divided into Retail Banking and Corporate Banking. According to CRD, the remaining two business lines, Payment & Settlement and Retail Brokerage, are included in the Trading and Sales business segment.

The total operational risk for all the business lines is currently measured at approximately ISK 16.2 billion, with the majority of the risk being controlled in Investment Banking, Trading and Sales and Corporate Banking. If the operational risk is accounted for in the CAD ratio, without estimating changes to the credit risk charge due to the new CRD, the CAD ratio would be approximately 11.1% instead of its current value, 12.2%.

The table 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 will come 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 Basel II rules include capital requirements for operational risk in addition to credit risk and market risk, which are already covered in the current rules.

The Basel II rules were developed by the Basel Committee for Banking Supervision to replace the current rules, known as Basel I. 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, which made necessary amendments to the CRD, the Recast Capital Requirement Directive 2000/12.

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 current Basel I rules), Foundation IRB and Advanced IRB—the difference being the sophistication of the capital requirement calculations. Under Foundation IRB and Advanced IRB, the financial institution uses it 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—the difference being the sophistication of methods and the processes required for operational risk monitoring and quantification.

We have applied for a permission to use the IRB approach to determine our capital requirements for credit risk. Our aim is to begin using the IRB approach for calculation of Risk Weighted Assets from January 1, 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 IRB approach by January 1, 2008.

We have been in the process of implementing the Basel II rules since December 2003, when the first rating models were introduced into part of our portfolio. Our focus in 2005 was on continuing the development of rating models and parameters such as the probability of default for corporate and retail portfolios, as well as loss given default and credit conversion factors for the retail portfolio. We have focused on data preparation and historical collection of statistical analysis and model construction, as well as on aligning our control environment and risk management processes with Basel II requirements.

With regard to operational risk, we intend initially to implement the Standardized approach, which has already been implemented in part within the group, and then move towards the Advanced Measurement Approach (AMA).

DESCRIPTION OF BUSINESS

Overview

We are a Northern European bank with shares listed on the ICEX and the Stockholm Stock Exchange. 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 six countries: Iceland, the United Kingdom, Denmark, Sweden, Finland and Luxembourg. In the United States, we operate through our subsidiary Kaupthing Securities Inc., a licensed broker-dealer. The United Kingdom, Iceland and Scandinavia currently are our most important markets, generating 34%, 30% and 26%, respectively, of our net operating income in 2005.

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 eight 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 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 2005 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. We expect this percentage to increase in 2006, as we seek to expand our activities in Finland, Luxembourg and the United Kingdom. We currently have senior long-term debt ratings of 'A1' from Moody's and 'A' from Fitch. As of December 31, 2005, our total assets were ISK 2,540,811 million, our Tier 1 ratio was at 9.4% and our CAD ratio was 12.2%. Our net earnings for 2005 were ISK 49,260 million, an increase of 178% from 2004.

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.

The following table illustrates our operations by business segment and location as at December 31, 2005:

	Headcount	Investment Banking	Capital Markets	Treasury	Banking	Asset Management and Private Banking
Iceland	1,046					
UK	574					
Sweden	284					
Denmark	190					
Luxembourg	109					
Finland	95					
Norway	46					
Faeroe Islands	12					
United States[(1)]	8					
Switzerland	4					
Total	2,368					

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 KB Líftryggingar hf. (formerly Althjóda Iíftryggingarfélagid hf.) ("KB-Líf") in Iceland, Kaupthing Ltd. and 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), Kaupthing Bank Sverige (in which we hold a 93.5% interest) and Norvestia (in which we currently hold a 30.6% economic interest and have 54.6% of the voting rights).

History

We were created in our present form by the merger of two of Iceland's foremost banks, Kaupthing Bank hf. and Búnadarbanki Islands hf. ("Búnadarbanki"), both of which enjoyed a strong market position in Iceland. Búnadarbanki dates back to 1929, when the Icelandic parliament, the Althing, 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. The bank was privatized in stages and this process was completed at the beginning of 2003. Búnadarbanki was listed on the Main List of the Iceland Stock Exchange in December 1998.

Kaupthing hf. was established in Reykjavík in 1982, coinciding with the launch of the free capital market 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 ICEX and in December 2002, it was listed on the O-list of the Stockholm Stock Exchange.

In May 2003, Kaupthing Bank hf. and Búnadarbanki merged under the name Kaupthing Búnadarbanki hf., which later became Kaupthing Bank hf. 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.

In recent years, we have strengthened our position abroad by acquiring financial companies and establishing subsidiaries. We believe that the most important developments so far have been the acquisition in 2002 of the Swedish bank, JP Nordiska AB (now Kaupthing Bank Sverige AB), the acquisition in September 2004 of the

Danish bank FIH and the acquisition in July 2005 of the UK-based bank Singer & Friedlander. The acquisition of JP Nordiska AB significantly strengthened our position in the Nordic countries, an area which we consider to be our home market. Our acquisition of FIH, a Danish corporate lending bank with a market share in corporate lending in Denmark of just under 15%, approximately doubled the size of our balance sheet and further diversified our loan portfolio. We continue to evaluate potential acquisition opportunities that could further expand our international banking operations. Currently, we are in various stages of discussions with a number of potential targets in the European Economic Area.

Strategy

Our goal is to become a leading provider of integrated financial services for medium-sized companies and high net worth individuals in Northern Europe and to expand our investment business. We believe we have established a strong platform through a combination of organic growth and strategic acquisitions in all of the Nordic countries, the United Kingdom and Luxembourg. As a provider of comprehensive services to growing companies, we have been able to grow with our clients and develop our business relationships with them. At the same time, we believe we have established strong relationships with our private clients which form the basis of our successful asset management and private banking services.

We intend to achieve this goal through the following measures:

- ***Cross-selling our products.*** We continually seek to build on synergies in our client base by cross-selling products of our different divisions and business units.
- ***Aggressively managing risk.*** We seek to minimize our potential for loss by continually improving the quality of our loan portfolio and carefully monitoring the exposures in our trading portfolio.
- ***Rapid and efficient integration of acquisitions.*** We look to maximize the benefits available to us from businesses we have acquired by quickly and efficiently integrating their operations within our group.
- ***Increasing the maturity profile of our loan portfolio.*** We seek to achieve a stable asset base by increasing the maturity profile of our loan portfolio.
- ***Expanding our investment activities.*** We intend to continue to acquire minority interests in certain businesses on a strategic basis with the intention of realizing a gain on these investments.

Competitive Strengths

We believe that we have a number of competitive strengths that will allow us to build on our position as a leading Nordic bank. These strengths include:

- ***Focused strategy.*** We maintain both a geographic and product focus, concentrating on Northern Europe and in particular on investment and corporate banking. We seek to exploit our market niche as an integrated financial service provider for medium-sized companies.
- ***Strong risk management culture.*** 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.
- ***Multi-product approach to clients.*** We have a strong culture of cross-selling products to our clients to reap maximum benefit from our client relationships. In particular, we have the ability to support investment banking advisory products with capital markets solutions.
- ***Track record in integrating acquisitions.*** We have a history of expanding through acquisitions in our target markets. This has resulted in increased profitability, better asset quality and further diversification of our business.

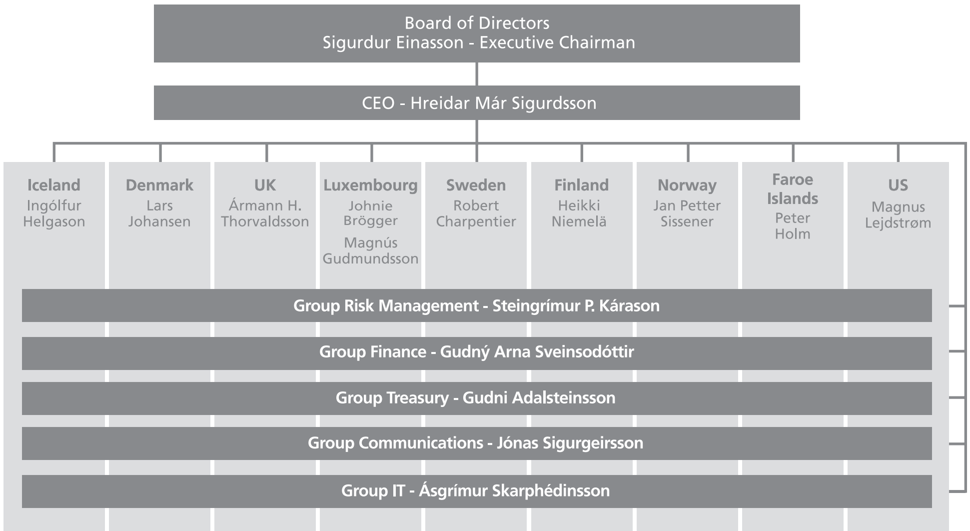
• ***High efficiency.*** We have a low cost/income ratio and high income per employee compared to our peer group.

• ***Clear and direct lines of communication.*** We have a relatively flat organizational and management structure that provides us with clear and direct lines of communication. We believe this structure enables us to make rapid, thorough and high-quality decisions, which is valued by our customers.

• ***Experienced management team.*** We have a highly experienced management team with an average of 15 years working in the industry and who have worked with us for an average of seven years.

Organizational Structure

The following chart illustrates our corporate structure as of December 31, 2005.



Investment Banking

Our Investment Banking division operates in most of our international offices and is centrally managed from our London office. Investment Banking generated 23.5% of our net operating income and 35.4% of our gross profit in 2005.

Investment Banking provides various services to corporate clients through its four main product areas:

• M&A advisory;

• capital market transactions;

• acquisition and leverage finance; and

• principal investments.

A key strategy of the Investment Banking division has been to combine its advisory expertise with our financing capabilities, creating an integrated solution for clients. This has been done in close co-operation with our other divisions, in particular the Capital Markets division and the Corporate Banking unit. We have been one of the leading providers of investment banking services in Iceland in recent years, both in terms of the number and size of managed offerings, arrangements of financing and advisory roles. As we have been placing an increasing focus on international projects, an increasing proportion of Investment Banking's transactions originate outside Iceland, particularly from the Nordic countries and the United Kingdom.

We have adopted a relationship-based approach, focusing on our core client base of mid-sized companies. We provide acquisition financing on a selective basis and can couple advisory services with the provision of our own funds for transactions of strategic importance. We selectively and carefully scrutinize all investments, and target companies with strong cash flow and where we have a clear exit strategy.

M&A advisory

Cross-border acquisitions by Icelandic companies have been increasing in recent years. We have advised on many of these transactions. We believe we were among the most active M&A advisory firms in Iceland in 2005 and were awarded the 2005 Euromoney award for best M&A house in Iceland for the fourth year in a row.

Significant M&A transactions for which we served as adviser in 2005 included the acquisition of Icelandic Telecom by a private investor group (which includes us), the acquisition of the British food producer Geest by Bakkavör Group, the acquisition by Össur of Royce Medical in the United States (a company which operates in the orthopedics & prosthetic industry), the acquisition of the Danish low-cost airline Sterling by FL Group (the parent company of Icelandair), the acquisition jointly by Baugur Group hf. and Kaupthing Bank hf. of Jane Norman in the United Kingdom, the acquisition of Yates in the United Kingdom by R2O and Kaupthing Bank hf., the acquisition of Rubicon, Principles and Warehouse in the United Kingdom by Studio Group (in which we are an investor), and finally our own acquisition of Singer & Friedlander in the United Kingdom.

Capital markets transactions

In the case of private equity offerings, the Investment Banking division generally co-operates with the Capital Markets division. We acted as lead manager on a number of offerings during 2005, primarily in Iceland. We managed offerings amounting to ISK 54.4 billion, including the ISK 44.0 billion offering of FL Group hf., Össur hf.'s ISK 5.1 billion rights issue, an ISK 5.0 billion IPO and private offering of Mosaic Fashions hf. (in which we are an investor).

Acquisition and leverage finance

Our Investment Banking division, in co-operation with Banking, has grown our acquisition and leverage finance business, particularly in the United Kingdom and in Sweden. Acquisition and leverage finance is positioned within the Bank as an Investment Banking product, supported by our Corporate Banking unit infrastructure. Fees and interest income are booked in our Corporate Banking unit.

Transactions in 2005 originated by Investment Banking included an ISK 32 billion senior debt facility for the acquisition of Iceland Telecom (in which we are an investor), an ISK 13 billion senior debt facility for Össur, and ISK 18 billion senior and subordinated debt facilities for The Studio Group (in which we are an investor).

Principal investments

A feature of Investment Banking's activities has been to invest in unlisted companies with the aim of selling the holding within a certain time period from the acquisition. The investments are, in most cases, related to advisory work in connection with management buy-outs, mergers, restructurings or acquisitions where clients have shown interest in having us co-invest with them. Our objective is to take minority stakes in the companies in which we invest. The capital invested can range from ordinary equity to hybrid investments, such as convertible bonds or capital loans.

In 2005 we invested in companies such as Iceland Telecom, FL Group, Jane Norman and Yates and sold a majority of our holding in Mosaic Fashions. Other examples of such investments and co-operation in recent years include Rubicon Retail Ltd. (formerly Studio Group), Laurel Pub Company, SÍF and Baugur Group hf. We sold our remaining interest in Baugur Group hf. on March 7, 2006.

In connection with these investments we have been able to advise clients and have been involved in financial restructurings and M&A transactions in order to facilitate stock market listings for companies. Examples of such co-operation include Bakkavör Group, Össur and Mosaic Fashions. Iceland Telecom is an ongoing example of co-operation of this kind, with Kaupthing and Exista B.V., both shareholders of Iceland Telecom, being obligated to list the company before the end of 2007.

On August 5, 2005, Skipti hf., a special purpose vehicle in which we invested together with Exista ehf., MP Investment Bank, Imis ehf. and certain pension funds, purchased Iceland Telecom for ISK 66.7 billion, which amount was potentially subject to adjustment. Skipti hf. was subsequently merged with and into Iceland Telecom, which then changed its name to Síminn hf. ("Síminn"). We currently own 29.4% of the share capital of Síminn. Pursuant to the share purchase agreement with the government of Iceland, the initial shareholders of Skipti ehf. (including us) are required to offer at least 30% of Síminn's existing shares in a public offering on the ICEX and have all of Síminn's share capital listed on the ICEX. Our shares in Síminn will be offered prior to the shares of the other shareholders being offered. Síminn will be subject to a monetary penalty if its owners (including us) do not consummate the public offering or if they fail to list Síminn on the ICEX prior to December 31, 2007. The penalty is payable monthly, beginning on January 1, 2008 and continues until the offering and listing obligations are satisfied. The amount of the penalty begins at 0.7% of 30% of the purchase price paid for Síminn (or approximately ISK 140 million) and increases monthly to 1.7% of 30% of the purchase price at July 1, 2008 and thereafter. We are liable for penalties in proportion to our 29.4% interest in Síminn.

