

**KAUPTHING BANK HF. CREDITORS' REPORT**

**5 FEBRUARY 2009**

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**KAUPTHING BANK**

## Disclaimer

This report (including all subsequent amendments and additions) was prepared by the Resolution Committee for the creditors of Kaupthing Bank hf. ("the Bank") for information purposes only. It should give creditors an overview of the background, the current situation and the potential steps going forward. The additions and amendments to this report since the previously published versions of this report are intended to give the creditors information on recent developments but are not necessarily and should not be regarded as an exhaustive list of all developments which creditors may consider material. In preparing and updating this report, the Bank has not taken account of the interest of any particular creditor or group of creditors.

Creditors will note that this report does not include an estimate of the likely level of recoveries for creditors. Very material uncertainties continue to exist regarding the timing and realisable value of assets and the eventual level of creditors' claims. The Resolution Committee wish to caution creditors against using the data in this report to estimate likely dividends as any such estimates are likely to be materially misleading.

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- (a) Resolution of issues regarding the quantum of claims
- (b) Additional claims being made against the Bank
- (c) The realisation method(s) used over time
- (d) The impact of set off and netting including in connection with derivative contracts
- (e) Movements in currency exchange rates and interest rates
- (f) Prevailing market conditions when assets are sold

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## Major additions and amendments in this report

During the moratorium period, the Bank intends to compile a report on a regular basis for creditors which will be available on the Bank's website, [www.kaupthing.com](http://www.kaupthing.com), so that creditors and other interested parties can keep abreast of the main developments and achievements since the previous report was issued.

The additions and amendments to this report since the previously published versions of this report are intended to give the creditors information on recent developments but are not necessarily and should not be regarded as an exhaustive list of all developments which creditors may consider material.

In order to help readers who read the previous report, the major additions and amendments have been highlighted in blue text but all minor changes are left as black text. Deleted text, which is not applicable anymore and none of which was significant, has been deleted without any notification to the readers. The major additions and amendments can be found in the following chapters:

- 2                    Timeline of events
- 4.2                 Derivatives
- 5.3                 Repayments and exits
- 6.7                 The claim process

## Abbreviations

The following abbreviations are used in this report:

FME	The Icelandic Financial Supervisory Authority
ICC	Informal Creditors' Committee
The Bank, Kaupthing	Kaupthing Bank hf.
<a href="#">Arion Bank</a>	<a href="#">Arion bank hf. (previously New Kaupthing)</a>
KSF	Kaupthing Singer and Friedlander Limited
FIH	FIH Erhvervsbank A/S
KT Lux	Kaupthing Bank Luxembourg S.A.
The Disbursement Act	Act No. 125/2008 on the Authority for Treasury Disbursements due to Unusual Financial Market Circumstances etc.
The Transfer Decision	Decision of the FME on the disposal of assets and liabilities of Kaupthing Bank hf. to Arion Bank dated 21 October 2008
The Bankruptcy Act	Icelandic Act on Bankruptcy, etc., No. 21/1991
IMF	International Monetary Fund
ICB	The Central Bank of Iceland

# 1. Background

## 1.1 *Broad context -The world wide credit crunch and the global financial crisis*

The world's banking system has taken centre stage in the world financial crisis. From around mid 2007, but particularly in 2008, the market experienced acute adverse conditions characterized by the severe disruption to credit markets and turbulence in the banking and mortgage sectors. These conditions created an extremely difficult environment for banks in general and came to a head in the second half of 2008 and particularly in September and October. The severity of the situation was underlined by: i) the collapse of banking and financial sector shares in and around September 2008, ii) the collapse of Lehman Brothers, an international investment bank, on 15 September 2008 and iii) the huge and unprecedented "bail out" of American banks announced by the US Treasury Secretary on 20 September 2008, followed by similar rescue measures undertaken by most western countries.

In short, the global financial system was experiencing unprecedented difficulties and, consequently, credit markets (so essential to the smooth operation of the world financial system and to the wider economy) were seizing up, leading to what is popularly called the credit crunch. This, in turn, was having serious implications for the global economy and governments across the world as evidenced by dramatic falls in share prices and extreme volatility in the currency and commodity markets. Rating agencies were forced to reassess the credit ratings of financial sector institutions across the world.

## 1.2 *The Icelandic banking crisis*

During the past decade, the Icelandic economy has undergone dramatic change. The development of an international financial sector, along with the growth of high tech industries, aluminium production and tourism, brought unprecedented wealth to a population of roughly 300,000 that had previously sustained itself mainly through a centuries-old fishing industry. In the course of that development, Iceland's three largest banks, Kaupthing Bank ("the Bank"), Glitnir banki hf. ("Glitnir"), and Landsbanki Islands hf. ("Landsbanki"), grew to levels almost ten times that of the country's gross domestic product.

On 29 September 2008, the Icelandic authorities announced their plans to acquire a 75% stake in Iceland's third largest bank, Glitnir, which had been encountering severe short-term funding problems. This government intervention seems to have triggered the opposite reaction to that of similar actions in other countries. Instead of restoring confidence, the reverse happened. The markets had no confidence in the approach taken by the Icelandic government and a crisis of confidence hit the Icelandic banking sector, resulting in outflows of deposits. It became clear that if it had not been for state intervention, Glitnir may have collapsed and there was speculation over the ability of the ICB to provide the necessary support to the wider Icelandic banking system during the crisis. This precipitated a severe drop in the value of the Icelandic krona and caused rating agencies to downgrade their credit ratings for the Icelandic state and the Icelandic banks. Foreign investors tried to divest themselves of Icelandic assets and British depositors began to withdraw their deposits from Icesave, Landsbanki's internet banking product. In addition, there was an increase in the outflow of deposits from Kaupthing Edge, the internet banking product of the Bank.

On Monday 6 October 2008, trading in most Icelandic banking shares (including the Bank's) was suspended in Iceland and emergency legislation, Act No. 125/2008 on the Authority for Treasury Disbursements due to Unusual Financial Market Circumstances etc ("The Disbursement Act") was enacted allowing the Icelandic Financial Supervisory Authority ("FME") to take over the running of the Icelandic banks.

### **1.3 KSF placed into administration**

After British depositors withdrew their deposits from Icesave, Landsbanki's internet banking product in the United Kingdom, the Icelandic authorities assumed control of Landsbanki. Immediately afterwards, there was a significant increase in the withdrawal of deposits from the Bank's UK subsidiary, Kaupthing Singer & Friedlander ("KSF"), despite the fact that Kaupthing Edge deposits in UK were guaranteed by the British compensation scheme and Icesave deposits by the Icelandic scheme. After the British Chancellor of the Exchequer stated that Iceland did not intend to honour its obligations to British depositors, the State Treasury, in the UK transferred Kaupthing Edge deposits from the Bank's subsidiary KSF to ING Direct, a wholly owned subsidiary of ING Group. KSF was subsequently placed into administration upon the application of the UK regulator, the Financial Services Authority ("FSA") in the UK. The Bank's creditors treated the situation as an event of default under various loan agreements and bond programs.

### **1.4 Overview of the Bank**

The Bank was the largest Icelandic bank and is headquartered in Reykjavik. It is registered in Iceland and operated through branches and subsidiaries in all of the Nordic countries, the United Kingdom, the United States, Dubai, Qatar, Luxembourg, Belgium, Switzerland, Germany, Austria, Hong Kong, Japan and the Isle of Man. The Bank offered integrated financial services to companies, institutional investors and individuals. These services included corporate and retail banking, investment banking, capital markets services, treasury services, asset management and wealth management for private banking clients. The Bank's shares were listed on the stock exchanges in Iceland and Stockholm and the Bank was the 7<sup>th</sup> largest bank in the Nordic region in terms of market capitalization for a period of time. The majority of the Bank's operating income was generated in Iceland, Scandinavia and the United Kingdom. Since its inception in 1982, Kaupthing expanded operations through organic growth and a number of strategic acquisitions, including FIH Erhvervsbank ("FIH") in 2004 and Singer & Friedlander (now KSF) in 2005. At the end of H1 2008, the Bank's group employed over 3,300 people and its total assets were close to EUR 53bn.

## **2. Timeline of events**

### ***29 September – 9 October 2008***

- The Icelandic authorities announce their plans to acquire a 75% stake in Glitnir
- The rating agencies downgrade Icelandic sovereign, Kaupthing, Glitnir and Landsbanki debt
- Trading in shares in the Bank suspended
- Icelandic parliament passes the Disbursement Act
- The Bank borrows EUR 500m from the ICB
- FSA in the UK succeeds in having administrators appointed over KSF
- The Bank's board of directors requests that the FME take control of the Bank pursuant to the Disbursement Act

### ***9 October – 22 October 2008***

- FME appoints a Resolution Committee which immediately assumes control of the Bank
- Arion Bank is created
- Certain domestic assets and domestic deposits transferred to Arion Bank in accordance with the transfer decision ("The Transfer Decision")

### ***22 October to date***

- The Resolution Committee works towards maximising the value of the Bank's assets
- The Resolution Committee holds meetings and conference calls with informal committee of the largest creditors of the Bank
- Moratorium granted and Olafur Gardarsson appointed as the Moratorium Supervisor
- Filing of Voluntary Petition under Chapter 15 of the US Bankruptcy Code
- Moratorium is recognized as a foreign main proceeding under Chapter 15 of the US Bankruptcy Code
- Morgan Stanley appointed as a financial advisor to advise and assist on restructuring the Bank
- Creditors' Meeting convened by the Moratorium Supervisor on 5 February 2009
- Moratorium of the Bank extended by the District Court of Reykjavik to 13 November 2009
- Important amendments made to the Act on Financial Undertakings on 22 April 2009
- The Bank's Winding-up Committee appointed on 25 May 2009
- The formal claim process started on 30 June 2009 and will last for 6 months. Forms for filing claims can be accessed on [www.kaupthing.com](http://www.kaupthing.com)

- On 20 July 2009, the agreement between the Resolution Committee and the Government with regards to Arion Bank was announced
- On 14 August 2009, the Government capitalized Arion Bank with approx. ISK 72bn in common equity which will allow Arion Bank to function as a fully operational bank
- On 3 September 2009, the Bank's Resolution Committee and the Government signed an agreement on settlement between the Bank and Arion Bank in accordance with the agreement announced on 20 July 2009
- On 20 October 2009 the Resolution Committee called for a creditors' meeting to discuss the agreement between the Resolution Committee and the Government on Arion Bank. At the meeting, creditors were provided with latest financial information on the Bank. Also, there was a discussion on possible extension of moratorium on debt payments. Further information and a presentation from the meeting can be accessed on the Bank's website
- On 30 October 2009 the Ministry of Finance and the Resolution Committee agreed to extend the deadline for the Resolution Committee to make a decision regarding the capitalization of Arion Bank until 30 November 2009
- On 13 November 2009 a nine months extension of moratorium was requested at a hearing at the District Court of Reykjavik. The Bank was granted an extension of moratorium on debt payments until 13 August 2010
- On 1 December 2009, the Resolution Committee announced it would acquire 87% share in Arion Bank by deciding for option 1, further discussed in subchapter 4.3 *The Bank/Arion Bank split*

### **Next steps**

- **30 December 2009:** The formal claim registration process which started on 30 June 2009 ends
- **22 January 2010:** List of claims made available to creditors
- **29 January 2010:** Creditors' Meeting held at 10:00 a.m. at Hilton Hotel Nordica
- **18 May 2010:** Creditors' Meeting from 29 January 2010 continued
- **24 November 2010:** Maximum moratorium period for the Bank ends

### **3. The Resolution Committee**

#### **3.1 *The adoption of the Disbursement Act***

As discussed in the previous chapter, Iceland suffered from a banking crisis of extraordinary proportions. The three main banks which all collapsed in less than a week, accounted for about 85 percent of the domestic banking system. On 9 October 2008, in accordance with the provisions of Iceland's new Disbursement Act, which had been passed into law because of the unusual and dire circumstances in the financial market, the board of directors resigned and the FME appointed a five-member Resolution Committee, which immediately assumed the powers, and wields all the authority, of the Bank's board of directors. These actions were taken to guarantee the appropriate level of activity by the banks in Iceland and to help stabilize the Icelandic financial system. The members of the Resolution Committee were selected by the FME from a broad cross-section of Icelandic business, legal and accounting fields. Today, the Bank's Resolution Committee consists of the following four members:

- Steinar Thor Gudgeirsson, Attorney to the Supreme Court of Iceland – Chairman
- Johannes Runar Johannsson, Attorney to the Supreme Court of Iceland
- Knutur Thorhallsson, Certified Public Accountant
- Theodor Sigurbergsson, Certified Public Accountant

Initially, the Resolution Committee operated in consultation and co-operation with the FME. However, after a moratorium status was granted to the Bank, on 24 November 2008, the Resolution Committee became virtually independent from any governmental body and currently directs the Bank in co-operation with Olafur Gardarsson, attorney to the Supreme Court, the Moratorium Supervisor.