At the end of 2005, our total holdings in unlisted companies amounted to approximately 1.1% of total assets. Our objective is that these investments comprise between 2-3% of total assets.

Banking

The Banking division was previously two separate profit centers: 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. The Banking division provides general banking services to individuals in Iceland as well as services such as advising and assisting in financing to medium-sized and large companies, particularly in Iceland, Sweden, the United Kingdom and Denmark.

Corporate banking

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

The majority of the unit's assets currently are held within FIH in Denmark, Kaupthing in Iceland and 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:

- Credit lines and working capital facilities;
- Bridge financing;
- Term loans;
- Syndicated loans;

- Acquisition and leverage finance;
- Mezzanine financing;
- Property and asset financing; and
- Investment financing.

In Iceland, Corporate Banking also provides comprehensive cash management and other complementary products and services, such as cash pooling and Internet banking.

Corporate Banking is involved in a number of large financing projects, often in collaboration with other financial institutions. Projects completed by Corporate Banking in 2005 included a $300 million PDP financing facility for FL Group, in connection with its acquisition of 15 Boeing 737—800 aircraft and a $365 million facility for Norðurál ehf. to finance the extension of its aluminum smelter in Iceland and its subsequent refinancing. We also participated in various syndicated loans, mainly in the UK syndication market.

Corporate Banking also played a role in the financing of merger and acquisition projects arranged by our Investment Banking division, including an ISK 40 billion bridge facility to Skipti ehf. in connection with its ISK 67.6 billion acquisition of Iceland Telecom, and a subsequent ISK 34 billion refinancing, and a $233 million term loan and credit line facility to Össur hf., in connection with its acquisition of Royce Medical Holdings Inc.

We are a large provider of corporate loans in Iceland. Our main competitors in corporate banking in Iceland are Íslandsbanki hf., which operates under the brand name Glitnir, Landsbanki Íslands hf. and the 22 Icelandic savings banks.

FIH has a market share in corporate loans in Denmark of just under 15%. It is the third largest participant in this market, behind Den Danske Bank and Nordea.

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 and clearing. On December 31, 2005, we operated 33 branches and service points in Iceland, including 14 branches in the Reykjavík area. We estimate our market share in Iceland in retail banking for private customers to be approximately 25% during 2005.

Our retail banking activities 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 more fully 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 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. Competition in the retail banking sector has increased sharply in recent years in Iceland. In 2004, we 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. The maximum amount of individual mortgage loans also increased. Following this new offering, values in the Icelandic real estate market have increased substantially, but by the end of 2005 the market stabilized to some degree.

Insurance

The Retail Banking unit co-operates closely with our subsidiary, KB-Líf, in offering a range of personal insurance products in Iceland. KB-Líf offers a broad range of life insurance and health insurance products in Iceland. KB-Líf only operates in personal insurance. To meet increasing competition, we have established co-operation 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 KB-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.

Capital Markets

The activities of the Capital Markets division are broadly divided into two parts: Institutional Sales and Proprietary Trading. Institutional Sales executes orders for institutional clients and places equity and bond offerings. Proprietary Trading trades for the Bank's own account in bonds and equities on the international securities markets and is also an active market maker. Our Research department, which is an independent operating unit, co-operates closely with Capital Markets. We also offer our clients securities trading services on international securities markets.

We are a member of the ICEX as well as the Stockholm Stock Exchange, the Oslo Stock Exchange, the Helsinki Stock Exchange and the Tallinn Stock Exchange through our subsidiary in Helsinki. These exchanges are all parties to the NOREX alliance and use the same trading system and harmonized trading rules. Through our subsidiary Kaupthing Securities Inc., we also are 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.

We have a substantial market share of debt and equity trading in the Nordic area, with 3.6% of the equities turnover on the Nordic stock exchanges in 2005. In Stockholm and Helsinki, the two largest Nordic markets, our market share in 2005 was approximately 4.2% and 4.4% respectively. On ICEX we have a market share in excess of 33% in equities trading and 28% in bonds.

Proprietary trading and market making

We engage in proprietary trading and market making in many instruments and markets. This 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. The proprietary trading units within the group have complimentary focus on different instruments and markets. The different units also vary in terms of strategy and timeframe.

Market making involves our committing to buying and selling 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.

Research

Our Research department, an independent operating unit, co-operates closely with Capital Markets. It provides equity and fixed income research as well as macroeconomic research. The equity research analysts are based locally and provide in-depth research, including sector and company reports, overall recommendations and strategic guidance.

Treasury

Our Treasury division is divided into the inter-bank trading desk, the foreign exchange (FX) and derivatives sales desk, the derivatives desk and the funding desk. Treasury functions are administered primarily from Reykjavík, but there also are operations in Luxembourg, Denmark, the United Kingdom, Sweden and Finland.

Inter-bank trading

The inter-bank trading desk manages our currency exposure and liquidity, 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.

FX and derivatives sales

Foreign exchange and derivatives sales offer companies and institutional investors foreign exchange 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. Our Treasury division also provides monitoring and advisory services on currency and interest rate risk management for its customers.

Derivatives

The derivatives desk is responsible for trading all derivatives. 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. We are a leading market maker for equity, interest rate and foreign exchange derivatives related to the Icelandic krona.

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, market funding of the group doubled 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.

Our growing financial strength and improved credit rating from Moody's Investors Service 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 finance terms, thus strengthening our competitive position.

In 2005, we completed a number of issuances of Eurobonds under our European medium-term note program. The current size of this program is €12 billion. In order to diversify our funding sources, we also entered the US bond market at the end of 2005 and set up a note program in Australia. We issued $1.25 billion of extendible notes and completed a $165 million Tier 1 private placement in the United States in the last quarter of 2005.

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 four units: Alternative Investments, Mutual Fund Management, Asset Management for Institutional Investors and Services for Institutional Investors. Private Banking consists of two units: Customer Relations and Portfolio Management.

Assets under management

In 2005, 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 the year as well as in the number of clients.

During the year, we 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. Assets in custody increased by ISK 1,426 billion, due primarily to our acquisition of Singer & Friedlander, to a total of ISK 2,500 billion under management and in custody, compared with ISK 1,418 billion in 2004. We offer Asset Management and Private Banking services in eight different countries within the Kaupthing Group: the Faeroe Islands, Finland, Iceland, Luxembourg, Norway, Sweden, Switzerland and the United Kingdom, the most important being Iceland and the United Kingdom. Our asset management operation in Denmark was sold in 2004 following the acquisition of the Danish corporate bank FIH Erhvervsbank.

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, we have focused 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.

We expanded our range of pension products during 2005. We operate private pension divisions for several pension funds and participate in the Swedish private pension fund system.

We have 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 2005, assets under management by the Asset Management division amounted to ISK 659 billion.

Private banking

Our Private Banking division 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. We offer private banking services from our offices in Iceland, Sweden, Luxembourg, Switzerland, the Faeroe Islands and Finland. 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 2005 assets under management by the Private Banking division amounted to ISK 415 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. As at December 31, 2005 a total of 784 people, or 33% of our total personnel, work in management and ancillary departments, of which the majority are based in Reykjavík.

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, Íslandsbanki hf., which operates under the brand name Glitnir, and Landsbanki, and the 22 savings banks (including Sparisjóður Reykjavíkur og Nágrennis, Sparisjóður Kópavogs, Sparisjóður Vélstjóra and Sparisjóður Mýrarsýslu) for retail banking. In the Nordic region, we mainly compete with the Nordic investment banks, such as Carnegie and Alfred Berg, and the corporate and capital market divisions of the big Nordic banks, such as Danske Bank, Nordea and SEB. In the United Kingdom, we face competition from a number of international banks and investment institutions, such as HBOS, RBS 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.

Property, Plant and Equipment

We own 49 properties, 31 of which include buildings for office use. These properties generally are 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. Most of our other properties have been acquired as a result of foreclosure on the collateral of defaulted loans. 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 significant real property holdings, as at December 31, 2005.

Address	Type of Property	Use	Area
Borgartún 19, Reykjavík	Building	Corporate HQ	42,937 ft^2
Laugavegur 120, Reykjavík	Building	Offices/Branch	11,065 ft^2
Geislagata 5, Akureyri	Building	Offices/Branch	9,558 ft^2
Laugavegur 120, Reykjavík	Building	Offices/Branch	9,774 ft^2
Fagradalsbraut 11, Egilsstaðir	Building	Offices/Branch	7,750 ft^2
Hamraborg 9, Kópavogur	Building	Offices/Branch	15,123 ft^2
Kringlan, Reykjavík	Building	Branch	4,618 ft^2
Garðatorg 5, Garðabær	Building	Branch	6,824 ft^2
Austurvegur 8-10, Selfoss	Building	Offices/Branch	9,569 ft^2
Kirkjubraut 28, Akranes	Building	Offices/Branch	9,569 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. There currently are approximately 15 court cases in progress within the group, most of which involve amounts of less than ISK 5 million each.

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, 2005, we had a total of 2,368 employees, compared to 1,606 in 2004 and 1,271 in 2003.

The table below sets forth the number of our employees, by division at December 31, 2005.

Division	Employees
Investment Banking	69
Banking	936
Capital Markets	118
Treasury	75
Asset Management and Private Banking	386
Management and ancillary units	784
Total	2,368

REGULATION

We operate in ten countries. In six of these countries, Iceland, the United Kingdom, Denmark, Sweden, Finland 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 Icelandic financial markets. 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 ICEX notification of changes (or plans to make changes) in our financing and we are required to submit to the Financial Services Authority 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. We cannot assure you that we will be in compliance with all the laws and regulations to which we are subject.

European Union Regulations

Iceland has been a member of the EEA since 1994. The framework for supervision and regulation of banking and financial services in Iceland has been, and continues to be, heavily influenced by EU regulations, some of which are required to be implemented in EEA member states through national legislation.

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 "Act").

The Financial Supervisory Authority of Iceland has the authority to grant operating licenses pursuant to this Act. A financial institution may commence operations upon receiving an operating license from the Financial Supervisory Authority 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 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. 87/1998 on Official Supervision of Financial Operations

Under this act, we are obliged to grant the Financial Supervisory Authority access to all of our accounts, minutes, documents and other material in our possession regarding our activities to whatever extent the Financial Supervisory Authority considers necessary. The Financial Supervisory Authority 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 Financial Supervisory Authority reveals that parties subject to supervision are not in compliance with the law or other regulations governing their activities, the Financial Supervisory Authority 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 Financial Supervisory Authority may impose daily fines. The Financial Supervisory Authority 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 Financial Supervisory Authority committed a criminal offence, the Financial Supervisory Authority 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 article 3 of this act, the Minister of Commerce (*viðskiptaráðherra*) will grant an operating license pursuant to the act upon receiving the opinion of the Financial Supervisory Authority.

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. Members of a stock exchange must apply for public listing of securities in the trading system of a stock exchange on behalf of the issuers unless the stock exchange board has otherwise agreed. Listing is subject to the approval of the stock exchange board, which sets detailed rules on securities accepted for public listing.

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 Financial Supervisory Authority 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.

Further rules are contained in Government Regulation No. 433/1999 on the disclosure requirements of issuers, stock exchange members and owners of shares listed on the stock exchange and Government Regulation No. 434/1999 on public listing of securities on a stock exchange.

Act No. 87/1992 on Foreign Exchange

According to article 2 of 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 (Seðlabanki Íslands) may decide in consultation with the Ministry of Commerce (*viðskiptaráðuneyti*) 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 Bankers' and Securities Dealers' Association of Iceland (*Samtök banka og verðbréfafyrirtækja*), 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 Bankers' and Securities Dealers' Association of Iceland.

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

According to Article 3 of 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 (*Tryggingarsjóður innstæðueigenda 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 Financial Supervisory Authority is unable to make payment of the amount of deposits, securities or cash, the amount of the customer's deposit from the deposit department (*Innstæðudeild*) and the value of their securities and cash in connection with securities trading from the securities department (*Verðbréfadeild*). 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 Commercial Banks and Savings Banks 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 bankruptcy estate will be assumed by the fund.

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, which must be approved by the Financial Supervisory Authority. The financial institution must inform the Financial Supervisory Authority of any violation of the provisions of its rules.

The act stipulates the rules which govern public offers of securities. Public offers 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 give notice to both the relevant registered securities market and the company immediately.

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 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 ICEX, the Financial Supervisory Authority, Bankers' and Securities Dealers' Association of Iceland, the Association of Small Investors (*Samtök fjárfesta*), the Icelandic Chamber of Commerce (*Viðskiptaráð Íslands*), the Ministry of Commerce and others.

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 Financial Supervisory Authority supervises the implementation of the act and rules adopted by virtue of it.

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 neysluverðs*), 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 fulfillment 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. 80/1993 on Measures to Counteract Money Laundering

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 a violation 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 Financial Supervisory Authority is responsible for supervising the activities of the persons subject to this act. The act is currently being revised and a new act implementing the provisions of the Third EU Money Laundering Directive is expected to enter into force in the spring.

Act No. 60/1994 on Insurance Activities

Our subsidiary KB-Líf, an insurance company, is subject to Act No. 60/1994 on Insurance Activities and Act No. 30/2004 on Insurance Contracts.

The Financial Supervisory Authority 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.

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, Act No. 38/2001 on Price and Indexation and Act No. 30/2003 Act on Undertakings for Collective Investment in Transferable Securities (UCITS).

Proposed Regulation

The Third European Anti-money Laundering Directive

A bill adopting the Third European Anti-money Laundering Directive is expected to be submitted to the Icelandic parliament during the 2006 spring term. We are in the process of adopting 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 will exceed the requirements of the directive.

Directive 2004/39 on Markets in Financial Instruments

The Icelandic legislature is expected to implement Directive 2004/39 on Markets in Financial Instruments ("MIFID") in 2007 along with other EU and EEA member states. The directive is aimed at enhancing cross-border and domestic competition among financial institutions in their dealings in securities, while enabling them to adopt a listing function by acting as a "systematic internalizer," or an investment firm which, on an organized, frequent and systematic basis, deals on its own account by executing client orders outside a regulated market or on a multilateral trading facility. It remains uncertain to what extent we will qualify as a systematic internalizer, and consequently to what extent we will become subject to the directive's obligations.

MANAGEMENT

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 Den Danske Bank. In 1988 he became Deputy Director of the International Division at Íslandsbanki 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 CEO from 1997 to 2003. Mr Einarsson was appointed Executive Chairman in May 2003.