On 25 May 2009, in accordance with a request from the Resolution Committee, the District Court of Reykjavik appointed a Winding-up Committee for the Bank in accordance with the recent amendments to the Act on Financial Undertakings. The Winding-up Committee comprises Olafur Gardarsson, the aforementioned Moratorium Supervisor, David B. Gislason, attorney to the District Court, and Feldis L. Oskarsdottir, attorney to the District Court. The Winding-up Committee together with the Resolution Committee act as joint administrator for the Bank. The role of the Winding-up Committee will be further discussed in subchapter 6.6 *The Winding-Up Committee*.

#### **3.2 *Initial objectives of the Resolution Committee***

At its inception, the Resolution Committee had the objectives laid out below. Some of these objectives were set with reference to the Disbursement Act. However, it should be noted that the Resolution Committee played no part in determining the creation of Arion Bank.

*Maintaining the Bank's commercial banking operations in Iceland* in line with the Disbursement Act. The Resolution Committee worked hard to ensure that the daily operations of the Bank's branches were not significantly affected. This objective was reached when Arion Bank was formally established on 18 October 2008 and took over the Bank's commercial banking operation in Iceland on 22 October 2008.

*Protecting depositors both domestically & overseas* in accordance with the Disbursement Act. The Resolution Committee co-operated abroad with governments, financial authorities and central banks. This objective was achieved domestically, where Arion Bank is now responsible for domestic deposits and, abroad where According to the Disbursement Act, deposits received by the Bank or its branches are priority claims against the Bank. The Bank is thus under an obligation to repay these deposits prior to non-priority claims. Icelandic law does not affect the repayment of deposits received by subsidiaries

or their branches. Possible repayment of those deposits is the concern of the boards of directors or administrators of the relevant subsidiaries.

*Ensuring cash flow in all currencies both domestically and to/from foreign jurisdictions.* The difficulties that were experienced with payments to and from Iceland were primarily due to the actions of foreign governments and foreign currency restrictions imposed by the ICB. Efficient movement of capital was vital for the Icelandic economy. These difficulties were resolved in part with the Transfer Decision.

*Ensuring expertise and knowledge by hiring key employees.* One of the main tasks of the Resolution Committee is to safeguard the value of Kaupthing assets until they have been transferred to creditors. In order to achieve this aim, there must be sufficient expertise in place to manage the assets and provide the necessary services. This objective was achieved through the appointment of several qualified full-time and part-time employees. Around 65 employees now work for the Resolution Committee, supported by an external advisory service as needed to ensure expertise in every case.

*Finalizing the Bank's balance sheet.* The aggregate balance sheet has been divided between the Bank and Arion Bank as at 22 October 2008. Separate balance sheets for the Bank and Arion Bank had to be prepared. Financial disclosure and financial information is an ongoing process, financial information for the Bank as of 30 June 2009 and 30 December 2008 can be seen in chapter 4 *Financial analysis*.

*Preserving the interests of creditors.* The Resolution Committee has focused on protecting the assets of the Bank and preserving value for creditors. Creditors have been informed of developments via the Bank's website, creditor contact address and press releases. This objective is an ongoing task and will not be fully attained until a permanent solution for the assets, satisfactory to the creditors of the Bank has been identified and executed.

### **3.3 Main tasks of the Resolution Committee today**

The Resolution Committee is responsible for the Bank's daily operations and holds a number of organized meetings every week. When formal meetings are held, the presence of all members of the committee is required. Currently the work of the Resolution Committee is subject to the supervision of the Moratorium Supervisor. The most significant projects of the Resolution Committee are as follows:

*Protection of creditors' interests.* The main task of the Resolution Committee is to protect the interests of the Bank's creditors. From discussions with various creditors early in the process, the Resolution Committee learned that creditors were concerned about the immediate sale of assets. The strategy of protecting the assets and maximize values; was adopted in the beginning in line with creditors' feedback.

*Communication with creditors.* The Bank endeavours to maintain good and effective relations with its creditors. In October 2008, Deloitte UK was engaged by the Resolution Committee to facilitate and advice on creditor relations. Early in January 2009, Deloitte's appointment was terminated and the Resolution Committee assumed responsibility for all communication and consultation with creditors. To facilitate communication with creditors all over the world, the Bank's website, [www.kaupthing.com](http://www.kaupthing.com) has been developed into an information centre for creditors. The website is updated frequently and invites creditors to ask questions via a specific email address, [creditorcontact@kaupthing.com](mailto:creditorcontact@kaupthing.com). Every effort is made to respond to questions or comments in a timely manner or when relevant information becomes available.

Shortly after Deloitte's appointment, a committee, the Informal Creditors Committee ("ICC") was formed and is composed of representatives of the Bank's largest creditors. Although this committee does not have formal powers or duties under Icelandic law, it is consultative in nature. Indeed the Resolution

Committee has engaged in discussions with the ICC with respect to, among other things, the protection, maximization and realization of the Bank's assets, and restructuring proposals aimed at making distributions to creditors of the Bank. The Resolution Committee meets with the ICC and holds conference calls with the committee on a regular basis.

*Internal audit.* In October 2008, the Bank's Resolution Committee, at the request of the FME, engaged the international accounting firm Pricewaterhouse Coopers ("PwC") to investigate whether the Bank or parties connected to it, had in the weeks before the collapse of the Bank deviated from its internal rules or violated the rules governing the activities of financial undertakings, the securities transactions act or the general penal code. A detailed report was submitted to the FME at the end of the year 2008 and it has already become the basis for further investigations. The Winding-up Committee is also looking into this matter and discussion in that regard can be found in subchapter 6.6 *The Winding-up Committee*.

The Resolution Committee has formed a sub-committee, the Inspection Committee, to identify and review certain transactions. The Inspection Committee prepares and commences legal proceedings against parties that might be in debt to the Bank due to those transactions, or are alternatively responsible for potential loss of the Bank resulting from the transactions. The aim of the Resolution Committee is, in other words, to realise all possible claims which the Bank might have against third parties in relation to the specific transactions mentioned above, including claims arising from possible or alleged wrongdoing by the former management of the Bank or third parties.

Furthermore, the Resolution Committee has decided that the aforementioned sub-committee shall be responsible for all correspondence and communication with the Special Investigation Commission ("SIC"), operating under the provision of Act No. 142/2008, the FME and the Special Prosecutor, operating under the provision of Act No. 135/2008.

This sub-committee is currently working on several projects with external experts, both domestic and foreign, e.g. a forensic team in London, external legal counsel, external auditors and other appointed consultants. The primary objective of these projects is to retrieve assets if and where appropriate.

*Closing derivative contracts and evaluating netting effects.* The Resolution Committee is working towards closing all derivative agreements and is evaluating any netting effects. Team of experts within the Bank is analysing the Bank's position on a counterparty by counterparty basis across all relevant financial instruments and a Set-off and Netting Committee has been established to review and conclude each case. The Bank has been reviewing and closing derivatives at their maturity dates or earlier upon client's requests, in accordance with the underlying agreements, terms and market conventions. Only derivatives which are in-the-money for the Bank have been settled. Other derivatives are netted in accordance with the agreement terms. Derivatives which are out-of-the-money represent unsecured senior claims against the Bank and have therefore not been settled. The Bank has reviewed several cases where set-off has been requested. The estimated size and impact of set-off and netting is still very uncertain.

The current preliminary estimated set-off effects is in total up to ISK 100bn on the face value of both the respective assets and the respective liabilities. The exact amounts on the assets and liabilities side may differ.

Collection procedures are currently being prepared in many cases. The Bank has started collection process in several cases where the underlying collateral is liquid assets, in particular cash and or securities.

*Prevent the provisional attachment of assets and facilitate the retrieval of the Bank's assets.* The Resolution Committee is committed to protect the interests of creditors by preventing litigations, the

provisional attachment or freezing orders on assets. In the European Economic Area the Bank seeks recognition of the moratorium on a case-by-case basis on grounds of the EU Winding-Up Directive No. 2001/24/EC. The Bank has also been granted an injunctive relief and the moratorium recognized as a foreign main proceeding under Chapter 15 of the United States Bankruptcy Code. This has provided the Bank with protection for its assets in the United States. The Resolution Committee has also facilitated the release of assets through negotiations with local authorities or private parties in several countries.

*Collecting claims and enforcing securities.* The Bank continues to enforce rights against its debtors in case of non-performance of obligations. That includes enforcing pledges and other securities, taking control of relevant entities etc.

*Review unusual transactions.* The Resolution Committee continues to review any unusual or irregular transactions which are brought to its attention and concern the Bank. Any transactions which merit further reviewing will be given appropriate attention and handled accordingly.

*Finding solutions for the Bank's main branches and subsidiaries.* The Resolution Committee has conducted a substantial amount of work abroad to: i) secure the future business of entities, ii) restructure and sell off entities, iii) close down entities. Furthermore, members of the Resolution Committee or representatives have been nominated by the committee to replace former representatives of the Bank in subsidiaries which can still be effectively controlled by the Bank.

*Policy formulation regarding the restructuring of the Bank.* The Resolution Committee is focused on finding the best possible closure for all relevant parties in a realistic time frame and distributing the resulting value to creditors.

The next two subchapters below discuss the current status of each of the Bank's subsidiaries and branches.

### 3.4 Current status of the Bank's subsidiaries

Foreign subsidiaries of the Bank and their branches are directly responsible for the deposits made with them. These entities are not governed by Icelandic law. The rights of depositors regarding deposits made with a subsidiary of the Bank or branch of a subsidiary will be determined by the law and regulations applicable to that entity.

The table below summarizes the status of subsidiaries of the Bank.

Name of subsidiary	Current status
FIH	Operational and owned by the Bank
Norvestia	Operational and partly owned by the Bank
Kaupthing Bank Sweden	Partially sold and its remainder wound down and assets transferred to the Bank
KSF	In administration
Kaupthing Singer & Friedlander (Isle of Man) Ltd.	In liquidation
Kaupthing Bank Luxembourg (KT Lux)	Dissolved
Kaupthing New York Inc.	Dissolved
Kaupthing Kabushiki Kaisha (Japan)	Has been wound down
Kaupthing (Hong Kong) Limited	In liquidation

More details on the subsidiaries are provided below.

*FIH* is a subsidiary wholly owned by the Bank. It is a Danish full service corporate & investment bank specializing in lending to Danish companies. The entity was acquired by the Bank in 2004. The entity is operational and is no longer in the process of being sold. The Bank remains the sole shareholder of *FIH* and two representatives of the Resolution Committee are board members. The ICB holds the entity's shares of the Bank as pledge against a EUR 500m loan. The board of directors of *FIH* has adopted a plan to adjust and focus *FIH*'s future activities to meet the current market situation of the financial sector. As part of this adjustment, *FIH* has closed down the equities trading, research and wealth management department. These business areas were not expected to contribute positively to *FIH*'s earnings on a short-term or a medium-term basis. In the future, *FIH* will focus on the core business areas: loans to corporate customers supplemented by two advisory units: Corporate Finance (*FIH* Partners) and Financial Solutions (advisory related to strategic risk management and liability management). The Resolution Committee believes *FIH* is a strong bank and that selling it at this point in time does not align with the interests of the Bank.

Further information on this entity can be found at [www.fih.dk](http://www.fih.dk).

*Norvestia Oyj* is a Finnish publicly listed Investment Company. The Bank owns approx. 32% of the outstanding shares and holds 56% of the voting rights. The Resolution Committee has two representatives on the board. Initially, the Resolution Committee received offers for the Bank's shares in *Norvestia* which were about 40% lower than the net asset value. The Resolution Committee concluded that the offered price was unacceptable and decided to hold on to the shares. Since then, the Bank has received EUR 1.25m dividend payment and the share price has risen about 30%. Furthermore, the Resolution Committee has received more feasible offers, indicating that the value of the Bank's stake has increased by approx. EUR 25m. [As for all other assets, Norvestia is monitored on a constant basis regarding further valuation upside and monetization options.](#)

*Kaupthing Bank Sweden* was a subsidiary wholly owned by the Bank, through *Kaupthing Sweden AB*. Following the opening of a Stockholm branch in September 2000, the Bank acquired both the Swedish securities firm *Aragon* and *JP Nordiska Bank* in 2002. Those acquisitions became the foundation for the Swedish operation, which grew organically in the years to follow. *Kaupthing Bank Sweden* offered integrated financial services to institutional investors, companies and (high net worth) individuals. These services included corporate banking, investment banking, capital markets services, asset management and comprehensive wealth management for private banking clients.

After 9 October 2008, the Resolution Committee managed to keep the entity operational with support from the Swedish government. Without the Resolution Committee's co-operation with *Riksbanken*, the Swedish Central Bank, and the Swedish Financial Authorities (*Finansinspektionen*), the entity would most likely have been closed down and the assets sold at a fire sale to cover the liabilities. Instead the Resolution Committee managed to dispose of certain assets after a structured sales process while other assets were transferred to the Bank.

Shortly after the fall of the Bank, *Kaupthing Pension Consulting* and *Kaupthing Finans AB* were sold as these business lines did not constitute a core business for *Kaupthing Sweden* and the latter would have required continued financial support. At the end of March, the Resolution Committee closed a transaction with *Ålandsbanken Abp* where the latter acquired the private banking, capital markets and asset management assets of *Kaupthing Bank Sweden*. The private banking, asset management and capital markets businesses had substantial funding needs in 2009 which did not align well with the current status of the Bank.

The Resolution Committee believes that the transaction with *Ålandsbanken Abp* constitutes a good deal for the Bank as the sale price was reasonable and enabled *Kaupthing Bank Sweden* to pay 100% of subordinated loans to the Bank of some SEK 6bn (through transfer of assets worth SEK 6bn) and around 50% of its equity. This transaction also freed up cash for the Bank since *Riksbanken* returned to the Bank EUR 170m it had pledged, plus Icelandic government bonds and bonds issued by the Icelandic Housing Financing Fund of ISK 9.5bn.

The corporate loan portfolio and some other loans and equity positions have been moved to the Bank as a payment for the subordinated loan and are now under management by the Nordic asset management team of the Banks. These assets fit well with the other asset pools the Bank is currently managing. This portfolio accounted for the majority of the Swedish corporate banking assets of the Bank.

Deposits held by *Kaupthing Sweden* have been repaid to depositors. The repayment was originally funded with a loan from *Riksbanken*, the Swedish Central Bank but the above mentioned sale to *Ålandsbanken* allowed for immediate repayment of the facility. This facility was put in place in early October last year by *Riksbanken* in order for *Kaupthing Bank Sweden* to be able to pay back all deposits. *Riksbanken* was very co-operative but a repayment was required at the earliest convenience.

If the entity had not been sold, there is a substantial risk that only the deposits which had already been paid and perhaps the Riksbanken's facility could be repaid. However, this solution enabled the Bank to settle the Riksbanken facility as well as retrieving a sizable loan portfolio. In case of a bankruptcy of the entity, the recovery of the subordinated loan had presumably been very low, there would have been uncertainty over how much the Bank had retrieved from the Swedish Central Bank and the equity would have been worthless. The result of the transaction is therefore that assets of approx. EUR 800m at nominal value were retrieved.

Further information on this entity can be found at [www.kaupthing.se](http://www.kaupthing.se).

KSF was a wholly owned subsidiary of the Bank, acquired in 2005. It was an established bank in the UK offering integrated financial services to companies, institutional investors and individuals. These services included corporate banking, investment banking, treasury services, and comprehensive wealth management services for private banking clients.

On 8 October 2008, KSF was taken into administration and Maggie Mills, Tom Burton, Alan Bloom and Patrick Brazzill of Ernst & Young, UK, were appointed as administrators. Kaupthing EDGE UK was transferred by the UK Treasury to ING Group and later the same day, the entity was put into administration on the application of the FSA.

Further information on this entity can be found on the liquidators' website [www.kaupthingsingers.co.uk](http://www.kaupthingsingers.co.uk).

*Kaupthing Singer & Friedlander (Isle of Man) Limited* was a wholly owned subsidiary of the Bank. The entity carried out traditional banking activities as well as asset management activities for a broad spectrum of corporate and private customers along.

At a hearing in the Isle of Man High Court on Wednesday 27 May 2009, a Winding-up Order was made placing the Company into liquidation. Michael Simpson of PricewaterhouseCoopers and Peter Spratt of PricewaterhouseCoopers (London) were appointed as joint provisional liquidators of the entity and Joint Deemed Official Receiver at that time.

Further information on this entity can be found on the administrators' website [www.kaupthingsingers.co.im](http://www.kaupthingsingers.co.im).

*Kaupthing Bank Luxembourg S.A.* ("KT Lux") was a wholly owned subsidiary of the Bank. *Kaupthing Bank Belgium* and *Kaupthing Bank Luxembourg, Geneva Branch* were branches of KT Lux. The main services offered at KT Lux were private banking and wealth management. On 9 October 2008, KT Lux's board of directors applied for a suspension of payments status with the Luxembourg District Court sitting in commercial matters. KT Lux was granted this status and its management was monitored by administrators. The Court appointed PriceWaterhouseCoopers Luxembourg, represented by Mrs Emmanuelle Caruel-Henniaux and Mr Franz Fayot, to act as KT Lux's administrators. This decision also applied to the Belgian branch of KT Lux.

KT Lux together with its management designed a restructuring plan approved by its creditors and the Luxembourg District Court. The plan involved a corporate restructuring of KT Lux, resulting in dividing it up. As of 13 July 2009 the banking operations were transferred to Banque Havilland S.A., a newly-created Luxembourg company which provides private banking service. Furthermore, some of KT Lux assets and liabilities were moved to a securitisation company called Pillar Securitisation S.à r.l. Due to this division, KT Lux was dissolved without being liquidated and the administration period is therefore over.

Further information on this entity can be found on the website [www.kaupthing.lu](http://www.kaupthing.lu).

*Kaupthing New York Inc* was a wholly owned subsidiary of the Bank established in 2000. The entity focused on securities brokerage and investment banking. The entity, as well as two other subsidiaries of the Bank in the United States, has been dissolved.

*Kaupthing Kabushiki Kaisha (Japan)* has been wound down without the need for any insolvency proceeding.

*Kaupthing (Hong Kong) Limited* is in insolvent liquidation.

**3.5 Current status of the Bank's branches**

According to the Disbursement Act, deposits made by private individuals and companies are priority claims. Whether the legislation applies to depositors depends on which entity in the Kaupthing Group they were deposited with. The legislation only applies to Icelandic financial undertakings. The Resolution Committee of the Bank anticipates that the Bank will be able to pay back its deposits which have been defined as priority claims, made at the parent company and in branches belonging to the parent company.

The table below summarizes the status of some of the branches of the Bank.

Name of branch	Current status
Kaupthing EDGE Austria	Has been wound down and is in the process of being deregistered
Kaupthing Bank Finland	Has been wound down and assets transferred to the Bank
Kaupthing EDGE Germany	Is being wound down and has been deregistered
Kaupthing Bank Norway	Under administration and assets transferred to the Bank
Kaupthing Bank Sweden	Is being wound down and has been deregistered
Kaupthing Bank Dubai and Qatar	Has been wound down and is in the process of being deregistered

Furthermore, the Bank had branches in Italy, France, the United Kingdom, the Netherlands, Spain and the Faroe Islands. These branches were not conducting banking operation in October 2008 and what limited functions they had at that time have since been wound down in all material respects.

More details on the branches listed in the table above are provided below.

*Kaupthing EDGE Austria* was a branch of the Bank. It was established in 2008 and offered competitive solutions for depositors. Depositors have now been paid back. The entity has been wound down and is in the process of being deregistered.

*Kaupthing Bank Finland* was a branch of the Bank. The branch offered a wide range of investment banking services to companies, institutions and wealthy private individuals. Following the appointment of the Resolution Committee the Finnish FSA took charge of the branch on 9 October 2008.

A few days after 9 October 2008, the Resolution Committee managed to prevent the entity from going into administration along with the associated potential fire sale of assets to protect the asset base of the Bank. In co-operation with the Finnish authorities, the Resolution Committee negotiated loans to the entity with three commercial banks in Finland which were guaranteed in part by the Finnish authorities. This enabled the entity to repay deposits in the branch. The credit portfolio and certain other assets of *Kaupthing Bank Finland* were pledged against these loans. There was a pressure to sell assets to repay the loans from the local banks and the Bank's local operations were disrupted and proactive management of assets suffered. The asset management operation was sold as well as a part of the loan portfolio. The remaining part of the loan portfolio has been transferred to the Bank and is now managed by specialists in the asset management team. The branch was closed down at the end of January. Had the entity ended up in administration, the assets of the entity would have been sold in order to pay back depositors and it is unlikely that any assets would have been transferred to the Bank in Iceland. Therefore, the Resolution Committee believes that this was the best solution for the Bank as it prevented potential fire sale of assets and instead, assets of approx. EUR 107m at nominal value were transferred and consolidated on the balance sheet in Iceland.

*Kaupthing EDGE Germany* was a branch of the Bank. It was established in 2008 and offered competitive solutions for depositors. The operation was seized by the German government, and its assets frozen by the German Financial Regulatory Authority, BaFin. On 22 June 2009 the BaFin lifted its freeze on the assets of the Bank.

Since last year, the Bank has worked hard in co-operation with the German authorities to develop a solution which fully ensured the secure repayment of deposits to the Bank's customers.

DZ Bank AG, which was appointed as the payment agent for the entity's customers, seized EUR 55m, which in the opinion of the Bank should have been used to reimburse the entity's depositors. Litigations on this matter are ongoing.