Hjörleifur Thór Jakobsson—Deputy Chairman of the Board of Directors. Mr Jakobsson, born in 1957, graduated from the Mechanical and Industrial Engineering department of 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. Mr Jakobsson currently serves as the CEO of Olíufélagid hf. and was elected to our board in 2003.

Finnur Ingólfsson—Director. Mr Ingólfsson, born in 1954, graduated with a degree in economics from the University of Iceland in 1984. He worked as an assistant to the Minister of Fisheries of Iceland in 1983 and later as an assistant to the Minister of Health and Social Security of Iceland. Between 1991 and 2000 he served as a member of parliament for Reykjavík and from 1995 to 2000 he also served as the Minister of Industry and Commerce of Iceland. From 2000 to 2003, he was a governor for the Central Bank of Iceland. Mr Ingólfsson currently acts as the CEO of VIS eignarhaldsfélag hf., the holding company of Vátryggingafélag Íslands hf., an Icelandic insurance company, and was elected to our board in 2003.

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 and the CFO. Mr Pálsson is now the CEO of the union and was elected to our board in 2001.

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.

Tommy Persson—Director. Mr Persson, born in 1948, is the CEO of the Swedish Insurance Federation (Länsförsäkringar AB) for which he also serves as a member of the board. In addition, he is the chairman of the Swedish Insurance Employers' Association and EurAPCO AG. He is also a member of the board of Eureko BV. Mr Persson was elected to our board in 2002.

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.

Niels de Coninck-Smith—Director. Mr de Coninck-Smith, born in 1956, graduated with a MSc in 1980 from the Copenhagen School of Economics and later received a masters in business administration concentrating in finance from the Wharton School of the University of Pennsylvania 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. He also serves on the boards of the Copenhagen International School and FVS A/S. Mr de Coninck-Smith was elected to our board in 2005.

Bjarnfredur H. Ólafsson—Director. Mr Ólafsson, born in 1967, graduated with a Cand. Jur. Degree from the University of Iceland in 1993 and later received a masters of law in comparative law from the University of Miami School of Law in 1997 and a degree in international business administration from Nova Southeastern University School of Business & Entrepreneurship in 1998. 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 is currently a partner at Logos Legal Services, 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.

Set forth below are details about our senior management:

Hreidar Már Sigurdsson—Chief Executive Officer (CEO). 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 Securities Inc. from its founding in March 2000 until late 2001. At the beginning of 2003, Mr Sigurdsson was appointed as our CEO.

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 master's 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 og Lybrant (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. 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 until becoming our Chief Risk Officer.

Ásgrímur Skarphédinsson—Chief Information Officer. Mr Skarphédinsson, born in 1958, graduated with a bachelor of science in electrical engineering from Odence 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 jointed 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.

Gudni Níels Adalsteinsson—Group Treasurer. Mr Adalsteinsson, born in 1967, graduated with a bachelor of science degree in economics from the University of Iceland in 1991, and later received a masters in 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 Treasurer in October 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 received a masters in business administration from the University of Tampa in 2000. Between 1993 and 1999, he managed a private publishing company.

Mr Sigurgeirsson joined our Investment Banking division in March 2000. In 2003, Mr Sigurgeirsson became our Head of Investor Relations and in 2005 he was appointed as our Chief Communications Officer.

Committees of our Board of Directors

Our board of directors currently has three committees: the audit committee, the compensation committee and the credit 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 is composed of three directors: Hjorleifur Jackobsson (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 compensation plans, in accordance with applicable rules and regulations. The compensation committee also outlines our policies with respect to employee stock options.

The compensation committee is composed of three directors: Ásgeir Thoroddsen (chairman), Finnur Ingólfsson and Tommy Persson.

Credit Committee

The credit committee makes decisions regarding credits that are equal to or in excess of 10% of the group's capital base.

The credit committee is composed of three directors: Sigurdur Einarsson (chairman), Bjanfredur Ólafsson and Gunnar Páll Pálsson. The Managing Director of Risk Management (our Chief Risk Officer) also attends these meetings as an observer.

CEO and Director Compensation

The table below provides a breakdown of the remuneration that we paid to our CEO and the members of our board of directors.

	As at and for the year ended December 31, 2005					
	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	39.6	2.2	39.6	25.0	3.2	2.8
Directors:						
Sigurdur Einarsson, Chairman	39.6	28.9	39.6	25.0	3.2	3.7
Ásgeir Thoroddsen	3.5	—	—	—	—	—
Bjarnfredur Ólafsson	4.2	—	—	—	—	—
Brynja Halldórsdóttir	3.5	—	—	—	—	—
Finnur Ingólfsson	3.5	—	—	—	—	—
Gunnar Páll Pálsson	3.5	—	—	—	—	—
Hjörleifur Thór Jakobsson	3.5	—	—	—	—	—
Tommy Persson	3.5	—	—	—	—	—
Niels de Coninck-Smith	2.3	—	—	—	—	—

At the annual general meeting of shareholders on March 17, 2006, 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 300,000 per month and the chairman of our board of directors will receive ISK 600,000 per month. Members of our board of directors who also serve on the Credit Committee, the Audit Committee or the Compensation Committee will receive an additional ISK 100,000 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 the credit committee.

In addition, we maintain a stock option plan for our employees in which members of our senior management and our board of directors participate. See note 50 “Executive employment terms” and note 108 “Stock options” to our audited consolidated financial statements as at and for the years ended December 31, 2005 and 2004 included elsewhere in this Offering Circular for more information regarding our stock option plan.

RELATED PARTY TRANSACTIONS

We engage in and we expect to continue to engage in transactions with our affiliates, including the transactions described below.

Loans to Related Parties

Outstanding loans to our associated companies amounted to ISK 3,063 million as at December 31, 2005 and ISK 3,128 million as at December 31, 2004. In addition, we have granted loans to members of our senior management and their immediate family members amounting to ISK 7,545 million as at December 31, 2005 and ISK 1,955 million as at December 31, 2004, which amounts do not include loans granted to members of our senior management in connection with our business activities. Loans granted to members of our senior management, other than loans granted for business activities, and their immediate family members were granted on terms and conditions similar to those loans granted to our other customers.

Other Related Party Transactions

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, 2005, 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, is a partner of the law firm Taxis, which has provided us with legal services. The total fees paid by us to Taxis in 2005 was ISK 16 million.

Bakkabraedur Holdings S.A.R.L. is the majority shareholder of Exista ehf., the parent of our largest shareholder. Bakkabraedur Holdings S.A.R.L. also is the largest shareholder of Bakkavör Group hf., which is one of our banking customers.

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 Iceland Stock Exchange and the Stockholm Stock Exchange. At December 31, 2005, we had 664,553,053 shares outstanding held by 33,027 shareholders of record. One shareholder, Exista B.V., owned approximately 21.1% of our voting shares outstanding as at that date. We in turn held a 19.2% interest in Exista ehf., the parent company of Exista B.V., on December 31, 2005. Exista ehf.'s largest shareholder is Bakkabraedur Holdings S.A.R.L., which holds 59.1% of Exista ehf.'s outstanding shares. Bakkabraedur Holdings S.A.R.L. also is the largest shareholder of Bakkavör Group, which is one of our banking customers. No shareholder other than Exista B.V. and Egla hf., which held 10.82% of our outstanding voting shares as at December 31, 2005, held more than 10% of our voting shares outstanding at that date.

We are currently considering disposing our ownership interest in Exista ehf. through a payment of extraordinary dividends to our shareholders in the form of Exista ehf. shares. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Recent Developments".

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 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 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).

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 or 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, or 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 or 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.

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 such Holders would be entitled in such proceedings to recovery in U.S. dollars and may be entitled only to a recovery in Icelandic currency and, as a general matter, the right to claim for any amounts payable on Notes may be limited by applicable insolvency law.

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.

"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.

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.

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.

"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 or Arrears of Interest, if any, and, in the case of Amortizing Notes, principal (other than interest and, in the case of Amortizing Notes (as defined below), principal payable at Maturity) 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 or Arrears of Interest, if any, and, in the case of Amortizing Notes, principal 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 or Arrears of Interest, if any, 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 and Arrears of Interest, if any, 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 and Arrears of Interest, if any, 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 and Arrears of Interest, if any, 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 and Arrears of Interest, if any, 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 and Arrears of Interest, if any, 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 a Note becomes due and payable in full in accordance with its terms and the terms of the applicable Indenture, whether at Stated Maturity or earlier by declaration of acceleration, call for redemption, request for redemption repayment at the option of the Holder 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.

"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

Unless otherwise specified in the applicable Pricing Supplement, "CMT 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 CMT Rate (a "CMT Rate Interest Determination Date"), the rate displayed on the Designated CMT Telerate Page under the caption ". . . . . Treasury Constant Maturities . . . . . Federal Reserve Board Release H.15 . . . . . Mondays Approximately 3:45 P.M.," under the column for the Designated CMT Maturity Index for (i) if the Designated CMT Telerate Page is 7051, the rate on such CMT Rate Interest Determination Date and (ii) if the Designated CMT Telerate Page is 7052, the weekly or monthly average, as specified in the applicable Pricing Supplement, for the week or the month, as applicable, ended immediately preceding the week or the month, as applicable, in which the related CMT Rate Interest Determination Date falls. If such rate is no longer displayed on the relevant page or is not so displayed by 3:00 P.M., New York City time, on the related Calculation Date, then the CMT Rate for such CMT Rate Interest Determination Date will be such treasury constant maturity rate for the Designated CMT Maturity Index as published in H.15(519). If such rate is no longer published or is not so published by 3:00 P.M., New York City time, on the related Calculation Date, then the CMT Rate on such CMT Rate Interest Determination Date will be such treasury constant maturity rate for the Designated CMT Maturity Index (or other United States Treasury rate for the Designated CMT Maturity Index) for the CMT Rate Interest Determination Date with respect to such Interest Reset Date as may then be published by either the Board of Governors of the Federal Reserve System or the U.S. Department of the Treasury that the Calculation Agent determines to be comparable to the rate formerly displayed on the Designated CMT Telerate Page and published in H.15(519). If such information is not so provided by 3:00 P.M., New York City time, on the related Calculation Date, then the CMT Rate on the CMT Rate Interest Determination Date will be calculated by the Calculation Agent and will be a yield to maturity based on the arithmetic mean of the secondary market offered rates as of approximately 3:30 P.M., New York City time, on such CMT Rate Interest Determination Date reported, according to their written records, by three leading primary U.S. government securities dealers in New York City (which may include the Dealers or their affiliates) (each, a "Reference Dealer") selected by the Calculation Agent (from five such 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 most recently issued direct noncallable fixed rate obligations of the United States ("Treasury Notes") with an original maturity of approximately the Designated CMT Maturity Index and a remaining term to maturity of not less than such Designated CMT Maturity Index minus one year. If the Calculation Agent is unable to obtain three such Treasury Note quotations, the CMT Rate on such CMT Rate Interest Determination Date will be calculated by the Calculation Agent and will be a yield to maturity based on the arithmetic mean of the secondary market offered rates as of approximately 3:30 P.M., New York City time, on such CMT Rate Interest Determination Date of three Reference Dealers in New York City (from five such 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 Treasury Notes with an original maturity of the number of years that is the next highest to the Designated CMT Maturity Index and a remaining term to maturity closest to the Designated CMT Maturity Index and in an amount of at least US$100,000,000. If three or four (and not five) of such Reference Dealers are quoting as described above, then the CMT Rate will be based on the arithmetic mean of the offered rates obtained and neither the highest nor the lowest of such quotes will be eliminated; provided, however, that if fewer than three Reference Dealers so selected by the Calculation Agent are quoting as mentioned herein, the CMT Rate determined as of such CMT Rate Interest Determination Date will be the CMT Rate in effect on such CMT Rate Interest Determination Date. If two Treasury Notes with an original maturity as described in the second preceding sentence have remaining terms to maturity equally close to the Designated CMT Maturity Index, the Calculation Agent will obtain quotations for the Treasury Note with the shorter remaining term to maturity.

"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 or, if no such maturity is specified in the applicable Pricing Supplement, 2 years.

"Designated CMT Telerate Page" means the display on Moneyline Telerate (or any successor service) on the page specified in the applicable Pricing Supplement (or any other page as may replace such page on such service) for the purpose of displaying Treasury Constant Maturities as reported in H.15(519) or, if no such page is specified in the applicable Pricing Supplement, page 7052.

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” on the display on Moneyline Telerate (or any successor service) on page 7058 (or any other page as may replace such page on such service) (“Telerate Page 7058”) 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 Telerate Page 7058 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 either: (a) if “EURIBOR Telerate” is specified in the applicable Pricing Supplement or if neither “EURIBOR Reuters” nor “EURIBOR Telerate” is specified in the applicable Pricing Supplement as the method for calculating EURIBOR, 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 (b) if “EURIBOR Reuters” is specified in the applicable Pricing Supplement, the arithmetic mean of the offered rates (unless the Designated EURIBOR Page by its terms provides only for a singe rate, in which case such single rate shall be used) for deposits in euro having the Index Maturity specified in such Pricing

Supplement, commencing on the applicable Interest Reset Date that appear (or, if only a single rate is required as aforesaid, appears) on the Designated EURIBOR Page as of 11:00 A.M., Brussels time, on such EURIBOR Interest Determination Date. If fewer than two such offered rates so appear, 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 than two offered rates appear, or no rate appears, as the case may be, 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 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 (a) if "EURIBOR Reuters" is specified in the applicable Pricing Supplement, the display on the Reuter Monitor Money Rates Service (or any successor service) on the page specified in such Pricing Supplement (or any other page as may replace such page on such service) for the purpose of displaying the Euro-zone interbank rates of major banks for the euro, or (b) if "EURIBOR Telerate" is specified in the applicable Pricing Supplement or neither "EURIBOR Reuters" nor "EURIBOR Telerate" is specified in the applicable Pricing Supplement as the method for calculating EURIBOR, the display on Moneyline Telerate (or any successor service) on the page specified in such Pricing Supplement (or any other page as may replace such page on such service for the purpose of displaying the Euro-zone interbank rates of major banks for the euro.