In mid-April, the Bank announced that it had secured sufficient funds to reimburse all Edge deposits in Germany. In mid-May the Bank was ready to start the repayment process and sent letters to more than 34,000 depositors.

On 22 June, the repayment process commenced and is now completed. Repayments to Edge depositors in Germany amounted to approx. EUR 322m.

The full principal of the deposits was paid. Depositors who intend to file a claim for interests are able to do so as the formal process of filing claims has begun. Further information on the process of filing claims can be found on the Bank's website, [www.kaupthing.com](http://www.kaupthing.com).

*Kaupthing Bank* has now repaid all deposits made at foreign branches belonging to the Bank which are defined by Icelandic law as priority claims.

*Kaupthing Bank Norway* was a branch of the Bank. *Kaupthing* entered the market in Norway in 2003, when the Bank acquired Tyren Holding AS, an asset management company. The branch provided comprehensive financial services including asset management, in a separate entity, and private banking to wealthy private individuals, investment banking and capital markets services to companies, institutional investors and private clients. In addition, it had started to provide their clients with banking services, adding retail banking and corporate banking to its range of services.

On 11 October 2008, the Norwegian government placed a freezing order on the assets of the entity and related companies and placed the operation of the branch under administration. In co-operation with the Norwegian government, the Resolution Committee managed to prevent the immediate sale of assets from the entity, including the Bank's position in Storebrand, which would have been done to pay back depositors. Instead, the deposits held by the branch were repaid to depositors by the Norwegian Banks' Guarantee Fund. In February, the Resolution Committee and the administrators in Norway reached an amicable agreement which included release of the assets which were under administration in Norway. As a result, the majority of the corporate loan portfolio has been transferred to the Bank in Iceland and other assets saved from imminent fire sale. This agreement also prevented lengthy and very costly process of dealing with the administrators and netting the entity. If the Resolution Committee had not managed to prevent the immediate sale of assets from the entity, the entity had presumably only been able to pay back part of the deposits and no assets would have been left to be transferred to the parent company. The result is that imminent fire sale of assets was prevented which resulted in retrieval of assets of approx. EUR 365m at nominal value.

*Kaupthing Bank Sweden* was a branch of the Bank in Sweden. It held the EDGE deposits in Sweden which have been repaid as described above in the clause on the Swedish subsidiary. The branch is in the process of being wound down and has been deregistered.

*Kaupthing Bank Dubai and Qatar* was two branches of the Bank, one in the Dubai International Financial Centre and one in the Qatar Financial Centre, both established in 2007. The branches focussed on providing investment banking services in the region. The ongoing operations of the branches have been sold to the Bank's previous management in Dubai and Qatar. The proceeds from the sale are held by the Bank.

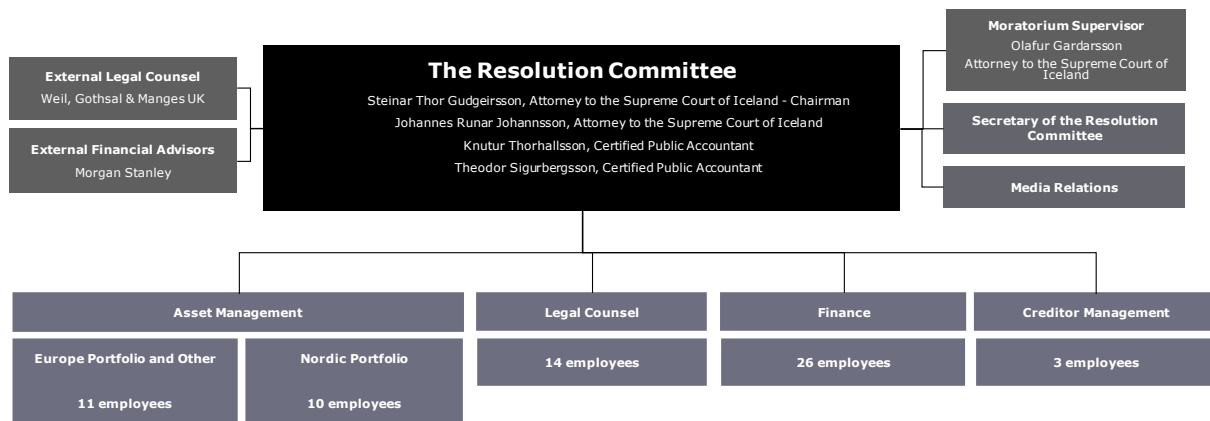
### **3.6 Current organizational structure of the Bank**

The Resolution Committee shares the creditors' desire to maximize the value of the Bank's estate and recognizes that this may take a significant period of time to achieve. As previously discussed, one of the Resolution Committee's main aims is to safeguard the value of the Bank's assets until they are transferred to the creditors in whatever form. In order to achieve this goal, the Resolution Committee must possess the requisite expertise to manage the assets and to provide the necessary services. Therefore the Resolution Committee has hired experts in various fields to manage the Bank's assets, which include the loan portfolio, bonds, shares, and foreign subsidiaries and branches.

The analysis of the tasks of the Resolution Committee, outlined in subchapter 3.3 *Main tasks of the Resolution Committee today*, was the first step towards making the work of the Resolution Committee and the Bank more efficient. The Resolution Committee's next step in this process was to hire experts with the requisite knowledge of the tasks of the Resolution Committee and asset management.

The Bank operates, today, as an asset management company where long-term goals are the key factor. It is clear from the discussions the Resolution Committee has had with several creditors that the main focus for creditors is for them to recover as much of their claims as possible, but the time frame for getting reimbursed is more flexible.

As stated above, the Resolution Committee has hired skilled employees specialized in the fields in which the Bank most needs them. Four divisions have been created which report to the Resolution Committee and each division has a managing director responsible for the operation of that division.



### **Asset management**

The role of the unit is to develop the Bank's asset pool of loans and securities with the ultimate goal of securing maximum recovery from these assets. This is amongst other done by pro-active management of every asset, maintaining a cash flow plan for the Bank's loan portfolio which is updated regularly; by assessing the capital requirements of the asset portfolio and the Bank's capacity to meet this. The Bank's loan to customers' portfolio consists of more than 113 borrower groups and the total outstanding notional is around ISK 440bn at fair value as at 30 June 2009.

There are 21 employees in this division, most of whom are very experienced in the investment & corporate banking field with up to 17 years experience in the industry from international reputable financial institutions. In this team, the Bank has hired specialists with a diversified background and experience both domestically and internationally, across corporate finance, corporate banking, private equity, leverage finance, operational and capital restructuring and workouts supported with a team of legal specialists with extensive experience across all legal aspects of banking transactions. Some members of staff have worked on both sides of the fence, that is whilst employees or managers of respective businesses and also from the banking side.

The specialists in the asset management division lead the projects internally and the process is supported by an external advisory service as needed. Tasks where the asset management has engaged with external advisers include corporate finance advisory, due diligence reports, business verification, tax planning and appraisal and valuation.

The objective of the division is to maintain and support the Bank's asset portfolio, increase the value of the asset portfolio and prevent a "fire sale" of assets. It is expected that the asset portfolio will be self-financing and instalments and interest payments on the loans will be sufficient to support other assets if needed. Furthermore, it is expected that in the current environment fees generated from the loan portfolio will cover the costs of running the asset management division.

### **Legal counsel**

The legal counsel division provides support and legal advice to the Resolution Committee and all the divisions within the Bank as needed. There are several legal experts in this division with extensive knowledge in financial legislations, the Icelandic bankruptcy legislation and the legal aspects of netting and set-off. The division also supervises the hiring of outside legal experts, both in Iceland and abroad, and the work they provide and is expected to have the requisite expertise on legal aspects of all agreements and related documents. The division also has an overview of all legal agreements and the services provided and costs incurred by external legal advice.

## **Finance**

The division is responsible for executing all aspects of the Bank's finances according to guidelines provided by the Finance Committee which is a sub-committee of the Resolution Committee. The finance division is broken into four sub-divisions:

*Accounting and Reporting* which is responsible for all accounting procedures. The unit prepares financial statements which are issued in the Creditors' Report semi-annually as well as other reports more frequently for internal purposes.

*Portfolio management* is responsible for monitoring and analysing the loan and securities portfolios in addition to managing the Bank's cash reserves. The unit provides extensive support to the asset management team. This entails tasks like loan administrative matters, collateral analysis, covenant monitoring, cash flow projections, credit risk analysis, internal and external reporting etc.

*Operations* which is responsible for day-to-day operations, records management, and human resource matters.

*Derivatives* which is responsible for valuations of outstanding unsettled derivative trades and management of open trades. In addition, the unit is responsible for the preparation of settlement notices to counterparties and other back office functions in relation to the settlement of the derivatives book.

## **Creditor management**

Creditor management is responsible for relations with creditors. The team manages the relationship with Morgan Stanley, the Bank's financial advisor and provides them with the necessary support. The team also organizes and prepares meetings, conference calls and memos to the ICC and other creditors when needed. In addition, the team maintains the online information centre for creditors, [www.kaupthing.com](http://www.kaupthing.com).

## **Internal committees**

To further strengthen the infrastructure and the operations of the Bank, several working committees have been established. These committees have at least weekly meetings and work within formal guidelines to resolve the tasks at hand.

The *Asset Committee* has the role of both credit committee and investment committee in a traditional financial institution. It comprises two members of the Resolution Committee and three MDs of the Asset Management team. Cases related to the assets of the Bank are presented with memos by the employees responsible and can range from a simple waiver request to a request for disposal of assets. If the Asset Committee wishes to approve a drawdown request or a request for disposal of assets, the case is referred to the Resolution Committee which makes the final decision to approve or decline the request.

The *Finance Committee* is responsible for the Bank's finances. Its main role is to formulate the finance division's strategy in terms of book-keeping and accounting procedures. The committee is responsible for all financial disclosure both externally and internally to the Resolution Committee and its sub-committees. The Finance Committee defines which guidelines the Bank adheres to, both with respect to accounting rules and international standards and internal work procedures. The committee develops and oversees the execution of budgetary plans. The committee is responsible for liquidity management of cash and cash equivalents.

The *Inspection Committee* has the role of reviewing transactions, identified by the Resolution Committee, and to prepare and commence legal proceedings against parties that might be in debt to the Bank due to those transactions, or are alternatively responsible for potential loss of the Bank resulting

from the transactions. The aim is, in other words, to realise all possible claims which the Bank might have against third parties in relation to the specific transactions mentioned above, including claims arising from unusual action by the former management of the Bank or third parties. This committee is also responsible for all correspondence and communication with the Special Investigation Commission ("SIC"), operating under the provision of Act No. 142/2008, the FME and the Special Prosecutor, operating under the provision of Act No. 135/2008.

The *Set-off and Netting Committee* is responsible for preparation of netting and set-off cases, collection of claims deriving from derivative contracts and related matters. The Set-off and Netting Committee consists of one member from the Resolution Committee, one member from the Winding-Up Committee and one employee from Kaupthing. The committee was originally established in February but was re-established in the beginning of June following the appointment of the Winding-up Committee. The participation of the Winding-up Committee is needed for the set off process, as its current role is to evaluate all claims brought against the Bank, including claims that might be used for set-off. The collection process of derivatives claims is ongoing but no actual set-off has been executed. It is difficult to evaluate the number of set-off cases since such cases might come up in the process of creditors filing their claims.

### **3.7 Current status on legal proceedings**

The Bank is currently in several litigation proceedings, including in the following matters:

- The Resolution Committee has successfully opposed litigation threats and or freezing orders in the United States, Luxembourg, the Netherlands, Spain, Finland the United Kingdom and Austria.
- The District Court of Reykjavik has ruled in favour of the Bank in its case against Oscatello Investments Limited because of about GBP 650m liability on an overdraft facility agreement. Two members from the Resolution Committee have now been appointed as board members in the board of Oscatello Investments Limited and also in a number of subsidiaries. The Bank has enforced securities it held as collateral, e.g. in shares in Oscatello Investments Limited.
- The Bank is in litigation because of a swap agreement which was in place with BTMU when the FME appointed the Resolution Committee to take control of the Bank in accordance with the Disbursement Act.
- Litigations are ongoing in Germany in regard to DZ Bank AG. The litigations involve disputes over freezing of assets and what the Bank considers to be unlawful set-off by DZ Bank AG.
- Exista and the Bank are in dispute regarding a valuation of a cross currency swap transaction between the two parties. Exista wants to use a different exchange rate to the normal benchmark used in similar circumstances, the official exchange rate of the Central Bank of Iceland, and wish to use the exchange rate given by the European Central Bank. The Bank has firmly rejected to use any other exchange rate as this is explicitly provided for in Act no. 36/2001 on the Central Bank of Iceland. The Bank and Exista have agreed to solve their case before the Icelandic Courts and legal proceedings have already been initiated.

On 20 October 2009, the High Court of England handed down its decision on the judicial review of the legitimacy of the decision taken by the UK Treasury to transfer assets and deposits from Kaupthing Edge accounts at Kaupthing Singer and Friedlander (KSF) in October 2008.

By its application for judicial review, the Bank claimed that the UK Treasury had exceeded its powers. It was Kaupthing's case that the Transfer Order had been made for the purpose of protecting KSF's depositors in the UK rather than for maintaining the stability of the UK financial system as a whole.

In a preliminary ruling on 3 March 2009, Kaupthing was given permission to proceed with the application for judicial review, and, at that stage, the Court expressly recognised the importance of the case to the nation of Iceland as a whole.

The Court heard the main application on 10 July 2009, when evidence and arguments concerning the UK Treasury's intervention into the operations of KSF were presented.

The Court considered contemporaneous documents as well as witness statements submitted by the UK Treasury and the Bank. The Court concluded that, although the contemporaneous documents provided only an incomplete statement of the UK Treasury's reasoning process, it was satisfied that a proper process had been followed. The Court held that the UK Treasury had acted within its statutory powers and there had been no error in its decision-making process.

The Bank's Resolution Committee has since last autumn been of the opinion that it was necessary to let the Court judge whether or not the UK Treasury's actions were just and legal. The Resolution Committee has been informed of its decision that the UK Treasury's actions were deemed within its powers. The sole objective of this litigation was to bring all existing and available information to the surface so that the Committee would know on what grounds the UK Treasury based its actions. [This was achieved, and therefore, the Resolution Committee has decided not to pursue this matter further.](#)

### **3.8 Corporate communications and creditor relations**

In order to improve communications and relations with stakeholders and the general public the Resolution Committee has appointed Helga Bjork Eiriksdottir as Communications Manager. The role of the Communications Manager is to formulate a corporate communications policy, manage media relations and promote the function and activities of the Resolution Committee and the Bank in Iceland and abroad. The Resolution Committee regularly looks for ways to further improve its corporate communications function in order to educate and foster transparency in its activities.

As this report clearly shows, relations with creditors are regular and ongoing. Since 9 October 2008, several meetings have been held with creditors to discuss how things are progressing and to invite them to express their views. In addition, weekly conference calls are held with the ICC.

The website, [www.kaupthing.com](http://www.kaupthing.com), is a source where creditors, the media, authorities and other parties can access regular updated information about the Bank. Interested parties can send questions, read the latest announcements and updates and can keep abreast of the main developments since 9 October 2008. The website has been updated to include material relating to the Winding-up Committee, such as information on the Bank's claim registration process. Additionally, the content was re-organised in order to improve user access and to enable users to subscribe to news and updated material. The site was launched a year ago, in the beginning of October 2008, and since then there have been nearly 1,260,000 page views through 430,000 visits.

The aim is to update this report for creditors on monthly. To facilitate overview by frequent readers, the Bank provides a summary of the main updates in each report. Numerous questions are sent to [creditorcontact@kaupthing.com](mailto:creditorcontact@kaupthing.com) and [winding-up@kaupthing.com](mailto:winding-up@kaupthing.com) every day which the Bank aims to respond to as quickly as possible. Since November last year the Bank has responded to numerous queries.

It is the aim of the Resolution Committee to be as transparent as possible. Therefore, the Resolution Committee has gone well beyond its legal obligations in its efforts to inform creditors and others on the progress of its work and intends to continue to do so. To this end, the ICC was formed; the consultation process regarding Arion Bank capitalization and other parts of the Committee's information disclosure has been implemented.

## 4. Financial analysis

### 4.1 *Estimated valuation of the Bank's assets and liabilities*

#### **Statement of compliance**

The financial information in this subchapter has been prepared in accordance with Rules on the Financial Statements of credit institutions (834/2003) that concern valuation of assets and liabilities, taken into account the current moratorium status of the Bank. It does not include all of the information required for full annual Financial Statements according to the Rules. The financial information is presented in Icelandic krona ("ISK"), rounded to the nearest million.

The valuation of assets and liabilities as at 30 June 2009 and 31 December 2008 was prepared by the Resolution Committee for Kaupthing Bank hf., the parent company. It is neither audited nor reviewed by independent auditors but was prepared with assistance from PwC in Iceland. The Resolution Committee emphasizes that the valuation herein is a historic valuation only, and one which only takes into account the Bank's current strategy, to safeguard and increase the value of the Bank's assets achieved to 30 June 2009 and not thereafter. No attempts were made to assess the possible future value of assets, nor to estimate likely recovery of creditors' claims.

Whilst significant data is included in this report, creditors are cautioned against estimating the likely level of recoveries as material uncertainties exist regarding, inter alia, the level of realizations and eventual level of admitted claims.

The valuation of assets and liabilities does not take into account the impact of set-off. Set-off impact could clearly make a difference to overall creditor recoveries. Further information will be provided on this matter as it becomes available. Further information on set-off is provided in note 25.

A formal process for the creditors of the Bank to file claims against the Bank began on 30 June 2009 and will end on 30 December 2009. Until all claims have been filed, the real and accurate amount of liabilities and priority claims is uncertain. In accordance with Act no. 44/2009, all liabilities are fixed as at 22 April 2009.

Due to uncertainty in valuation of underlying collateral, potential deficiency claims resulting from insufficient collateral in secured funding agreements has not been accounted for herein.

As noted in this report's disclaimer the actual realisable value of the Bank's assets and liabilities may differ materially from the values set forth herein. Factors which may lead to material differences include:

- (a) Resolution of issues regarding the quantum of claims
- (b) Additional claims being made against the Bank
- (c) The realisation method(s) used over time
- (d) The impact of set off and netting including in connection with derivative contracts
- (e) Movements in currency exchange rates and interest rates
- (f) Prevailing market conditions when assets are sold

Readers' attention is also drawn to other terms of the disclaimer at the beginning and the end of this report.

## Valuation methodology

The valuation methodology for each asset class is abbreviated below .

Cash in hand .....	The balance of all cash accounts as at 30 June 2009 without any discount
Loans to credit institutions .....	Is valued at amortised cost. Estimated credit risk of the counterparty has been taken into account in provisions for losses.
Loans to customers at fair value ....	Loans to customers are valued at fair value. The fair value is based on market transactions where possible or recognised valuation techniques.  The values assigned reflect the market fluctuations in general by taking into account various loan indices with appropriate discounts for the Kaupthing portfolio due to lack of liquidity and the small-scale size of these exposures.  The valuation only takes into account the current strategy of the Resolution Committee, to safeguard and increase the value of the Bank's loans to customers portfolio achieved to 30 June 2009 and not thereafter.
Bonds and debt instruments .....	Listed: the market value as at 30 June 2009 Unlisted: similar valuation methodology was applied to this category as in 'Loans to customers at fair value'
Shares and instruments with variable income.....	Listed: the market value as at 30 June 2009 Unlisted: similar valuation methodology was applied to this category as in 'Loans to customers at fair value'
Derivatives and unpaid derivatives.....	The calculated amount of derivative assets and liabilities before provisions is based on the bank's own valuations, which may differ from the final settlement amounts. When determining the value of more complex derivatives and structured products, the Bank is using the services of a leading independent company which specializes in derivative valuations and risk management services. Derivative assets and liabilities with the same legal entity are netted.  Default valuation rules under the ISDA framework generally favour the non-defaulting counterparty which may result in adverse effect on the value of the derivatives assets and liabilities. Once ISDA derivative contracts have been terminated the non-defaulting counterparty must determine the net amounts owed by or to the defaulting counterparty. Close out notices providing details of such calculations enable the Bank to reconcile amounts. In some cases, either no close out statement has been received or has been inadequately detailed. Some provisions were made to the Bank's valuation of ISDA derivatives to account for potential disputes in valuation. For Non-ISDA counterparties, a significant valuation adjustment was made on derivative assets to account for credit, liquidity and collateral risk associated with each counterparty.
Investments in subsidiaries .....	The book value of subsidiaries is an estimated fair value as at 30 June 2009
Borrowings .....	The book value of borrowings is at notional amount and accrued interests at 22 April 2009. Interests accruing after this date are included with subordinated liabilities.

# Balance Sheet

## as at 30 June 2009

	Notes	30.6.2009	31.12.2008
<b>Assets</b>			
Cash in hand .....	1	98.799	77.963
Loans to credit institutions .....	2-3	442.923	522.714
Loans to customers at fair value .....	4-8	439.521	337.023
Bonds and debt instruments .....	9-10	119.064	115.931
Shares and instruments w ith variable income .....	11-12	214.600	161.851
Derivatives and unpaid derivatives .....	13-14	246.073	233.862
Investments in subsidiaries .....	15	135.562	129.464
Other assets .....	16	9.102	13.361
<b>Total Assets</b>	1-16	<u>1.705.644</u>	<u>1.592.169</u>
<b>Liabilities</b>			
Due to credit institutions .....	17	151.808	173.892
Deposits .....	18	2.140	54.775
Derivatives and unpaid derivatives .....	19-20	136.296	138.751
Borrow ings .....	21	3.237.006	3.091.636
Liability to New Kaupthing Bank hf. in return of assets and liabilities transferred .....	22	43.335	41.027
Other liabilities .....	23	108.302	125.177
<b>Total Senior Liabilities</b>	17-23	<u>3.678.887</u>	<u>3.625.258</u>
Subordinated loans .....		422.624	400.677
Interest expense from 22.4.2009-30.6.2009 .....		27.804	-
<b>Total Subordinated Liabilities</b>		<u>450.428</u>	<u>400.677</u>
<b>Equity</b>			
Share capital .....		7.270	7.270
Share premium .....		136.471	136.471
Retained earnings .....		<u>(2.567.412)</u>	<u>(2.577.507)</u>
<b>Total Equity</b>		<u>(2.423.671)</u>	<u>(2.433.766)</u>
<b>Total Liabilities and Equity</b>		<u>1.705.644</u>	<u>1.592.169</u>
Other information .....	24-25		

## Notes to the Balance sheet

### Cash in hand

1. According to FME's transfer decision from 21 October 2008, all cash balances were transferred to Arion bank, resulting in the Bank's cash balances being wiped out. The primary drivers behind positive cash position at year end are proceeds from 'Loans to Credit Institutions' (principal repayments and interest payments) of ISK 38.808 million and 'Loans to customers at fair value' (principal repayments and interest payments) of ISK 26.052 million.