"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)", as such rate is displayed on Moneyline Telerate (or any successor service) on page 120 (or any other page as may replace such page on such service) ("Telerate Page 120"), or, if such rate does not appear on Telerate Page 120 or is not so published by 3:00 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 Telerate Page 120 or 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 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 either: (a) if "LIBOR Telerate" is specified in the applicable Pricing Supplement or if neither "LIBOR Reuters" nor "LIBOR Telerate" is specified in the applicable Pricing Supplement as the method for calculating LIBOR, 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 (b) if "LIBOR Reuters" is specified in the applicable Pricing Supplement, the arithmetic mean of the offered rates (unless the Designated LIBOR Page by its terms provides only for a single rate, in which case such single rate shall be used) for deposits in the Designated LIBOR Currency having the Index Maturity specified in such Pricing Supplement, commencing on the applicable Interest Reset Date that appear (or, if only a single rate is required as aforesaid, appears) on the Designated LIBOR Page as of 11:00 A.M., London time, on such LIBOR Interest Determination Date. If fewer than two such offered rates so appear, 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 fewer than two offered rates appear, or no rate appears, as the case may be, 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, 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 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 (a) if “LIBOR Reuters” is specified in the applicable Pricing Supplement, the display on the Reuter Monitor Money Rates Service (or any successor service) on the page specified in such Pricing Supplement (or any other page as may replace such page on such service) for the purpose of displaying the London interbank rates of major banks for the Designated LIBOR Currency, or (b) if “LIBOR Telerate” is specified in the applicable Pricing Supplement or neither “LIBOR Reuters” nor “LIBOR Telerate” is specified in the applicable Pricing Supplement as the method for calculating LIBOR, the display on Moneyline Telerate (or any successor service) on the page specified in such Pricing Supplement (or any other page as may replace such page on such service) for the purpose of displaying the London interbank rates of major banks for the Designated LIBOR Currency.

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 3:00 P.M., New York City time, on the related Calculation 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 3:00 P.M., New York City time, on the related Calculation Date, then the Prime Rate shall be the arithmetic mean of the rates of interest publicly announced by each bank that appears on the Reuters Screen US PRIME 1 Page (as defined below) as such bank’s prime rate or base lending rate as of 11:00 A.M., New York City time, on such Prime Rate Interest Determination Date. If fewer than four such rates so appear on the Reuters Screen US PRIME 1 Page for such Prime Rate Interest Determination Date, then the Prime Rate shall be the arithmetic mean of the prime rates or base lending rates quoted on the basis of the actual number of days in the year divided by a 360-day year as of the close of business on such Prime Rate Interest Determination Date by three major banks (which may include affiliates of the Dealers) in New York City selected by the Calculation Agent; provided, however, that if the banks so selected by the Calculation Agent are not quoting as mentioned in this sentence, the Prime Rate determined as of such Prime Rate Interest Determination Date will be the Prime Rate in effect on such Prime Rate Interest Determination Date.

“Reuters Screen US PRIME 1 Page” means the display on the Reuter Monitor Money Rates Service (or any successor service) on the “US PRIME 1” page (or such other page as may replace the US PRIME 1 page on such service) for the purpose of displaying prime rates or base lending rates of major U.S. banks.

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 “INVESTMENT RATE” on the display on Moneyline Telerate (or any successor service) on page 56 (or any other page as may replace such page on such service) (“Telerate Page 56”) or page 57 (or any other page as may replace such page on such service) (“Telerate Page 57”) 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".

"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.

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 Notes with the amount of principal thereof and interest thereon payable in installments over the term of such 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 or Amortizing Note, at the Redemption Price (as defined below) specified in the applicable Pricing Supplement) (and premium, if any, thereon) together with interest and Arrears of Interest accrued, if any, 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 or Arrears of 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 (2) and (3) above, any

obligation for the payment of any principal or interest in respect of the Capital Notes) provided that the Issuer shall not by virtue of the institution of any such proceedings be obliged to pay any sum or sums sooner than the same would otherwise have been payable by it.

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.

(4) 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 and Arrears of Interest, if any, 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 66⅔% 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 66⅔% 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 66⅔% 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, 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, (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, or (v) any other person whose income or gain in respect of a Note is effectively connected with the conduct of a United States trade or business. A non-U.S. Holder is a beneficial Holder of a Note that is not a United States person for U.S. federal income tax purposes.

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.

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

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 paid to a Holder who is not a tax resident of Iceland.

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.

For a recipient who is not a tax resident of Iceland, we may be required to withhold tax in the amount of 10% on any payment of interest due under the Notes, if the recipient does not file an application (on Form RSK 5.35) with the Icelandic Revenue Service to qualify for the exemption from such withholding. If an application is not made prior to such withholding, the recipient may apply through the same channels for a refund of the withholding tax. 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".

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., Deutsche Bank Securities Inc., Credit Suisse Securities (USA) LLC, 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.

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 for the years ended December 31, 2005 and 2004, and our annual consolidated Icelandic GAAP financial statements for the years ended December 31, 2004 and 2003 appear on pages F-1 through F-97. 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 Global 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 Endurskodun 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 will be made to the CSSF to approve this document as a Offering Circular and application for approval will be made to the Luxembourg Stock Exchange 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.

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, 2005 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, 2005 and December 31, 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-74 are in ISK millions unless otherwise indicated.

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 amortization	(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) gain 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	79
Other assets	31,380	19,069	80
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 AFS 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—notes

	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
Amortization 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:

	2005	2004	2003
Cash and cash equivalents at year-end			
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 extend differ from the estimates and the assumption 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.

ACCOUNTING POLICIES (Continued)

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 the 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 Bank has set the cumulative translation differences for all foreign operations to zero at 1 January 2004.

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 the 50% of the voting power of the subsidiary. In assessing control, potential

ACCOUNTING POLICIES (Continued)

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.

ACCOUNTING POLICIES (Continued)

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 IAS 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

ACCOUNTING POLICIES (Continued)

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 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.

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.

ACCOUNTING POLICIES (Continued)

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,

ACCOUNTING POLICIES (Continued)

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 2a) and 2b)),

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

ACCOUNTING POLICIES (Continued)

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.

ACCOUNTING POLICIES (Continued)

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 amortization and impairment losses.

Expenditure on internally generated goodwill and brands is recognised in the Income Statement as an expense as incurred.

ACCOUNTING POLICIES (Continued)

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) Amortization

Amortization 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.

ACCOUNTING POLICIES (Continued)

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 is 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.

ACCOUNTING POLICIES (Continued)

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.

ACCOUNTING POLICIES (Continued)

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 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 disclosed 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. Illiquid mortgage bonds will be carried at a value calculated by discounting cash flows.

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

ACCOUNTING POLICIES (Continued)

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.

ACCOUNTING POLICIES (Continued)

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 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.

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.

ACCOUNTING POLICIES (Continued)

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.

<u>Individually assessed loans</u>

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;

ACCOUNTING POLICIES (Continued)

- 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; and
- future cash flows in a group of loans evaluated for impairment are estimated on the basis of the contractual cash
- 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.

ACCOUNTING POLICIES (Continued)

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.

ACCOUNTING POLICIES (Continued)

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 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 amortization, 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 Lysing hf. At the same time it bought back 82.3% of shares in Eik fasteignafelag hf. that was owned by Lysing hf. As a result, Lysing hf. ceased to be a subsidiary of Kaupthing Bank hf. from January 1, 2005 and therefore it is not included in the Bank´s Consolidated Financial Statements from that date, but Eik fasteignafelag hf. is still part of the Consolidated Financial Statement of the Bank. The shares were paid for in cash.

ACCOUNTING POLICIES (Continued)

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:			
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		22,127	22,127
Gain on disposal	(3,093)		(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

ACCOUNTING POLICIES (Continued)

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: 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 centres are: Overhead, Back office, Risk Management, Finance, Legal department, IT and HR.

NOTES TO THE INCOME STATEMENT (Continued)

35. Summary of the Bank's profit centres' operations:

2005	Capital Markets	Investment Banking	Treasury	Banking	Asset Managem. 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)	(34,730)
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 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
Total assets	70,277	80,433	428,027	1,849,845	1,823	110,406	2,540,811
Depreciation and amortization	19	22	4	1,475	15	1,283	2,818

2004	Capital Markets	Investment Banking	Treasury	Banking	Asset Managem. 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 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
Total assets	64,667	51,732	223,310	1,151,079	589	63,076	1,554,453
Depreciation/amortization	29	12	3	223	1	1,079	1,347

NOTES TO THE INCOME STATEMENT (Continued)

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	Scandi-navia	UK	Luxem-bourg	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	Scandi-navia	UK	Luxem-bourg	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 Kaupthing Bank hf.	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**

NOTES TO THE INCOME STATEMENT (Continued)

	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	**6,083**	**8,842**	**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 Kaupthing 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 (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 expense on deposits and balances	(18,856)	(8,374)
Interest expense on borrowings	(37,776)	(10,987)
Interest expense on subordinated loans	(3,646)	(2,242)
Net interest expense on liabilities measured at amortised cost	**(60,278)**	**(21,603)**
Interest expenses on liabilities designated at fair value through profit (loss)	(1,000)	(175)
Interest expense on derivatives used for hedging	(1,154)	0
Interest expense 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**

NOTES TO THE INCOME STATEMENT (Continued)

Net fee and commission income

39. Fee and commission income and expenses are specified as follows:

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:

	2005	2004
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

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**

NOTES TO THE INCOME STATEMENT (Continued)

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:

	2005	2004
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**

NOTES TO THE INCOME STATEMENT (Continued)

Personnel

48. The Bank's total number of employees is as follows:

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**

Singer & Friedlander has a defined benefit pension scheme. All accrued cost in respect of the plan has been entered into the Financial Statements. At year-end 2005 the total liability is ISK 2,557 million, based on actuarial calculation.

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 Már Sigurdsson	39.6	2.2	39.6	25.0	3.2	2.8
Directors:						
Sigurdur Einarsson, Chairman	39.6	28.9	39.6	25.0	3.2	3.7
Ásgeir Thoroddsen	3.5					—
Bjarnfredur Ólafsson	4.2					—
Brynja Halldórsdóttir	3.5					—
Finnur Ingólfsson	3.5					—
Gunnar Páll Pálsson	3.5					—
Hjörleifur Thor Jakobsson	3.5					—
Tommy Persson	3.5					—
Peter Gatti	1.3					—
Niels de Coninck-Smith	2.3					—
Five Group Managing Directors	84.1	87.0	84.1		0.3	4.1

Bjarnfredur Ólafsson, 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.

NOTES TO THE INCOME STATEMENT (Continued)

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 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**

		2005		2004
Reconciliation of effective tax rate:				
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**

NOTES TO THE INCOME STATEMENT (Continued)

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**

NOTES TO THE BALANCE SHEET (Continued)

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:

	31.12.2005	1.1.2005
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:

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**

NOTES TO THE BALANCE SHEET (Continued)

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

64. Financial assets measured at fair value are specified as follows:

	31.12.2005	**1.1.2005**
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:

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 amounting 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.

NOTES TO THE BALANCE SHEET (Continued)

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%
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:

	31.12.2005	1.1.2005
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:

Equity instruments	**167**	**1,507**

NOTES TO THE BALANCE SHEET (Continued)

Investment in associated companies

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:

	Owner-ship	Profit share	Nominal value	Book value
Vatryggingafelag Islands hf., Iceland	24.7%	1,446	161	8,252
Icopal Holding A/S, Denmark	25.0%	0	190	1,903
Drake Management LLC, USA	20.0%	149	10	1,168
Mezzanin Kapital A/S, Denmark	22.7%	(24)	13	429
Greidslumiðlun 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/S, 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 Holsted 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

NOTES TO THE BALANCE SHEET (Continued)

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.

74. Intangible assets are specified as follows:

	Goodwill	Other intangible assets	2005	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
Amortization	0	(381)	(381)	(205)
Book value 31 December	**50,481**	**4,462**	**54,943**	**35,098**

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.

NOTES TO THE BALANCE SHEET (Continued)

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.

77. Property and equipment are specified as follows:

	Real estate for own use	Machinery and equipm. 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)	(1,551)
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 amortization in the Income Statement is specified as follows:

	2005	2004
Depreciation of property and equipment	2,437	1,142
Amortization of intangible assets	381	205
Depreciation and amortization in the Income Statement	**2,818**	**1,347**

NOTES TO THE BALANCE SHEET (Continued)

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.

80. Non-current assets and disposal groups classified as held for sale are specified as follows:

	31.12.2005	1.1.2005
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**

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:

	31.12.2005	1.1.2005
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:

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**

NOTES TO THE BALANCE SHEET (Continued)

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	8,773
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**

NOTES TO THE BALANCE SHEET (Continued)

Subordinated loans

87. Subordinated loans are specified as follows:

		Original interest	Interest change	Interest after change	Maturity date	31.12.2005 Book value	1.1.2005 Book value
Loans that qualify as Tier I capital:							
Issued in 2001	ISK	8.7%	2011		No maturity date	1,232	1,190
Issued in 2004	EUR	5.9%	2014	3m Eurobor + 245bps	No maturity date	12,545	12,757
Issued in 2005	EUR	6.3%	2010	6.3%	No maturity date	13,517	
Issued in 2005	ISK				No maturity date	3,352	
Issued in 2005	USD	5.1%			No maturity date	10,555	
						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	
Issued in 2002	EUR	3 m Euribor + 115bps.	2007	3 m Euribor + 365bps.	2012	374	418
Issued in 2003	GBP	7.5%			2019	5,646	
Issued in 2004	ISK	5.4%	2009	7.4%	2014	1,557	1,917
Issued in 2004	EUR	3 m Euribor + 65bps.	2009	3 m Euribor + 165bps.	2014	22,284	24,909
Issued in 2004	DKK	3.0%			2008	112	
Issued in 2005	USD	0.0%			2032	3,660	
Issued in 2005	USD	7.5%	2010	4x(CMS 10y/2y) 10%/3,75%	2045	4,835	
Issued in 2005	EUR	6.5%	2010	4x(CMS 10y/2y) 9%/3%	2045	6,227	
Issued in 2005	EUR	3 m Euribor + 40bps.	2012	3 m Euribor + 140bps.	2017	3,749	
						61,487	**43,676**
Total						**102,688**	**57,623**

NOTES TO THE BALANCE SHEET (Continued)

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. Deferred 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:

	Assets	Liabilities
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)	(1,022)
Calculated income tax for the year	75	11,303
Income tax because of 2005 to be paid in year 2006	0	(8,205)
Deferred tax assets and liabilities at the end of the year	**5,004**	**10,343**

NOTES TO THE BALANCE SHEET (Continued)

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.

NOTES TO THE BALANCE SHEET (Continued)

Increase of share capital during the year is broken down as follows:

2005	Share capital	Market value
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)	(3,208)
Shares outstanding at 31 December	**6,521**	**288,228**
Own shares	**86**	**6,521**

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**

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 at 1 January 2005, adjusted	**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**

NOTES TO THE BALANCE SHEET (Continued)

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 (AFS) 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 ISK 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%.