The increase from 31 December 2008 in recorded book value of cash in hand as at 30 June 2009 is driven by proceeds from the sale of the Bank's subsidiary in Sweden of ISK 27.647 million and 'Loans to customers at fair value' (principal repayments and interest payments) of ISK 36.323 million less repayments to Kaupthing Edge Germany depositors of ISK 57.368 million.

### Loans to credit institutions

	30.6.2009		31.12.2008	
	Unpledged	Pledged	Total	Total
2. Loans to credit institutions specified by types of loans:				
Bank accounts .....	21.334	281.785	303.119	354.775
Overdrafts .....	12	-	12	12
Subordinated loans to subsidiaries .....	17.911	118.239	136.150	133.528
Loans at fair value .....	-	-	-	29.578
Other loans .....	9.950	-	9.950	13.647
Provision for losses .....	(6.308)	-	(6.308)	(8.826)
<b>Loans to credit institutions</b> .....	<b>42.899</b>	<b>400.024</b>	<b>442.923</b>	<b>522.714</b>

All unpledged bank accounts are currently frozen. The Bank is currently attempting to retrieve these bank accounts. The pledged bank accounts represent collateral posted under derivative trades and repurchase agreements.

In a report dated 15 November 2008 loans from and to credit institutions were netted in 'Loans to credit institutions'. At 31 December 2008 ISK 173.892 million are reclassified to 'Due to credit institutions'.

Of subordinated loans to subsidiaries, the pledged position is a loan to Kaupthing Mortgage Fund.

Loans at fair value loans to credit institutions 31.12.2008 are subordinated claims against Kaupthing Sverige AB. Following the sale of Kaupthing Bank Sverige on 14 of February 2009, an agreement was reached in which Kaupthing bank Sverige AB were to transfer a portfolio of loans, with book value of SEK 4,5 billion, to Kaupthing hf. to meet the claims. Estimated fair value of the underlying loan portfolio was ISK 29.578 million in 31.12.2008. This loan portfolio is included in loans to customers at fair value 30.6.2009.

	30.6.2009		31.12.2008	
	Unpledged	Pledged	Total	Total
3. Loans to credit institutions specified by counterparties:				
Domestic .....	1.117	696	1.813	2.135
Foreign .....	23.360	252.266	275.626	308.675
Subsidiaries and subsidiaries taken into administration .....	18.422	147.062	165.484	211.904
<b>Loans to credit institutions</b> .....	<b>42.899</b>	<b>400.024</b>	<b>442.923</b>	<b>522.714</b>

Collateral posted against derivative trades is included in the pledged positions as can be seen in note 20.

### Loans to customers at fair value

4. Loans to customers at fair value are also shown at carrying value, i.e. notional value including accrued interests:

This specification includes pledged positions.

	30.6.2009		31.12.2008	
	Carrying value	Fair value	Carrying value	Fair value
<b>Loans to customers</b> .....	<b>1.363.696</b>	<b>439.521</b>	<b>1.184.829</b>	<b>337.023</b>

The loan portfolio which was transferred from Kaupthing bank Sverige AB is included in 'Loans to customers at fair value' as at 30 June 2009.

Principal repayments and interest payments proceeds from the loans to customers portfolio in H1 2009 amounted to ISK 36.323 million.

5. Loans to customers at carrying value specified by sectors:

This specification includes pledged positions.

	30.6.2009	31.12.2008
	Carrying value	Carrying value
Individuals .....	175.738	139.598
Industry .....	220.588	189.632
Real estate .....	184.631	149.062
Service .....	167.864	97.087
Trade .....	110.845	113.156
Holding companies .....	504.030	496.294
<b>Loans to customers at carrying value</b> .....	<b>1.363.696</b>	<b>1.184.829</b>

6. Loans to customers at carrying value specified by geographical region:

This specification includes pledged positions.	30.6.2009	31.12.2008
	Carrying value	Carrying value
UK* .....	744.624	711.729
Iceland .....	139.804	114.626
Scandinavia .....	246.255	168.354
Other .....	233.013	190.120
<b>Loans to customers at carrying value .....</b>	<b>1.363.696</b>	<b>1.184.829</b>

\*UK includes UK overseas territories and Crown dependencies

7. Loans to customers at carrying value - breakdown by currency:

This specification includes pledged positions.	30.6.2009	31.12.2008
	Carrying value	Carrying value
GBP .....	559.555	472.095
EUR .....	224.484	218.841
USD .....	237.807	238.437
JPY .....	34.230	29.342
CHF .....	37.321	29.246
SEK .....	127.901	65.957
ISK .....	108.078	103.099
Other .....	34.320	27.812
<b>Loans to customers at carrying value .....</b>	<b>1.363.696</b>	<b>1.184.829</b>

8. Ten largest loans to customers at fair value - sector and country

This specification is of the fair value of loans to customers, and includes pledged positions.	30.6.2009	31.12.2008
UK* / Holding company .....	7,8%	8,5%
UK* / Trade .....	7,8%	7,5%
UK* / Real Estate .....	4,1%	3,4%
Scandinavia / Industry .....	4,0%	4,4%
Iceland / Government related entity .....	3,3%	4,0%
UK* / Service .....	3,1%	2,6%
UK* / Service .....	2,4%	2,0%
UK* / Holding company .....	2,2%	1,6%
Scandinavia / Holding company .....	2,1%	2,8%
Scandinavia / Individual .....	1,6%	1,9%
<b>Ten largest loans to customers of total loans to customers at fair value .....</b>	<b>38,5%</b>	<b>38,7%</b>

\*UK includes UK overseas territories and Crown dependencies

**Bonds and debt instruments**

9. Bond and debt instruments are specified as follows:	30.6.2009			31.12.2008
	Unpledged	Pledged	Total	Total
Listed .....	9.855	87.043	96.898	94.441
Unlisted .....	2.489	19.677	22.166	21.490
<b>Bonds and debt instruments .....</b>	<b>12.344</b>	<b>106.720</b>	<b>119.064</b>	<b>115.931</b>

10. Bonds and debt instruments specified by issuer:	30.6.2009			31.12.2008
	Unpledged	Pledged	Total	Total
Financial institutions .....	-	43.765	43.765	41.428
Housing Financing Fund .....	5.441	40.705	46.146	45.807
Government .....	4.414	20.273	24.687	24.682
Corporates .....	2.489	1.977	4.466	4.014
<b>Bonds and debt instruments .....</b>	<b>12.344</b>	<b>106.720</b>	<b>119.064</b>	<b>115.931</b>

## Shares and instruments with variable income

	30.6.2009		31.12.2008	
	Unpledged	Pledged	Total	Total
11. Shares and instruments with variable income are specified as follows:				
Listed .....	20.095	179.524	199.619	153.274
Unlisted .....	14.960	21	14.981	8.577
<b>Shares and instruments with variable income .....</b>	<b>35.055</b>	<b>179.545</b>	<b>214.600</b>	<b>161.851</b>

All investments in associates other than Storebrand AS were transferred to New Kaupthing Bank hf. or impaired in the year 2008. Kaupthing Bank hf. held approximately 20% stake in Storebrand AS. Half of the Bank's holdings, i.e. 10% stake, was sold within the year in a forced sale, but the remaining 10% which was classified in 'Investments in associates' in the last published financial information as at 15 November was transferred to 'Shares and instruments with variable income'. Of the remaining stake, 4,5% stake in Storebrand AS is currently pledged.

	30.6.2009		31.12.2008	
	Unpledged	Pledged	Total	Total
12. Ten largest positions:				
Trade/UK .....	-	51.246	51.246	45.191
Service/UK .....	-	48.489	48.489	26.285
Financial/Scandinavia .....	-	30.462	30.462	28.351
Financial/Scandinavia .....	14.640	12.080	26.720	21.364
Industry/UK .....	-	23.470	23.470	15.403
Service/Scandinavia .....	-	7.486	7.486	7.486
Industry/Iceland .....	-	6.174	6.174	6.174
Industry/Netherlands .....	4.130	-	4.130	2.015
Financial/Canada .....	3.939	-	3.939	3.047
Industry/UK .....	3.427	-	3.427	1.184
<b>Ten largest positions total .....</b>	<b>26.136</b>	<b>179.407</b>	<b>205.543</b>	<b>156.500</b>

## Derivatives and unpaid derivatives

	30.6.2009		31.12.2008	
	Gross fair value	Provisions	Net fair value	Net fair value
13. Derivatives and unpaid derivatives are specified as follows by status:				
Derivatives .....	41.972	(17.555)	24.417	43.098
Unpaid derivatives* .....	381.012	(159.356)	221.656	190.764
<b>Derivatives and unpaid derivatives .....</b>	<b>422.984</b>	<b>(176.911)</b>	<b>246.073</b>	<b>233.862</b>
Collateral received from counterparties .....	(143.517)	-	(143.517)	(137.236)
<b>Net derivatives and unpaid derivatives .....</b>	<b>279.467</b>	<b>(176.911)</b>	<b>102.556</b>	<b>96.626</b>

\*Matured and terminated trades, and unpaid cash flow from open trades

	30.6.2009		31.12.2008	
	Gross fair value	Provisions	Net fair value	Net fair value
14. Derivatives and unpaid derivatives are specified as follows by type:				
Open FX Trades, Asset Swaps & Interest Rate Swaps .....	39.990	(16.726)	23.264	42.651
Open Caps, Floors, Barriers .....	1.982	(829)	1.153	447
Unpaid FX Trades, Asset Swaps, Interest Rate Swaps & FX Options* .....	378.713	(158.393)	220.320	189.493
Unpaid Credit Derivatives* .....	(4.860)	2.032	(2.828)	(2.693)
Unpaid Equity Options* .....	6.254	(2.616)	3.638	3.463
Unpaid Caps, Floors, Barriers* .....	905	(379)	526	501
<b>Derivatives and unpaid derivatives .....</b>	<b>422.984</b>	<b>(176.911)</b>	<b>246.073</b>	<b>233.862</b>
Collateral received from counterparties .....	(143.517)	-	(143.517)	(137.236)
<b>Net derivatives and unpaid derivatives .....</b>	<b>279.467</b>	<b>(176.911)</b>	<b>102.556</b>	<b>96.626</b>

\*Matured and terminated trades, and unpaid cash flow from open trades

Collateral received from counterparties in relation to derivative trades is included in Due to Credit Institutions and amounts to ISK 143.517 million at 30.06.2009 and ISK 137.236 million at 31.12.2008.

The Bank had before the collapse received collateral from counterparties in relation to some derivative trades. This collateral was part of the Bank's own funds and had been re-used, re-invested or moved to New Kaupthing in October 2008.

Therefore, to estimate the value of the Bank's assets distributable to creditors as at 30 June 2009 the collateral already received which amounts to ISK 143.517m as at 30 June 2009 needs to be deducted from Derivatives and unpaid derivatives on the asset side and from Due to credit institutions on the liability side.

## Investments in subsidiaries

15. Investments in subsidiaries at 30 June 2009 are specified as follows:

	Functional currency	Ow ner- ship	30.6.2009		31.12.2008
			Pledged	Total	Total
FIH Erhvervsbank, Denmark .....	DKK	99,9%	91.168	91.168	86.213
Kaupthing Mortgage Institutional Investor Fund, Iceland .....	ISK	100,0%	18.317	18.317	17.544
Kaupthing Sverige AB, Sweden .....	SEK	100,0%	-	5.734	5.403
Norvestia Oyj, Finland .....	EUR	32,7%	-	8.139	7.445
New Bond Street Diversified Credit Fund, UK .....	EUR	100,0%	-	5.898	5.898
Kirna ehf., Iceland .....	ISK	100,0%	-	5.375	5.375
Other subsidiaries and foreign branches .....			-	931	1.586
<b>Subsidiaries</b> .....			<u>109.485</u>	<u>135.562</u>	<u>129.464</u>

The Bank controls 56.0% of the votes in Norvestia Oyj and the company is thus considered to be a subsidiary of the Bank.