NOTES TO THE BALANCE SHEET (Continued)

The ratio is calculated as follows:

	31.12.2005		31.12.2004	
	Book value	Weighted value	Book value	Weighted value
Risk I:				
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 I 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 II 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 I 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	861	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
	682,484	**244,772**	**854,790**	**1,782,046**	**24,027**	**50,769**

NOTES TO THE BALANCE SHEET (Continued)

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	0	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
	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	1.1.2005
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

OFF BALANCE SHEET INFORMATION (Continued)

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	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:

	31.12.2005	1.1.2005
Liabilities		
Repo agreements with central banks	14,364	18,017

Details of the carrying amounts the assets pledged as collateral are as follows:

	31.12.2005	1.1.2005
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.

ADDITIONAL INFORMATION (Continued)

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 at 16 November 2005	3,922	Three years of service. One third of total stock option is exercisable every year for three years.	3 years	600
Options granted to employees at 16 November 2005	8,720	Three years of service. One third of total stock option is exercisable every year for three years.	3 years	600/630/660
Total share options	**20,811**			

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

	2005		2004	
	Weighted average exercise price	Number of option contracts	Weighted 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 millions 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.

ADDITIONAL INFORMATION (Continued)

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 Vátryggingafélag Íslands hf. (4.0%). This definition is based on IAS 24. Information regarding related parties are as follows:

	2005	2004
Significant related companies:		
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

ADDITIONAL INFORMATION (Continued)

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 centralized 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

ADDITIONAL INFORMATION (Continued)

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 emphased 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

ADDITIONAL INFORMATION (Continued)

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 center tries to minimise or prevent loss on behalf of the bank by special monitoring of clients with deteriorating credit worthiness. 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:

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 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.

ADDITIONAL INFORMATION (Continued)

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.

c) 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 dependant 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.

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 for 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 coordinated 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	1-2 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)

ADDITIONAL INFORMATION (Continued)

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	0	0	0	0
Loans and advances	111,572	403,904	172,269	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	0	0	0	0
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**

Monitoring and controlling market risk

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.

ADDITIONAL INFORMATION (Continued)

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.

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

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. The Bank is exposed to some FX 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.

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 million, and the total amount of liabilities amounted to ISK 2,198 million, respectively, at year-end. Included in these assets and liabilities are forward contracts and interest rate swaps, see note 102.

ADDITIONAL INFORMATION (Continued)

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.

	Carrying value 31/12/05	Fair value 31/12/05	Unrealised gain (loss) 31/12/05
Assets			
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 transactions 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 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.

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

ADDITIONAL INFORMATION (Continued)

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 valuation 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.

ADDITIONAL INFORMATION (Continued)

Subsidiaries

122. Shares in main subsidiaries are specified as follows:

Company:	Country	Currency	Business Group[1]	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, Tr, Ba	842	100.0
Kaupthing Bank Luxembourg S.A.	Luxembourg	EUR	CM, Tr, Ba, AM & PB	7,936	100.0
Kaupthing Bank Oyj	Finland	EUR	IB, CM, Tr, Ba, AM & PB	1,670	100.0
Kaupthing Føroyar Virdisbrævameklarafelag P/F	Faroe Islands	DKK	IB, CM, AM & PB	112	100.0
Kaupthing Holding UK Ltd. (S&F)	UK	GBP	IB, CM, Tr, Ba, AM & PB	28,847	100.0
Kaupthing New York Inc.	USA	USD	CM	260	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	93.5
Kaupthing UK Ltd.	UK	GBP	IB, CM, Tr, Ba, AM & 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
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, O: Other Divisions

Changes to accounting policies in accordance with International Financial Reporting Standards (IFRS)

123. 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.

ADDITIONAL INFORMATION (Continued)

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.

		Shareholders' equity
Changes in equity from previous GAAP to IFRS:		
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 amortization	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.

ADDITIONAL INFORMATION (Continued)

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 amortization 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 profit and loss account 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.

ADDITIONAL INFORMATION (Continued)

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 profit and loss. 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 to IFRS

The following tables provide an overview of the effect of the transition to IFRS broken down by valuation and presentation.

ADDITIONAL INFORMATION (Continued)

Income Statement for 2004, change from previous GAAP to IFRS

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, paid	(2,348)	0	2,348	0	
Dividends from shares and other holdings	4,216	0	(244)	3,972	Dividend income
Trading gains	11,290	0	(10,798)	492	Net gain on financial assets / liabilities not at fair value
		0	12,755	12,755	Net gain on financial assets / liabilities at fair value
		670	(1,562)	(892)	Foreign exchange difference
		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 amortization	(2,642)	1,289	6	(1,347)	Depreciation and amortization
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**

ADDITIONAL INFORMATION (Continued)

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 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	(461)	(4,156)	3,649	Investment in associates
Goodwill	34,208	(11)	901	35,098	Intangible assets
—		377	18,778	19,155	Investment property
Fixed assets	6,467	12	(387)	6,092	Property and equipment
Deferred tax assets	1,039	0	53	1,092	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**
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**

Auditors' Report

To the Board of Directors of Kaupthing Bank hf.

We have audited the accompanying Balance Sheet and Consolidated Balance Sheet of Kaupthing Bank hf. as of 31 December 2004 and the related Profit and Loss Account, Statement of Cash Flows for the year then ended and a five-year summary. These Annual Accounts are the responsibility of the Bank's management. Our responsibility is to express an opinion on these Annual Accounts based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the Annual Accounts are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the Annual Accounts. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the Annual Accounts. We believe that our audit provides a reasonable basis for our opinion.

In our opinion the Annual Accounts give a true and fair view of the financial position of Kaupthing Bank hf. as of 31 December 2004, and the results of its operations and its cash flows for the year then ended, in accordance with the law and generally accepted accounting principles in Iceland.

Reykjavik, 25 January 2005

Sigurdur Jonsson

KPMG Endurskodun hf.

PROFIT AND LOSS ACCOUNT
for the year 2004

	Group		Parent		
	2004	**2003**	**2004**	**2003**	**Notes**
Financial Income:					
Interest from credit institutions	1,804	2,173	2,473	1,650	
Interest on loans	44,076	22,245	21,997	17,466	
Interest on bonds	3,832	1,861	1,789	1,716	
Other interest income	3,605	3,369	3,450	3,172	
	53,317	**29,648**	**29,709**	**24,004**	7
Financial Expenses:					
Interest to credit institutions	3,119	5,724	1,991	5,838	
Interest on deposits	8,374	7,221	6,596	5,438	
Interest on borrowings	20,158	5,435	8,713	4,567	28
Interest on subordinated loans	2,419	938	2,139	917	
Other interest expenses	347	206	285	137	
	34,417	**19,524**	**19,724**	**16,897**	7
Net interest income	18,900	10,124	9,985	7,107	
Other Operating Income:					
Dividends from shares and other holdings	4,216	1,101	5,333	2,358	8
Fees, commissions and other service charges	15,645	11,125	7,121	6,223	9
Fees, commissions and other service charges, paid	(2,348)	(1,442)	(1,444)	(1,207)	
Trading gains	11,290	10,044	11,911	7,367	5,6,29
Other operating income	866	828	555	651	30
	29,669	**21,656**	**23,476**	**15,392**	
Net operating income	48,569	31,780	33,461	22,499	
Other Operating Expenses:					
Salaries and salary-related expenses	12,652	10,110	5,798	5,099	31-35
Other administrative expenses	9,108	7,028	5,972	4,596	
Depreciation and amortization	2,642	1,355	709	528	17,54
	24,402	**18,493**	**12,479**	**10,223**	
Provision for losses	**(3,819)**	**(3,894)**	**(3,586)**	**(3,631)**	13,47
Pre-tax profit	20,348	9,393	17,396	8,645	
Income tax	**(4,040)**	**(1,486)**	**(1,636)**	**(1,125)**	18,65
Profit before minority interest	16,308	7,907	15,760	7,520	
Minority interest	(548)	(387)			2
Net Earnings	**15,760**	**7,520**	**15,760**	**7,520**	68
Earnings Per Share:					10,37
Earnings per share	31.7	18.5			
Diluted earnings per share	31.2	18.4			

BALANCE SHEET
31 December 2004

	Group		Parent		
	2004	2003	2004	2003	Notes
ASSETS					
Cash and Amounts due from Credit Institutions:					
Cash and demand deposits with the Central Bank	4,101	771	1,522	608	
Amounts due from credit institutions:					
Required deposits with the Central Bank	12,604	2,717	0	2,100	
Amounts due from other credit institutions	96,838	47,057	152,396	59,770	
	113,543	**50,545**	**153,918**	**62,478**	21,38-40,58
Loans:					
Loans to customers	991,093	327,019	328,064	247,923	
Lease contracts	94,851	22,014	0	0	
Mortgages foreclosed	2,402	1,962	888	1,623	
	1,088,346	**350,995**	**328,952**	**249,546**	12-14,41-47
Bonds and Shares in Other Companies:					
Bonds and other fixed-income securities	169,666	80,832	88,978	74,904	15,48-49
Shares and other variable-yield securities	78,686	50,327	50,181	36,485	15,50-51
Shares in associated companies	7,066	2,070	1,215	922	4,52
Shares in subsidiaries	1,200	856	113,280	23,263	2,3
	256,618	**134,085**	**253,654**	**135,574**	
Other Assets:					
Goodwill	34,208	5,948	168	226	16,53
Fixed assets	6,467	5,441	5,123	4,162	17,54
Other assets	14,614	8,638	4,366	5,069	55
Prepaid expenses and accrued income	19,185	2,086	10,271	769	56
Deferred tax assets	1,039	831	0	0	18,65
	75,513	**22,944**	**19,928**	**10,226**	
TOTAL ASSETS	**1,534,020**	**558,569**	**756,452**	**457,824**	

BALANCE SHEET—(Continued)
31 December 2004

	Group		Parent		
	2004	2003	2004	2003	Notes
LIABILITIES AND EQUITY					
Amounts owed to Credit Institutions	147,455	79,267	79,753	69,553	60-61
Savings Deposits:					
Demand deposits	79,929	103,432	65,354	77,620	
Time deposits	122,109	79,065	47,586	41,567	62
	202,038	**182,497**	**112,940**	**119,187**	
Borrowings	**884,219**	**210,645**	**349,956**	**206,580**	63
Other Liabilities:					
Sundry liabilities	20,546	13,701	3,326	3,016	64
Accrued expenses	54,221	3,577	11,251	2,062	
	74,767	**17,278**	**14,577**	**5,078**	
Provision for Deferred Income-Tax Liability	**9,165**	**1,646**	**1,265**	**979**	65
Total liabilities	**1,317,644**	**491,333**	**558,491**	**401,377**	
Subordinated Loans	**57,627**	**10,704**	**48,518**	**10,518**	19,66
Minority Interest in Subsidiaries' Equity	**9,306**	**10,603**	**0**	**0**	2
Equity:					67-69
Share capital	6,521	4,384	6,521	4,384	
Share premium	110,402	23,304	110,402	23,304	
Accrued stock options	157	316	157	316	
Retained earnings	32,363	17,925	32,363	17,925	
Equity	**149,443**	**45,929**	**149,443**	**45,929**	
TOTAL LIABILITIES AND EQUITY	**1,534,020**	**558,569**	**756,452**	**457,824**	
Off Balance Sheet Items:					
Obligations					72-75

STATEMENT OF CASH FLOWS
for the Year 2004

	Group		Parent		
	2004	2003	2004	2003	Notes
Cash Flows from Operations:					
Net earnings	15,760	7,520	15,760	7,520	68
Difference between net earnings and cash from operations:					
Indexation and exchange rate difference	2,442	(338)	868	(365)	
Net earnings of subsidiaries and associated companies	(786)	(616)	(2,578)	(1,629)	
Provision for losses	3,819	3,894	3,586	3,631	47
Income tax	1,945	915	286	530	18,65
Other items	2,096	1,541	240	408	
Minority interest	(1,297)	387			
Changes in assets and liabilities	425	1,634	(313)	1,738	
Net cash provided by operating activities	**24,404**	**14,937**	**17,849**	**11,833**	
Cash Flows from Investing Activities:					
Time deposits with the Central Bank, changes	(9,887)	6,502	2,100	2,891	
Other time deposits with credit institutions, changes	23,769	(32,177)	(125,129)	8,820	
Loans to customers, changes	(98,832)	(101,983)	(83,416)	(70,631)	
Trading securities, changes	(35,021)	(21,909)	(19,235)	(19,809)	
Investment bonds, changes	(8,536)	2,274	(8,536)	1,460	
Investment securities, changes	(1,520)	41		52	
Subsidiaries and associated companies, changes	223	605	(88,628)	(27)	
Cash flows from new companies within the group	(87,899)				
Investment in fixed assets	(2,852)	(1,042)	(2,469)	(822)	
Proceeds from the sale of fixed assets	1,466		838	12	
Other assets, changes	(3,513)	(3,470)	702	(1,458)	
Net cash used in investing activities	**(222,602)**	**(151,159)**	**(323,773)**	**(79,512)**	
Cash Flows from Financing Activities:					
Amounts owed to credit institutions, changes	(10,433)	(6,430)	10,200	(53,695)	
Deposits, changes	12,255	22,842	(5,609)	22,068	
Borrowings, changes	90,972	108,848	143,408	112,458	
Other liabilities, changes	9,697	7,735	309	1,345	
Subordinate loans, changes	19,242	(116)	37,999	(359)	
Treasury stock, bought	(3,208)	(65)	(3,208)	(65)	67,68
Paid-in capital	92,443		92,443		67,68
Dividend paid	(1,322)	(1,244)	(1,322)	(1,244)	68
Net cash provided by financing activities	**209,646**	**131,570**	**274,220**	**80,508**	
Increase (Decrease) in Cash	**11,448**	**(4,652)**	**(31,704)**	**12,829**	
Cash and Cash Equiv. at Beginning of Year	**15,537**	**20,189**	**39,065**	**26,236**	
Cash and Cash Equivalents at Year-End	**26,985**	**15,537**	**7,361**	**39,065**	21
Other Information:					
Income tax paid	481	127	368	127	
Dividend from subsidiaries and associated companies	268	178	225	175	
Investment in other companies, non-cash transactions, paid with treasury stock	0	6,152	0	6,152	

NOTES TO THE ANNUAL ACCOUNTS

SUMMARY OF ACCOUNTING PRINCIPLES

Basis of preparation

1. The Annual Accounts of Kaupthing Bank hf. contain the Consolidated Annual Accounts of the Bank and its subsidiaries. The Annual Accounts have been prepared in accordance with the Annual Accounts Act and the Rules on the Financial Statements of Credit Institutions. They are based on cost accounting with the exception of trading securities that are entered at market price. The Annual Accounts are prepared according to the same accounting principles as for the previous year, they are prepared in Icelandic currency and amounts are presented in millions of Icelandic kronas.

2. Subsidiaries are companies in which the Bank holds controlling interest. Controlling interest exists when the Bank has significant influence, direct or indirect, to control a subsidiary's financial and operational policies. The Annual Accounts of the subsidiaries are included in the Consolidated Annual Accounts of the Bank from the acquisition of majority interest and until the interest is no longer held. Balances between group companies, transactions and profits created in intra-group transactions, are eliminated in the Annual Accounts. Minority interest in the performance of subsidiaries and in their shareholders' equity is specifically entered in the Profit and Loss Account and in the Balance Sheet. One subsidiary, Althjoda liftryggingarfelagid hf., is not included in the Bank's Consolidated Annual Accounts as the operations of this subsidiary are different from the operations of the others. This subsidiary is accounted for in accordance with the equity method in the Annual Accounts.

3. Shares in subsidiaries are specified as follows:

	Ownership
FI Holding A/S, Denmark	100.0%
BI Management Company S.A., Luxembourg	100.0%
Gen hf., Iceland	100.0%
Global Arbitrage & Trading S.A., Switzerland	100.0%
Kaupthing Asset Management Sàrl, Switzerland	100.0%
K Invest Holding S.A., Luxembourg	100.0%
Kaupthing Bank Luxembourg S.A., Luxembourg	100.0%
Kaupthing Foroyar Virdisbraevameklarafelag P/F, Faeroe Islands	100.0%
Kaupthing Ltd., England	100.0%
Kaupthing New York Inc., USA	100.0%
Kaupthing Norge AS, Norway	100.0%
Kaupthing Services S.A., Switzerland	100.0%
Kaupthing Bank Oyj, Finland	100.0%
Kirna ehf., Iceland	100.0%
Lysing hf., Iceland	100.0%
Radgjof Kaupthings ehf., Iceland	100.0%
Rekstrarfelag Kaupthings Bunadarbanka hf., Iceland	100.0%
Sjavarutvegssjodurinn ehf., Iceland	100.0%
Urdur ehf., Iceland	100.0%
Arion verdbrefavarsla hf., Iceland	99.9%
Sparisjodur Kaupthings hf., Iceland	99.9%
Kaupthing Advisory Company S.A., Luxembourg	99.3%
Alpha Venture Capital Fund Management S.A., Luxembourg	99.0%
Kaupthing Bank Sverige AB, Sweden	93.5%
Althjoda liftryggingarfelagid hf., Iceland	58.0%
Norvestia Oyj, Finland	30.4%

SUMMARY OF ACCOUNTING PRINCIPLES (Continued)

The Bank wields 54.4% of the votes in Norvestia Oyj and the company is thus considered to be a subsidiary of the Group.

4. Associated companies are companies where Kaupthing Bank hf. has significant influence over the financial and operational policies but not controlling interest. The Annual Accounts contain Kaupthing Bank hf.'s share in the performance of associated companies from the beginning of influence until the influence no longer exists. Should Kaupthing Bank hf.'s part of an assocated company's loss exceed the book value of an associated company the book value is recorded as zero and further entries of loss are ceased unless the Bank has granted guarantees to the associated company or financed it. If the Group has purchased shares for a price that does not correspond to its share in the shareholders' equity of the company in question the difference is expensed over a period of five to twenty years.

Foreign currency

5. Assets and liabilities in foreign currencies are converted to Icelandic currency at the year-end 2004 exchange rate. Operational revenue and expenses in foreign currencies are converted at the exchange rate of the date of transaction.

Annual accounts of foreign subsidiaries

6. The Group's foreign activities are closely related to the activities of the Parent Company. Accordingly assets and liabilities related to the foreign operations are converted into Icelandic kronas at the year-end 2004 exchange rate. Revenue and expenses of the foreign activities are converted into Icelandic kronas at the average exchange rate for the year. Exchange rate difference thus created due to the conversion into Icelandic kronas is entered as exchange rate difference in the Profit and Loss Account.

Financial income and expenses

7. Interest income and interest expenses are entered into the Profit and Loss Account as they accrue based on the actual interest rate. Interest income is calculated on amounts due from other financial institutions, loans, market securities and derivatives. Interest expenses are calculated on amounts owed to financial institutions, deposits, borrowings and subordinated loans. If loans have been in default for more than three months interest income is no longer recognized. Revenue and expenses equivalent to interest, such as borrowing charges, are included with interest income and interest expenses as they accrue.

Income from shares and other holdings

8. The Bank's share in the profit or loss of associated companies and subsidiaries is included in income from shares and other holdings, along with dividends on shares.

Fees and commission income

9. The Bank provides various services to its clients and derives income therefrom. Commission income includes income from investment banking, corporate banking, securities brokerage, asset management and lending activities. Commission income is entered into the Bank's Profit and Loss Account when it is derived.

SUMMARY OF ACCOUNTING PRINCIPLES (Continued)

Earnings per share

10. Earnings per share is the ratio between profit and weighted average number of outstanding shares during the period and shows the profit per share. The profit for the year amounted to ISK 15,760 million and the weighted average number of shares was 497.4 million. The nominal value of each share is 10 Icelandic kronas. In calculating diluted earnings per share it is taken into account that the market value of shares in the Bank exceeds the expected sales price according to stock option agreements.

Functional summary

11. The functional summary shows the division of operating income and operating expenses by functions on the one hand and by location on the other.

Loans

12. Loans are capitalized with accrued interest, indexation and exchange rate difference at year-end. Indexed loans are entered based on indices effective at the beginning of January 2005 and loans in foreign currency based on the exchange rate of the relevant currencies at year-end 2004.

13. Provision for losses on the loan portfolio is made to meet the risk attached to lending operations. The loss provision is based on estimation and does not represent a final write-off. In addition to the required contribution, certain risk factors are evaluated to determine the total contribution for this purpose. Firstly, there are specific provisions to adjust for obligations of creditors that have received a poor risk evaluation, and secondly there is a general provision to meet the general risk of lending operations. Interest on loans, the collection of which is uncertain, is not entered as income. The provision has been deducted from the appropriate Balance Sheet items, less the provision for issued guarantees that is posted among sundry liabilities in the Balance Sheet.

14. The Bank has redeemed assets on foreclosed mortgages. In some cases the foreclosing has been made through special managing companies owned by the Bank and loans to them are included in foreclosed mortgages. These companies are all included in the Consolidated Annual Accounts. Foreclosed mortgages are entered at estimated market price or cost price whichever is lower.

Securities

15. The Bank's securities are partly presented as trading securities and partly as investment securities. Investment securities are those that by a formal decision are expected to be held for more than one year whereas other securities are categorised as trading securities.

Investment bonds are valued at the yield of purchase. Investment shares are valued at the cost price or market price, whichever is lower. Listed trading securities are valued at the year-end market value. Unlisted trading bonds are valued according to the required rate of return at the time of purchase and unlisted trading shares are valued at the lower of cost or market.

Goodwill

16. In cases where the Bank has purchased or acquired shares in subsidiaries at a price that does not correspond to the Bank's share in the company's equity the difference is capitalized as goodwill. Goodwill is expensed in the Profit and Loss Account over a period of five to twenty years.

SUMMARY OF ACCOUNTING PRINCIPLES (Continued)

Property and equipment

17. Property and equipment are capitalized at cost price less depreciation. Depreciation is calculated as a fixed annual percentage based on the estimated useful life of the property and equipment until a scrap value is reached. Estimated useful life is specified as follows:

Buildings	25 - 50 years
Fixtures	5 years
Machinery and equipment	3 - 5 years
Vehicles	6 years

Deferred income-tax liability / asset

18. The deferred income-tax liability / asset 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 Annual Accounts on the other, taken 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 Annual Accounts, mostly because expenses, especially depreciation, are entered earlier in the tax return than in the Annual Accounts. A calculated tax asset is only offset against income-tax liability if they are due to tax assessment from the same tax authorities.

Subordinated loans

19. The Bank has borrowed funds by issuing bonds on subordinate terms. The bonds have the characteristics of equity in being subordinate to other liabilities of the Bank. In the calculation of the capital ratio, the bonds are included with equity, as shown in note 66. 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 capital ratio. On the other hand, there are subordinated loans with various dates of maturity over the next 10 years. The loans are entered as liabilities with accrued interest and indexation at year-end 2004.

Stock option contracts

20. Stock option contracts enable the Bank's employees to acquire shares in the Bank. The purchase price equals the market value 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 Profit and Loss Account and posted as a special item among equity. Upon the implementation of international accounting standards the cost in relation to stock option agreements is expected to be evaluated in a manner similar to the present practice.

The Bank has sold shares in the Bank to some employees at market value. Employees hold put options on the shares at pre-determined terms. The cost attached to the agreements is evaluated in accordance with the evaluation of comparable agreements on the market during the term of the agreements.

Cash and cash equivalents

21. Cash and cash equivalents in the Statement of Cash Flows consist of cash, demand deposits with the Central Bank and demand deposits with other credit institutions.

SUMMARY OF ACCOUNTING PRINCIPLES (Continued)

Derivatives

22. Derivatives are financial instruments, the contracted or nominal amounts of which are not included in the Bank's Balance Sheet, either because rights and obligations arise out of one and the same contract, the contracts perform after the Balance Sheet date or because the nominal amounts serve merely as variables for calculating purposes. The nominal amounts of derivatives do not necessarily give any indication of the size of the cash flows and the market and credit risk attached to derivatives transactions. Examples of derivatives are forward exchange contracts, forward rate agreements, futures, options and swaps. The underlying value may involve interest rate, currency, commodity, bond or equity products.

The Bank's derivatives transactions are conducted as trading activity, entered at their market value, and as a hedge against the Bank's own interest rate and currency exposure. Hedge contracts are entered in the same manner as the hedged item. The Bank's derivatives are mainly intended to reduce the price, exchange and interest rate risk assumed by the Bank. Derivatives performance is entered in the Profit and Loss Account and in the Balance Sheet. Net assets are capitalised among amounts due from credit institutions and other assets whereas net obligations are entered among sundry liabilities and amounts owed to credit institutions.

The market risk attached to derivatives is created by changes in the price of the factors on which the contracts are based, such as interest rate changes or exchange rate changes in currency and listed securities. Risk attached to borrowings reflects the loss incurred by the Bank if the counter party in a derivative contract could not fulfil its part of the contract.

Forward rate agreements, futures and options relating to currency, securities and interest rate are entered in the Bank's Annual Accounts at their year-end market value.

International Financial Reporting Standards

23. According to an EC Directive, companies listed on European Stock Exchanges must prepare Consolidated Annual Accounts in accordance with international financial reporting standards (IFRS) as of the year 2005. The Bank plans to present its report for the first quarter of 2005 in accordance with IFRS. The main changes in the Bank's Annual Accounts will be in relation to the evaluation of goodwill, unlisted securities and derivatives. Furthermore, the presentation of the Profit and Loss Account as well as the Balance Sheet will be altered and Notes to the Annual Account will be more detailed.

CHANGES IN THE GROUP

24. In June Kaupthing Bank hf. concluded an agreement with Swedbank on the purchase of all issued shares in FI-Holding A/S, which owned the Danish bank FIH Erhvervsbank A/S. The purchase price was ISK 84 billion. FI-Holding A/S forms a part of the Group's Annual Accounts as of 1 July 2004.

At 31 December 2004 Kaupthing Bank Denmark was sold to Foroya Sparikassi. The sales price was ISK 1,448 million and proceeds from the sale amounted to ISK 350 million.

At 31 December 2004 the Bank acquired all outstanding shares in Kaupthing Foroyar Virdisbraevameklarafelag P/F. The purchase price was ISK 167 million.

QUARTERLY STATEMENTS

25. Summary of the Group's operating results by quarters:

	Q1	Q2	Q3	Q4	Total
Net interest income	**3,501**	**3,165**	**5,523**	**6,711**	**18,900**
Other operating revenue:					
Income from shares and other holdings	924	2,520	194	578	4,216
Commissions, income and expenses	3,212	2,584	2,289	5,212	13,297
Trading gains	1,862	2,146	6,327	955	11,290
Other operating income	72	87	8	699	866
	6,070	**7,337**	**8,818**	**7,444**	**29,669**
Net operating income	9,571	10,502	14,341	14,155	48,569
Other operating expenses:					
Salaries and salary-related expenses	2,622	2,846	3,120	4,064	12,652
Other administrative expenses	2,047	1,910	2,133	3,018	9,108
Depreciation	402	465	919	856	2,642
	5,071	**5,221**	**6,172**	**7,938**	**24,402**
Provision for losses	(1,150)	(1,112)	(582)	(975)	(3,819)
Pre-tax profit	3,350	4,169	7,587	5,242	20,348
Income tax	(558)	(504)	(1,965)	(1,013)	(4,040)
Profit before minority interest	**2,792**	**3,665**	**5,622**	**4,229**	**16,308**
Minority interest	(142)	(157)	(75)	(174)	(548)
Net earnings	**2,650**	**3,508**	**5,547**	**4,055**	**15,760**

FUNCTIONAL SUMMARY

26. Summary of the Group's operations by functions:

	Capital Markets	Investment Banking	Treasury	Corporate Banking	Asset Management and Private Banking	Retail Banking	Total
Net interest income	(182)	(802)	2,040	11,225	(188)	6,671	18,764
Net commission income	2,808	2,743	1,353	1,531	2,954	1,352	12,741
Trading gains	6,245	8,449	651	72	0	4	15,421
Other operating income	0	33	0	0	0	61	94
Total income	**8,871**	**10,423**	**4,044**	**12,828**	**2,766**	**8,088**	**47,020**
Operating expenses	2,483	1,150	922	961	1,527	3,869	10,912
Provision for losses	0	0	24	1,293	0	2,502	3,819
Total expenses	**2,483**	**1,150**	**946**	**2,254**	**1,527**	**6,371**	**14,731**
Gross margin	**6,388**	**9,273**	**3,098**	**10,574**	**1,239**	**1,717**	**32,289**

FUNCTIONAL SUMMARY (Continued)

27. Income specified by location of its markets and customers:

	Net interest income	Net commission income	Trading gains	Other income	Total
Iceland	7,928	7,173	3,950	969	20,020
Scandinavia	7,628	3,344	1,612	2,365	14,949
United Kingdom	1,142	1,197	4,208	1,733	8,280
Luxembourg	1,749	1,411	1,519	12	4,691
Other countries	453	172	1	3	629
Total	**18,900**	**13,297**	**11,290**	**5,082**	**48,569**

INTEREST EXPENSES

28. Interest on borrowings is specified as follows:

	Group		Parent	
	2004	2003	2004	2003
Bonds issued	14,532	4,035	3,089	3,258
Loan contracts	5,626	1,400	5,624	1,309
Total	**20,158**	**5,435**	**8,713**	**4,567**