The book value of subsidiaries is an estimated fair value.

The equity stake in FIH Erhvervsbank is shown as fully pledged against a loan with the Icelandic Central Bank.

## Other assets

16. Other assets are specified as follows:

	30.6.2009	31.12.2008
Accounts receivables .....	37.887	35.513
Sundry assets .....	1.233	3.804
Deferred tax assets .....	1.954	3.466
Accrued income .....	2.676	2.244
Prepaid expenses .....	566	779
Impairment on other assets .....	(35.214)	(32.445)
<b>Other assets</b> .....	<u>9.102</u>	<u>13.361</u>

Unpaid derivatives' which was classified as 'Other assets' in the last published financial information as at 15 November was transferred to 'Derivatives and unpaid derivatives'.

## Due to credit institutions

17. Due to credit institutions specified as follows:

	30.6.2009	31.12.2008
Collateral accounts .....	143.517	137.236
Other .....	8.291	36.656
<b>Due to credit institutions</b> .....	<u>151.808</u>	<u>173.892</u>

## Deposits

18. Deposits are specified as follows:

	30.6.2009	31.12.2008
Deposits in Germany branch .....	2.140	54.775
<b>Deposits</b> .....	<u>2.140</u>	<u>54.775</u>

The deposits in the Germany branch were defined as priority claims acc. to Act 125/2008. The vast majority of these deposits were paid in H1 2009.

## Derivatives and unpaid derivatives - liabilities

19. Derivatives and unpaid derivatives are specified as follows by status:	30.6.2009	31.12.2008
Derivatives .....	(6)	538
Unpaid derivatives* .....	136.302	138.213
<b>Derivatives and unpaid derivatives</b> .....	136.296	138.751
Collateral received from counterparties .....	(88.932)	(80.432)
<b>Net derivatives and unpaid derivatives</b> .....	47.364	58.319

\*Matured and terminated trades, and unpaid cash flow from open trades

20. Derivatives and unpaid derivatives are specified as follows by type:	30.6.2009	31.12.2008
Open FX Trades, Asset Swaps & Interest Rate Swaps .....	(6)	535
Open Caps, Floors, Barriers .....	-	3
Unpaid FX Trades, Asset Swaps, Interest Rate Swaps & FX Options* .....	67.972	73.518
Unpaid Credit Derivatives* .....	69.137	65.436
Unpaid Equity Options* .....	(798)	(734)
Unpaid Caps, Floors, Barriers* .....	(9)	(7)
<b>Derivatives and unpaid derivatives</b> .....	136.296	138.751
Collateral received from counterparties .....	(88.932)	(80.432)
<b>Net derivatives and unpaid derivatives</b> .....	47.364	58.319

\*Matured and terminated trades, and unpaid cash flow from open trades

Collateral posted against derivative trades is included in 'Loans to credit institutions' and amounts to ISK 88.932 million at 30.06.2009 and ISK 80.432 million at 31.12.2008.

## Borrowings

21. Borrowings are specified as follows:	30.6.2009	31.12.2008
Bonds issued .....	1.951.213	1.855.478
Bills issued .....	61.520	56.753
Money market loans .....	568.885	420.847
Central Bank of Iceland .....	314.857	316.471
Other loans .....	340.531	442.087
<b>Borrowings</b> .....	3.237.006	3.091.636

A formal process for the creditors of Kaupthing bank to file claims against the bank began at 30 June 2009 and will end at 30 December 2009. Until all claims have been filed and validated, the real and accurate amount of borrowings is uncertain. In accordance with Act no. 44/2009, all liabilities are fixed in ISK as at that 22 April 2009.

## Liabilities to New Kaupthing Bank hf. in return of assets and liabilities transferred

22. In October 2008 all of the Bank's deposit liabilities in Iceland were transferred to New Kaupthing Bank hf., and also the bulk of the Bank's assets that relate to its Icelandic operations, such as loans and other claims. This transfer was done according to the FME's Transfer Decision dated 21 October 2008. Negotiations on the valuation of the assets and liabilities were concluded on 3 September 2009 when the Government and the Bank agreed not to conclude the valuation of the assets at present but in 3 years time. This solution allows the Bank to capture further upside in the valuation of the assets.

The Bank is to provide cover for any negative initial value ("valuation gap") from the transfer of assets and liabilities from the Bank to New Kaupthing; the valuation gap is assessed at ISK 38.102 million as at 22 October 2008. The value of the assets is guaranteed for the time period of the agreement which ends 30 June 2012. The size of the valuation gap will be reassessed semi-annually by an independent auditor. Therefore, the size of the valuation gap can decrease but has been capped at the initial value save for currency movements and accrued interests. The valuation gap is denominated 50% in EUR and 50% in ISK.

## Other liabilities

23. Other liabilities are specified as follows:	30.6.2009	31.12.2008
Sundry liabilities .....	86.544	81.048
Trading liabilities - Securities borrowed .....	18.593	18.419
Liability to Norway and Finland regarding deposits, priority claim .....	-	14.120
Accounts payable .....	3.165	11.590
<b>Other liabilities</b> .....	108.302	125.177

Trading liabilities - Securities borrowed represents an obligation towards the Icelandic Central Bank where the Bank had borrowed liquid domestic government bonds in exchange for other liquid domestic government bonds.

## Other Information

### 24. Balance sheet net of pledged assets and priority claims:

	30.6.2009	Pledged	Known	30.6.2009	31.12.2008
	Balance sheet	positions	priority	Balance	Balance
			claims	sheet after	sheet after
				subtracting	subtracting
<b>Assets</b>					
Cash in hand .....	98.799	-	-	98.799	77.963
Loans to credit institutions .....	442.923	(400.024)	-	42.899	148.548
Loans to customers at fair value .....	439.521	(82.262)	-	357.259	259.666
Bonds and debt instruments .....	119.064	(106.720)	-	12.344	2.652
Shares and instruments with variable income .....	214.600	(179.545)	-	35.055	23.203
Derivatives and unpaid derivatives .....	246.073	-	-	246.073	233.862
Investments in subsidiaries .....	135.562	(109.485)	-	26.077	25.707
Other assets .....	9.102	-	-	9.102	13.361
Less: Payment of known priority claims .....	-	-	(53.022)	(53.022)	(119.055)
<b>Total assets</b> .....	<b>1.705.644</b>	<b>(878.036)</b>	<b>(53.022)</b>	<b>774.586</b>	<b>665.907</b>
<b>Liabilities</b>					
Due to credit institutions .....	151.808	-	-	151.808	173.892
Deposits .....	2.140	-	(2.140)	-	-
Derivatives and unpaid derivatives .....	136.296	-	-	136.296	138.751
Borrowings .....	3.237.006	(878.036)	-	2.358.970	2.284.429
Liability with New Kaupthing Bank in return of assets and liabilities transferred .....	43.335	-	(43.335)	-	-
Other liabilities .....	108.302	-	(7.547)	100.755	101.924
<b>Total Senior liabilities</b> .....	<b>3.678.887</b>	<b>(878.036)</b>	<b>(53.022)</b>	<b>2.747.829</b>	<b>2.698.996</b>
Subordinated loans .....	422.624	-	-	422.624	400.677
Interest expense from 22.4.2009-30.6.2009 .....	27.804	-	-	27.804	-
Equity .....	(2.423.671)	-	-	(2.423.671)	(2.433.766)
<b>Total liabilities and equity</b> .....	<b>1.705.644</b>	<b>(878.036)</b>	<b>(53.022)</b>	<b>774.586</b>	<b>665.907</b>

Readers' attention is drawn to the terms of the disclaimer at the beginning and the end of this report, statement of compliance and valuation methodology in the beginning of this chapter.

As stated in notes 14 and 17, collateral accounts in 'Due to credit institutions' amount to ISK 143.517 million at 30.06.2009 and ISK 137.236 million at 31.12.2008 which will presumably be deducted from the 'Derivatives and unpaid derivatives' on the asset side once these agreements are settled with the counterparties.

As stated in notes 2 and 20, collateral accounts in 'Loans to credit institutions' amount to ISK 281.785 million. Thereof, the collateral accounts related to derivatives amount to ISK 88.932 million at 30.06.2009 and ISK 80.432 million at 31.12.2008 which will presumably be deducted from the 'Derivatives and unpaid derivatives' on the liabilities side once these agreements are settled with the counterparties. This is already included in the pledged positions above.

Hindsight has been used regarding events after 30 June 2009 for pledged positions.

Pledged positions in 'Loans to customers at fair value' and 'Investments in subsidiaries' are represented at the value of the corresponding obligation, i.e. after any haircuts have been taken into account.

Pledged positions for 'Bonds and debt instruments' and 'Shares and instruments with variable income' are represented at the assumed market value of the underlying collateral. The haircut on the corresponding obligation is excluded on the liability side.

It should also be noted that there were significant currency movements in the first half of 2009.

### 25. Set-off

The valuation of assets and liabilities in this report does not take into account the impact of set-off. The reason thereof is twofold; firstly, counterparties have the right to claim until the end of the formal claim period which started on 30 June 2009 and will end on 30 December 2009. Secondly, every case needs to be looked into and evaluated before each claim can be accepted or rejected. Therefore, the estimated size and impact of set-off is still very uncertain.

The Bank has received to date set-off claims from counterparties amounting to ISK 200 billion. The preliminary estimated set-off effects is in total up to ISK 100 billion on the face value of both the respective assets and the respective liabilities. The exact amounts on the assets and liabilities side may differ.

## **Exchange rates for ISK as at 30 June 2009 and 31 December 2008.**

<b>Currency</b>	<b>30 June 2009</b>	<b>31 December 2008</b>
CAD	109,9069	98,716
CHF	117,4831	113,8163
DKK	24,0425	22,7274
EUR	179,0383	169,2733
GBP	210,0403	176,4826
HKD	16,478	15,6299
JPY	1,3235	1,336
NOK	19,8358	17,3906
SEK	16,5203	15,4411
USD	127,5565	121,0955

## **4.2 Derivatives**

### **Appointment of advisors**

In line with Resolution Committee's objective to maximise recoveries for the creditors of the Bank, the Resolution Committee has retained Alvarez and Marsal ("A&M") to review the existing portfolio of derivatives transactions and execute a plan that will maximise recoveries. A&M's mandate is to manage the overall process of the winding down of the derivatives book. To do this A&M will work with and coordinate the existing employees of the Bank along with external derivatives valuation specialists. Furthermore, the business law firm Olswang was appointed as an external legal counsel to work on the legal process associated with recoveries of the derivatives portfolio.

Starting in October 2009, A&M defined 4 work streams for the derivatives recovery: Counterparty interaction, Valuations, Legal and Back office-Treasury. A further distinction was made between parties operating under ISDA agreements (predominantly international parties) and the Bank's General Terms (predominantly domestic counterparties).

Each stream is predominantly staffed by employees of the Bank supported by external advisors where specialist expertise is required. All streams follow a narrowly defined process to achieve resolution of the exposures, involving systematic checks on the streams' output and a full audit trail. After legal due diligence and valuation analysis each individual proposal is submitted to the Bank's management for approval before proceeding.