OTHER OPERATING INCOME

29. Trading gains are specified as follows:

	Group		Parent	
	2004	2003	2004	2003
Trading shares	7,735	4,626	4,856	2,747
Trading bonds	2,948	4,784	3,219	4,837
Assets and liabilities in foreign currency	607	634	3,836	(217)
Total	**11,290**	**10,044**	**11,911**	**7,367**

30. Other operating income is specified as follows:

Capital gains on the sale of subsidiaries	350	356	350	356
Other income	516	472	205	295
Total	**866**	**828**	**555**	**651**

PERSONNEL

31. The total number of employees is as follows:

Average number of employees during the year measured as full time equivalent positions	1,501	1,328	938	850
Full time equivalent positions at year-end	1,606	1,237	922	832

PERSONNEL (Continued)

32. Salaries and salary-related expenses are specified as follows:

Salaries	10,102	7,670	4,771	4,053
Salary-related expenses	2,550	2,440	1,027	1,046
Total	**12,652**	**10,110**	**5,798**	**5,099**

EXECUTIVE EMPLOYMENT TERMS

33. Salaries to the executives of the Bank, their stock options and shares, owned at year-end, are specified as follows (thousand shares):

	Salaries and bonuses	Stock options	Put options	Shares at year-end
CEOs:				
Hreidar Mar Sigurdsson, CEO	97.2	3,642	812	2,007
Solon R. Sigurdsson, CEO	67.9	555		24
Directors:				
Sigurdur Einarsson, Chairman	108.7	4,080	812	2,526
Asgeir Thoroddsen	2.3			1
Bjarnfredur Olafsson	2.3			0
Brynja Halldorsdottir	1.8			9
Finnur Ingolfsson	2.3			78
Gudmundur Hjaltason	2.3			0
Gunnar Pall Palsson	2.3			6
Hjorleifur Thor Jakobsson	2.3			22
Peter Gatti	2.3			0
Tommy Christer Persson	2.3			0
Former Director:				
Jon Helgi Gudmundsson	0.5			0
14 managers of the Bank	439.5[1)]	1,155	4,500	12,246
Total	**734.0**	**9,432**[2)]	**6,124**[3)]	**16,919**[4)]

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. At year-end there are no pension liabilities due to the directors and the CEO. At year-end Solon R. Sigurdsson retired and he will receive ISK 60 million over the next two years as retirement benefits.

1) The managers have realized an amount of ISK 21 million on their stock options during the year. This amount is included in their total salaries for the year.
2) Stock option agreements with the CEO, the Chairman and the Managing Directors, that are based on the exercise prices 102.5 – 303.0, were concluded in 2000 – 2004 and are exercisable in the period 2005 – 2008.
3) Put option contracts with the CEO, Chairman and the Managing Directors were concluded in 2003 and in 2004. They are based on the exercise prices 210.0 and 303.0 and are exerciseable in the years 2006 and 2008.
4) Included among the holdings of the aforementioned persons are holdings of their spouses, minor children and companies controlled by them, if appropriate.

EXECUTIVE EMPLOYMENT TERMS (Continued)

34. The Bank has granted the Bank's Directors, the CEO and the Managing Directors loans amounting to a total of ISK 1,944 million at year-end on terms similar to those on which loans are granted to other customers of the Bank. Loans granted are in relation to purchases of shares in the Bank and in relation to purchases of shares in the Bank with put options. The aforementioned amounts do not include loans related to the business activities of the Directors.

35. In order to motivate and reward its employees Kaupthing Bank hf. has a system of paying bonuses. Bonuses to key managers are paid with regard to Kaupthing Group's operating profit and upon reaching certain targets on return on equity. Furthermore, Kaupthing Bank hf. pays its employees performance-related bonuses on projects increasing the number of customers in asset management and as a percentage of growth of assets under management. The CEO and the managing directors of each division determine these bonus payments. Bonus payments for the CEO are proportionate to the profits of the Kaupthing Group. In 2004 bonus payments totalled ISK 2,290 million.

AUDITORS' FEE

36. Fee to the Bank's auditors is specified as follows:

	Group	Parent
Audit of the Annual Accounts	101	10
Other related audit services	53	18
Review of the Interim Accounts	31	12
Other services	50	11
Total	**235**	**51**
Fee to others than the Parent Company's auditors, included in the above total	184	

These amounts include VAT.

EARNINGS PER SHARE

37. Earnings per share is the ratio between profit and weighted share capital during the year:

Net earnings	15,760
Weighted average share capital:	
Weighted average of outstanding shares for the last 12 months	497.4
Effects of stock options	7.6
Weighted average of outstanding shares for the last 12 months taking into consideration employee stock options	**505.0**
Earnings per share	31.7
Diluted earnings per share	31.2

CASH AND AMOUNTS DUE FROM CREDIT INSTITUTIONS

38. Cash and demand deposits with the Central Bank are specified as follows:

	Group		Parent	
	2004	2003	2004	2003
Cash	764	763	744	600
Demand deposits with the Central Bank	3,337	8	778	8
Total	**4,101**	**771**	**1,522**	**608**

39. Amounts due from credit institutions:

	Group		Parent	
	2004	2003	2004	2003
Required deposits with the Central Bank according to regulation	12,604	2,717	0	2,100
Amounts due from other credit institutions:				
Subsidiaries	0	0	124,179	43,227
Other	96,838	47,057	28,217	16,543
Total	**96,838**	**47,057**	**152,396**	**59,770**

40. Amounts due from other credit institutions mature as follows:

On demand	22,884	14,767	5,839	8,271
Up to 3 months	65,172	31,611	96,806	30,285
Over 3 months and up to a year	3,863	621	7,268	11,308
Over 1 year and up to 5 years	2,919	58	28,858	9,806
Over 5 years	2,000	0	13,625	100
Total	**96,838**	**47,057**	**152,396**	**59,770**

LOANS

41. Loans to customers and lease contracts specified by types of loans:

Overdrafts	39,623	34,319	23,049	26,634
Bonds	142,714	170,708	142,712	167,175
Loan contracts	808,756	121,992	162,303	54,114
Total	**991,093**	**327,019**	**328,064**	**247,923**

42. Loans to customers specified by sectors:

Government	0.0%	0.6%	0.1%	0.1%
Municipalities	4.3%	0.7%	0.7%	0.9%
Industries:				
Agriculture	0.6%	1.0%	1.2%	1.2%
Fishing industry	1.0%	2.6%	3.1%	3.3%
Commerce	7.5%	13.0%	11.4%	16.5%
Industry	31.1%	13.2%	13.5%	14.7%
Service	43.3%	43.7%	45.7%	44.0%
Individuals	12.2%	25.2%	24.3%	19.3%
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**

CASH AND AMOUNTS DUE FROM CREDIT INSTITUTIONS (Continued)

43. Loans to customers and lease contracts specified by maturity:

	Group		Parent	
	2004	2003	2004	2003
On demand	39,611	21,177	13,749	14,422
Up to 3 months	141,288	122,160	50,321	72,286
Over 3 months and up to a year	124,813	58,196	39,513	46,309
Over 1 year and up to 5 years	402,552	117,105	137,174	90,211
Over 5 years	377,680	30,395	87,307	24,695
Total	**1,085,944**	**349,033**	**328,064**	**247,923**

44. Lease contracts are specified as follows:

Buildings	69,014	3,487	0	0
Current assets	25,837	18,527	0	0
Total	**94,851**	**22,014**	**0**	**0**

45. Mortgages foreclosed are specified as follows:

Buildings	1,545	1,841	886	1,313
Current assets	84	121	2	10
Loans and shares in foreclosing and management companies	773	0	0	300
Total	**2,402**	**1,962**	**888**	**1,623**

46. Non-performing loans are specified as follows:

Loans with a specific provision for losses	16,561	7,149	6,602	6,708
Specific provision for losses	(12,521)	(5,465)	(4,057)	(5,014)
Other non-performing loans	2,973	4,900	2,587	4,751
Non-performing loans, total	**7,013**	**6,584**	**5,132**	**6,445**

CASH AND AMOUNTS DUE FROM CREDIT INSTITUTIONS (Continued)

47. Changes in the provision for losses are specified as follows:

	Provision for losses		2004	2003
Group	**Specific**	**General**	**Total**	**Total**
Balance at the beginning of the year	**5,465**	**2,836**	**8,301**	**5,764**
Provision for losses during the year	2,989	830	3,819	3,894
Exchange rate difference on the translation of foreign subsidiaries	(378)	(65)	(443)	25
Actual losses during the period	(5,566)	(35)	(5,601)	(1,402)
Paid in, previously written off	21	0	21	20
Taken over at acquisitions	9,990	405	10,395	0
Balance at year-end	**12,521**	**3,971**	**16,492**	**8,301**
Provision for losses on the loan portfolio as a percentage of loans and issued guarantees	1.1%	0.3%	1.4%	2.4%
Parent				
Balance at the beginning of the year	**5,015**	**2,317**	**7,332**	**4,950**
Provision for losses during the year	3,268	318	3,586	3,631
Actual losses during the year	(4,282)	0	(4,282)	(1,266)
Paid in, previously written off	56	0	56	17
Balance at year-end	**4,057**	**2,635**	**6,692**	**7,332**
Provision for losses on the loan portfolio as a percentage of loans and issued guarantees	1.1%	0.7%	1.8%	2.7%

BONDS AND SHARES IN OTHER COMPANIES

48. Bonds and other fixed-income securities are specified as follows:

	Group		Parent	
	Market value	**Book value**	**Market value**	**Book value**
Trading bonds:				
Listed on the Iceland Stock Exchange	67,052	67,052	67,052	67,052
Listed on foreign stock exchange	75,702	75,702	663	663
Bonds, unlisted		17,002		11,369
		159,756		**79,084**
Investing bonds:				
Listed on the Iceland Stock Exchange	9,854	9,854	9,838	9,838
Bonds, unlisted		56		56
		9,910		**9,894**
Bonds and other fixed-income securities, total		**169,666**		**88,978**

BONDS AND SHARES IN OTHER COMPANIES (Continued)

The Bank's market risk on bonds, derivatives included, amounts to ISK 72,456 million.

49. Bonds and other fixed-income securities specified by issuers:

	Group	Parent
Bonds issued by public bodies	72,317	72,315
Bonds issued by other borrowers	97,349	16,663
Total	**169,666**	**88,978**

Bonds that mature within a year amount to ISK 17,406 / 4,420 million for the Group / Parent Company.

50. Shares and other variable-yield securities are specified as follows:

	Group		Parent	
	Market value	Book value	Market value	Book value
Trading shares:				
Listed on the Iceland Stock Exchange	29,826	29,826	28,948	28,948
Listed on foreign stock exchange	35,825	35,825	12,021	12,021
Shares, unlisted		11,376		9,156
		77,027		**50,125**
Investing shares:				
Shares, unlisted		1,659		56
Shares and other variable-yield securities, total		**78,686**		**50,181**

Kaupthing Bank hf. has entered into derivatives amounting to ISK 12,925 million against its shares. Derivatives on listed shares amount to ISK 10,921 million and derivatives on unlisted shares amount to ISK 2,004 million. The agreements are entered at market value.

51. Investing shares are specified as follows:

	Owner-ship	Dividend	Nominal value	Book value
Shares held by the Parent:				
Audkenni hf., Iceland	17.8%	0	18	20
Eignarhaldsfelagid Verdbrefathing hf., Iceland	20.0%	1	14	18
Shares in four other companies		0	8	18
Total shares held by the Parent		**1**		**56**
Shares held by subsidiaries:				
Puhelinosuuskunta KPY Finland	13.7%	1	0	891
PolystarInstruments AB Sweden	12.6%	1	0	143
Tetra Island ehf., Iceland	25.6%	0	57	115
Shares in 17 other companies		4	0	454
Total shares held by subsidiaries		**6**		**1,603**
Total investing shares		**7**		**1,659**

BONDS AND SHARES IN OTHER COMPANIES (Continued)

52. Shares in associated companies are specified as follows:

	Ownership	Profit share	Nominal value	Book value
Shares held by the Parent:				
Greidslumidlun hf., Iceland	21.0%	32	84	296
DSK A/S, Denmark	42.5%	27	143	220
Kreditkort hf., Iceland	20.0%	40	9	218
Reiknistofa bankanna, Iceland	17.1%	(8)		207
Shares in three other companies		24	169	274
Total held by the Parent		**115**		**1,215**
Shares held by the subsidiaries:				
Axcel Industri Investor Invest A/S, Denmark	50.0%	35	253	1,235
Drake Management LLC., USA	20.0%	67	612	1,156
KIFU—AX II, Denmark	25.0%	50	169	751
Netdesign Invest A/S, Denmark	25.4%	212	33	741
KFU—AX II, Denmark	33.3%	45	150	708
Mezzanin Kapital A/S, Denmark	22.7%	3	140	454
FA A/S, Denmark	50.0%	91	3	345
Shares in 11 other companies		18	334	461
Total shares held by the subsidiaries		**521**		**5,851**
Total shares in associated companies		**636**		**7,066**

OTHER ASSETS

53. Goodwill is specified as follows:

	Group	Parent
Balance 1.1.2004	**5,948**	**226**
Additions during the year	31,145	
Disposals during the year	(34)	
Currency exchange rate difference	(1,292)	
Amortized during the year	(1,559)	(58)
Book value 31.12.2004	**34,208**	**168**

OTHER ASSETS (Continued)

54. Fixed assets and depreciation are specified as follows:

Group	Real estate	Machinery and equipment	Total
Total value 1.1.2004	**4,161**	**5,410**	**9,571**
Taken over / Sold	(45)	11	(34)
Additions during the year	1,977	1,164	3,141
Disposals during the year	(1,095)	(414)	(1,509)
Total value 31.12.2004	**4,998**	**6,171**	**11,169**
Previously depreciated	1,325	2,805	4,130
Taken over / Sold	3	113	116
Depreciation during the year	102	981	1,083
Disposals during the year	(263)	(364)	(627)
Total depreciation 31.12.2004	**1,167**	**3,535**	**4,702**
Book value 31.12.2004	**3,831**	**2,636**	**6,467**
Annual depreciation ratios	2-4%	15-33%	
Parent Company			
Total value 1.1.2004	**3,760**	**3,290**	**7,050**
Addition during the year	1,728	741	2,469
Disposals during the year	(1,016)	(327)	(1,343)
Total value 31.12.2004	**4,472**	**3,704**	**8,176**
Previously depreciated	1,260	1,627	2,887
Depreciation during the year	69	582	651
Disposals during the year	(223)	(262)	(485)
Total depreciation 31.12.2004	**1,106**	**1,947**	**3,053**
Book value 31.12.2004	**3,366**	**1,757**	**5,123**
Annual depreciation ratios	2-4%	15-33%	

Depreciation in the Profit and Loss Account is specified as follows:

	Group	Parent
Depreciation	1,083	651
Amortization, see note 53	1,559	58
Depreciation in the Profit and Loss Account	**2,642**	**709**

The official assessment value and fire insurance value of fixed assets are specified as follows:

The official assessment value of buildings and leased land	2,674	2,452
The fire insurance value of buildings	4,111	3,814
The insurance value of machinery and equipment	551	0

OTHER ASSETS (Continued)

55. Other assets are specified as follows:

	Group 2004	Group 2003	Parent 2004	Parent 2003
Unsettled securities trading	4,001	5,916	2,465	2,700
Amounts due from subsidiaries	0	0	1,587	1,070
Sundry assets	10,613	2,722	314	1,299
Total	**14,614**	**8,638**	**4,366**	**5,069**

The above item "Unsettled securities trading" was settled within three days from the Balance Sheet date.

56. Prepaid expenses and accrued income is specified as follows:

Prepaid expenses	5,421	380	5,043	119
Accrued income	13,764	1,706	5,228	650
Total	**19,185**	**2,086**	**10,271**	**769**

BALANCES WITH ASSOCIATED COMPANIES AND SUBSIDIARIES

57. Specification of balances with associated companies and subsidiaries:

	Group Associated companies	Group Sub-sidiaries	Parent Associated companies	Parent Sub-sidiaries
Assets:				
Amounts due from credit institutions	0	0	0	124,179
Loans to customers	0	2,394	0	3,980
Other assets	0	376	0	1,031
Total	**0**	**2,770**	**0**	**129,190**
Liabilities:				
Amounts owed to credit institutions	0	0	0	20,576
Deposits	0	0	0	594
Total	**0**	**0**	**0**	**21,170**

SUBORDINATED LOANS

58. Specification of subordinated loans:

	Sub-sidiaries	Other companies
Amounts due from credit institutions	14,147	0
Loans to customers	0	6,890
Bonds and other fixed-income securities	0	1,971
Total	**14,147**	**8,861**

ASSETS AND LIABILITIES IN FOREIGN CURRENCY

59. The total amount of assets denominated in foreign currencies in the Group's / Parent's Annual Accounts amounted to ISK 630,341 / 1,507,243 million, respectively, at year-end, and the total amount of liabilities amounted to ISK 629,877 / 1,505,673 million at the same time. Included in assets and liabilities are forward contracts and currency and interest rate swaps, see note 73.

AMOUNTS OWED TO CREDIT INSTITUTIONS

60. Liabilities owed to credit institutions are specified as follows:

	Group		Parent	
	2004	2003	2004	2003
Liabilities to the Central Bank	18,017	24,026	18,017	24,026
Liabilities to other credit institutions	129,438	55,241	61,736	45,527
Total	**147,455**	**79,267**	**79,753**	**69,553**

61. Liabilities owed to credit institutions mature as follows:

On demand	9,270	3,249	5,419	1,588
Up to 3 months	93,705	71,151	72,771	63,307
Over 3 months and up to a year	1,826	2,444	183	2,235
Over 1 year and up to 5 years	9,763	1,944	1,088	1,944
Over 5 years	32,891	479	292	479
Total	**147,455**	**79,267**	**79,753**	**69,553**

SAVINGS DEPOSITS

62. Time deposits mature as follows:

Up to 3 months	82,980	36,274	14,208	14,414
Over 3 months and up to a year	8,773	20,999	3,565	6,818
Over 1 year and up to 5 years	23,922	16,797	23,378	15,539
Over 5 years	6,434	4,995	6,435	4,796
Total	**122,109**	**79,065**	**47,586**	**41,567**

BORROWINGS

63. Borrowings are specified as follows:

Bonds issued	850,159	150,424	315,896	147,474
Loans	34,060	60,221	34,060	59,106
Total	**884,219**	**210,645**	**349,956**	**206,580**

Borrowings that mature within a year amount to ISK 307,941 / 87,583 million for the Group / Parent.

SUNDRY LIABILITIES

64. Sundry liabilities are specified as follows:

	Group		Parent	
	2004	2003	2004	2003
Unsettled securities trading	7,967	5,455	464	169
Income tax and net worth tax	1,729	127	1,676	279
Loans on mortgages foreclosed	75	1,026	75	903
Provision for losses on guarantees	240	147	156	147
Other liabilities	10,535	6,946	955	1,518
Total	**20,546**	**13,701**	**3,326**	**3,016**

The above item "Unsettled securities trading" was settled within three days from the Balance Sheet date.

DEFERRED TAX ASSET / DEFERRED INCOME-TAX LIABILITY

65. Deferred tax asset / income-tax liability is specified as follows:

	Group		Parent
	Asset	Liability	Liability
Deferred tax asset / income-tax liability at the beginning of 2004	**(831)**	**1,646**	**979**
Taken over at acquisitions	(303)	5,364	0
Exchange rate difference on the translation of foreign subsidiaries	71	(406)	
Joint taxation effects	0	0	(1)
Calculated income tax for 2004	115	3,925	1,636
Income tax because of 2004 operations to be paid in the year 2005	(91)	(1,364)	(1,349)
Deferred tax asset / income-tax liability at year-end	**(1,039)**	**9,165**	**1,265**

Deferred tax asset / income-tax liability is specified as follows:

Shares in other companies	(3)	1,478	606
Currency-linked assets and liabilities	0	346	346
Loans	0	4,670	0
Derivatives	0	2,726	0
Other items	0	65	0
Fixed assets	(1)	357	313
	(4)	**9,642**	**1,265**
Carry-forward tax loss	**(1,035)**	**(477)**	**0**
Deferred tax asset / income-tax liability at year-end	**(1,039)**	**9,165**	**1,265**

SUBORDINATED LOANS

66. Subordinated loans are specified as follows:

		Original interest	Interest change	Interest after change	Maturity date	Book value
Loans that qualify as Tier I capital:						
Issued in 2001	ISK	8.7%	2011		No maturity date	1,190
Issued in 2004	EUR	5.9%	2014	3 mth. Euribor + 245 bps.	No maturity date	12,758
						13,948
Loans that qualify as Tier II capital:						
Issued in 2000	ISK	6.0%	2005	7.5%	2010	1,470
Issued in 2000	ISK	7.0%	2007	9.0%	2012	2,128
Issued in 2001	ISK	6.0%	2006	7.5%	2011	122
Issued in 2001	ISK	8.0%	2006	10.0%	2011	1,421
Issued in 2002	ISK	6.0%	2007	7.5%	2012	904
Issued in 2002	ISK	7.5%	2009	10.0%	2014	1,279
Issued in 2004	ISK	5.4%	2009	7.4%	2014	1,917
Issued in 2002	EUR	3.3%	2007	5.8%	2012	418
Issued in 2004	EUR	3.3%	2009	3 mth. Euribor + 165 bps.	2014	24,911
						34,570
Parent company's total subordinated loans						**48,518**
Subsidiaries' subordinated loans:						
Issued in 1999, Tier II	EUR	6.4%			2009	2,505
Issued in 1996, Tier II	DKK	0.0%			2007	684
Issued in 1999, Tier II	JPY	4.8%			2032	5,920
Subsidiaries' total subordinated loans						**9,109**
Total						**57,627**

EQUITY

67. According to the Parent Company's Articles of Association, total share capital amounts to ISK 6,607 million. At year-end 2004 own shares amounted to ISK 86 million and share capital, according to the Balance Sheet, thus amounted to ISK 6,521 million. One share amounts to a nominal value of ISK 10. One vote is attached to each share. Increase of share capital during the year is specified as follows:

	Share capital	Market value
Issued new share capital due to the acquisition of FIH	1,101	39,649
Issued new share capital	1,100	52,794
Own shares bought and sold	(64)	(2,949)
Total	**2,137**	**89,494**

EQUITY (Continued)

68. Changes in equity are specified as follows:

	Share capital	Share premium	Accrued stock options	Retained earnings	Total
Equity 1.1.2004	**4,384**	**23,304**	**316**	**17,925**	**45,929**
Dividend paid				(1,322)	(1,322)
Treasury stock, sold	2,201	90,242			92,443
Own shares, bought and sold	(64)	(3,144)	(159)		(3,367)
Net earnings				15,760	15,760
Equity 31.12.2004	**6,521**	**110,402**	**157**	**32,363**	**149,443**

Share premium is specified as follows:

Share premium account	110,036
Statutory reserve	366
Share premium, total	**110,402**

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

	Group	
	Book value	Weighted value
Risk base:		
Assets recorded in the Annual Accounts	1,534,020	1,166,377
Assets deducted from capital		(50,335)
Guarantees and other items not included in the Balance Sheet		73,129
Risk base, total		**1,189,171**
Capital:		
Tier I capital:		
Recorded equity		149,443
Minority interest		9,306
Goodwill		(34,208)
Other assets		(1,232)
Subordinated loans		13,947
Tier II capital:		
Subordinated loans		43,108
Investment in credit institutions		(11,598)
Total equity base		**168,766**
Capital ratio		14.2%
Thereof Tier I capital		11.5%

STOCK OPTIONS

70. The Bank has granted its employees stock options exercisable from 2005 until 2008. The Bank will use own shares and increase share capital to meet employee stock options. Employee stock options at year-end are 12.6 million shares. Changes in stock options are specified as follows:

	Shares (in thous.)
Stock options at the beginning of the year	**7,654**
Stock options issued during the year	8,120
Stock options exercised during the year	(2,999)
Expired or terminated stock options during the year	(145)
Stock options at year-end 2004	**12,630**

Stock options are specified as follows at year-end:

	Price	Shares (in thous.)
Exercisable in:		
2005	114.9	150
2005	102.5	2,767
2005 – 2007	102.5	81
2005	122.0	1,000
2005 – 2006	120.0	240
2005 – 2008	114.9	1,896
2005 – 2008	303.0	6,496
		12,630

71. The Bank has sold shares to 64 of its employees at market value. These shares hold put options on 12.7 million shares at the strike price of 210 – 457 exercisable in 2006 – 2008. At year-end the Bank has no obligations with respect to these put options.

OBLIGATIONS

72. The Bank has granted its customers guarantees and overdraft permissions. These guarantees and overdrafts are specified as follows:

	Group		Parent	
	2004	2003	2004	2003
Guarantees	116,160	16,139	38,865	15,505
Unused overdrafts	14,787	13,404	13,439	12,638
Loan commitments	144,688	13,769	85,939	13,769

OBLIGATIONS (Continued)

73. Derivatives, remaining maturity date of principal and book value, are specified as follows:

Group	Principal				Book value	
	Up to 3 months	Over 3 months and up to a year	Over 1 year	Total	Assets	Liabilities
Currency and interest 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	8,675	45,167
Options, purchased	12,530	2,989	2,357	17,876	293	0
Options, sold	8,848	5,094	22,819	36,761	0	188
Total	**410,507**	**225,005**	**754,070**	**1,389,582**	**13,138**	**48,782**
Equity derivatives						
Agreements unlisted:						
Swaps	6,015	5,106	2,581	13,702	879	528
Options, purchased	0	2,089	2,000	4,089	31	
Options, sold	0	721	2,000	2,721		96
Agreements:						
Futures	0	5,029	0	5,029	0	6
Total	**6,015**	**12,945**	**6,581**	**25,541**	**910**	**630**
Bond derivatives						
Agreements unlisted:						
Swaps	45,546	1,335	0	46,881	181	2,941
Derivatives total	**462,068**	**239,285**	**760,651**	**1,462,004**	**14,229**	**52,353**

Parent	Principal				Book value	
	Up to 3 months	Over 3 months and up to a year	Over 1 year	Total	Assets	Liabilities
Currency and interest rate derivatives						
Agreements unlisted:						
Forward exchange rate agreements	175,914	12,678	213	188,805	2,694	2,834
Interest rate and exchange rate agreements	2,989	26,287	170,790	200,066	5,388	4,810
Options, purchased	12,530	2,708	0	15,238	293	0
Options, sold	8,848	3,971	0	12,819	0	188
Total	**200,281**	**45,644**	**171,003**	**416,928**	**8,375**	**7,832**
Equity derivatives						
Agreements unlisted:						
Swaps	6,015	5,106	77	11,198	879	528
Options, purchased	0	0	2,000	2,000	0	0
Options, sold	0	0	2,000	2,000	0	36
Total	**6,015**	**5,106**	**4,077**	**15,198**	**879**	**564**
Bond derivatives						
Agreements unlisted:						
Swaps	45,546	1,335	0	46,881	181	2,941
Derivatives total	**251,842**	**52,085**	**175,080**	**479,007**	**9,435**	**11,337**

OBLIGATIONS (Continued)

The objective of the above-mentioned agreements is to control the currency and interest rate risk of the Group. The credit risk is valued at ISK 25,583 / 14,251 million when calculating the capital ratio of the Group / Parent Company.

74. The lease agreements in force at year-end are for a period of up to 20 years and the Bank has a priority right to purchase the leased real estate or right to extend the lease agreement at the end of that period. The net present value of the Bank's obligations in relation to the lease is approximately ISK 1,110 million. The Bank has concluded lease agreements regarding the real estate it uses for its operations in Iceland.

75. According to the Act on Deposit Guarantees and Investor Compensation Scheme, the total assets of the Depositors' and Investors' Guarantee Fund shall be a minimum of 1.0% of the average insured deposits in Commercial Banks and Savings Banks for the previous year. At year-end 2004 the Bank has no obligation in relation to its participation in the Fund.

OTHER ITEMS

76. Reconciliation of net earnings according to the Annual Accounts and the Swedish GAAP:

	Group		Parent	
	2004	2003	2004	2003
Annual Accounts, net earnings	15,760	7,520	15,760	7,520
Amortization of goodwill	(168)	(168)	(168)	(168)
Net earnings in accordance with Swedish GAAP	**15,592**	**7,352**	**15,592**	**7,352**

Had the Swedish GAAP been used, equity in the Annual Accounts as of 31 December 2004 would have been ISK 1,073 million higher, corresponding to the goodwill item that arose upon the acquisition of Sofi Financial Services Group.

77. The Board of Directors of Kaupthing Bank hf. laid down detailed rules regarding its work procedures, i.a. for the purpose of operating in accordance with exemplary corporate management practices. Furthermore, the Board has appointed two committees, the audit committee and the compensation committee. The majority of the Directors and committee members are independent of the Bank. The Bank's Board of Directors will continue to ensure that the Bank conducts its operations in accordance with exemplary corporate management practices.

FIVE-YEAR SUMMARY

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

Trading between Kaupthing Bank hf. and Bunadarbanki Islands hf. formed an insignificant part of the banks' trading in 1999 to 2002 and should therefore not have a significant impact when the operations of the merged bank are compared.

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