Overall prioritisation has taken place across the portfolio, factoring in 'live' or 'terminated' agreements, payable or receivable as well as the counterparty credit rating.

At the end of 2009, over one third of the ISDA counterparties have been reviewed and discussions started. These discussions range from seeking to gain additional information to demanding full payment.

On the parties operating under the Bank's General Terms the derivatives stream is working with the asset management team to review each counterparty in turn and propose a solution that benefits the estate as a whole.

The position of each counterparty in this stream has been calculated, notices of payments have been sent out and settlement has taken place in some cases. Legal proceedings have commenced in some of the disputed cases.

The number of counterparties involved are over 350 including both Icelandic and international names, with over 2,500 individual transactions. The plan, by applying a strict prioritisation process, puts the highest emphasis on those transactions that will maximise recovery of funds to the Bank.

It is anticipated that the high priority transactions, those that will recoup the maximum value, will be processed by February 2010. The remaining transactions will be dealt with in order of their ability to return value to the Bank.

### **Overview**

There are total of 149 foreign counterparties in the derivatives portfolio which can be broken down as follows:

- 103 ISDA counterparties (in 92 ISDA agreements, as some are multi entity)
- 32 non-ISDA counterparties, i.e. the Bank's general terms and conditions counterparties
- 14 counterparties within the Bank's group, i.e. subsidiaries and branches

The number of transactions with foreign counterparties is less than 1,000. The vast majority of these are traded under the ISDA agreements, most of which have been terminated by the counterparty.

There are total of 224 domestic counterparties in the derivative portfolio which can be broken down as follows:

- 14 ISDA counterparties (mostly domestic financial institutions but also some large companies)
- 195 non-ISDA counterparties, i.e. the Bank's general terms and conditions counterparties
- 15 counterparties within the Bank's group, i.e. subsidiaries and branches

The number of transactions with domestic counterparties is over 1,600. The vast majority of these are traded under general market agreements and a minority under ISDA agreements.

### **Open derivatives**

There are open derivatives both in the domestic and in the foreign derivatives book and the total number of open derivatives contracts are less than 300. The transactions concern mainly plain vanilla interest rate swaps (IRS) and long term FX/Currency swaps with non-ISDA domestic counterparties. Process has been set up for regular review in order to determine whether the positions should be kept or terminated in order to maximise the recovery of the contracts. The Bank is in selective cases fulfilling its contractual obligations if it concludes it to be beneficial for the Bank:

## **4.3 The Bank/Arion Bank split**

On 6 October 2008 the Disbursement Act was passed by the Icelandic parliament, providing the FME with the authority and power to intervene in the operations of financial undertakings in order to respond to the unusual circumstances in the Icelandic financial sector. On 9 October 2008, in accordance with the same act, the FME appointed the Resolution Committee to take control of the Bank. On 21 October 2008, the FME issued the Transfer Decision, by which it determined to transfer certain specific assets of the Bank and certain specific obligations of the Bank, to Arion Bank. According to the FME, these actions were taken to secure the continuation of vitally important domestic banking and payment services.

Under the Transfer Decision, Arion Bank takes over the entire Bank's deposit liabilities in Iceland, and also the bulk of the Bank's assets that relate to its Icelandic operations, such as loans and other claims. Other assets and liabilities will remain in the Bank, which will in turn remain under the control of the Resolution Committee.

The FME appointed Deloitte to prepare an independent net asset valuation for Arion Bank and Oliver Wyman was appointed to co-ordinate the valuation process and review the valuation. The valuation of the net assets by Deloitte and the review of the valuation by Oliver Wyman took longer than initially envisaged but was completed towards the end of April 2009.

PwC has audited the asset transfer from the Bank to Arion Bank to ensure that it was completed in full accordance with the FME transfer decision. PwC has completed their revision and have concluded that some assets that were initially moved to Arion Bank should have stayed with the Bank. Hence, this has now been corrected and these assets will increase the size of the corporate loan portfolio of the Bank. It should be added that all cash flow to and from the assets since the FME transfer decision was made will be compiled and corrected for between the two banks. The Resolution Committee supports these amendments as they are in full accordance with the FME transfer decision and the committee consider these assets to be above average quality of the Bank's assets.

Total of approx. ISK 190bn in assets at book value were transferred back, thereof approx. ISK 90bn which were unpledged. These assets present additional value to the creditors, but instead the compensation instrument will be lower than initially expected. The liabilities related to the pledged assets had remained within the Bank based on the preliminary balance sheets.

The Resolution Committee has, together with Morgan Stanley and creditors' representatives, been negotiating with the Government during the summer 2009 on the disposition of the assets and liabilities taken over by Arion Bank in October 2008. The Resolution Committee entered into a Heads of Terms Agreement with the Government on 17 July 2009 and signed binding agreements on 3 September 2009.

On 1 December the Resolution Committee announced its decision regarding Arion Bank. The Resolution Committee, in consultation with the creditors and being supported by its financial advisor throughout the process, decided that the Bank and thereby its creditors shall acquire 87% of common equity in Arion Bank by deciding for option 1. The Government will continue to own 13% of common equity. The Resolution Committee believes that active ownership of Arion Bank will maximize the value of assets which were transferred between the banks in October 2008. When Arion Bank was capitalized the Government committed itself to contributing ISK 72 billion in common equity. A part of the agreement the Resolution Committee will contribute up to ISK 66 billion of the amount promised by the Government.

**Key points:**

- Kaupthing Bank acquires 87% of the share capital in Arion Bank and 13% remain under Government ownership.
- The Resolution Committee contributes up to ISK 66 billion in common equity instead of the Government.
- Arion Bank has strong foundations and employs a team of highly qualified and experienced staff. The success of Arion Bank is directly linked to the interests of Kaupthing Bank's creditors.
- Arion Bank remains governed by Icelandic law and Icelandic supervisory institutions ensuring deposits held in the bank remain as secure as before.
- The Resolution Committee appoints four members to the new board of Arion Bank and the Government one.
- Arion Bank becomes an independent operating subsidiary of Kaupthing Bank.

- By continuing to work closely with foreign creditors, Arion Bank has the opportunity to rebuild the trust and reputation of the Icelandic banking sector.

The common equity of Arion Bank is approximately ISK 72 billion and the Tier I ratio 12%. The bank is fully capitalized and its liquidity position is strong. The bank has been profitable since it was established in October 2008. With the Resolution Committee's involvement, Arion Bank will become a strong bank and well positioned to lead the development of the Icelandic economy for the good of Icelandic people and domestic companies as well as its owners. The agreement with the Government entails that the Government contributes a subordinated, FX denominated loan which will increase Arion's capital ratio to 16%.

#### **4.4 Portfolio statistics**

This chapter gives a brief overview of the *Loans to customers'* portfolios while a more detailed analysis of the portfolios can be found in the 20 October Creditors' Meeting presentation available on the Bank's website.

##### **Overview**

Loans to customers are divided into three portfolios:

- **Nordic portfolio:** the vast majority of loans to customers in the Nordic region.
- **Europe portfolio:** the vast majority of loans to customers in Europe.
- **NOA portfolio:** mainly non-operational assets.

The Nordic and Europe portfolios are actively managed by the asset management team and the vast majority of the stakes in these portfolios have underlying operations or assets.

The loans in the NOA portfolio are under the supervision and management of the Inspection Committee and undergo thorough revision by the Committee.

Loans to customers at nominal value amounted to ISK 1.364bn as at 30 June 2009.

Loans to customers at fair value amounted to ISK 357bn as at 30 June 2009 (compared to ISK 260bn at year-end 2008).

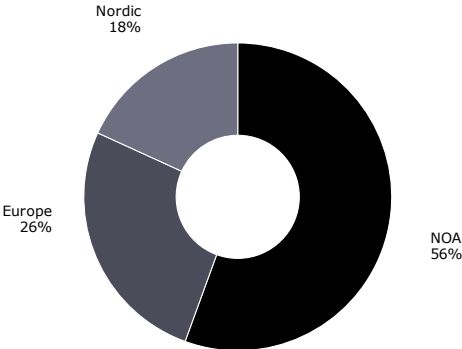
Fair value of *Loans to customers* as at 30 June 2009:

- **Nordic portfolio:** approx. ISK 140bn
- **Europe portfolio:** approx. ISK 170bn
- **NOA portfolio:** approx. ISK 47bn

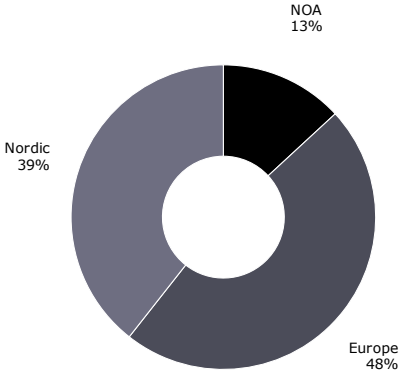
Further breakdown of the portfolios are shown below.

**Loans to customers broken down by portfolios.**

**Portfolio Categorization by nominal value  
30 June 2009**

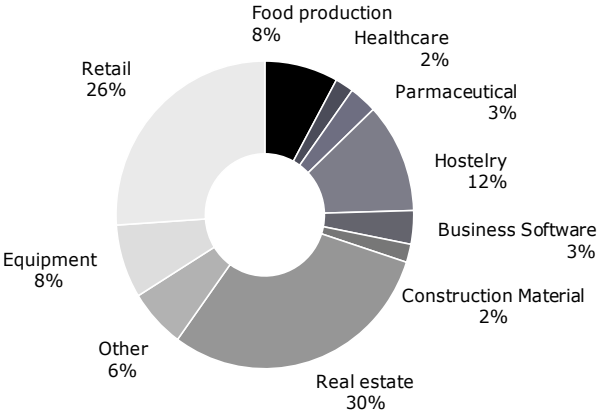


**Portfolio Categorization by fair value  
30 June 2009**

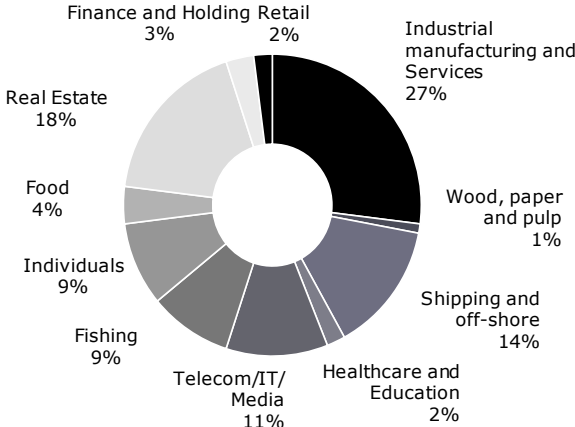


**Loans to customers broken down by sector – at nominal value as at 30 June 2009.**

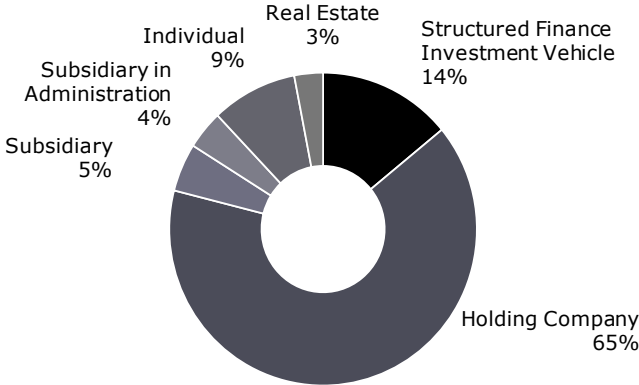
**Europe portfolio**



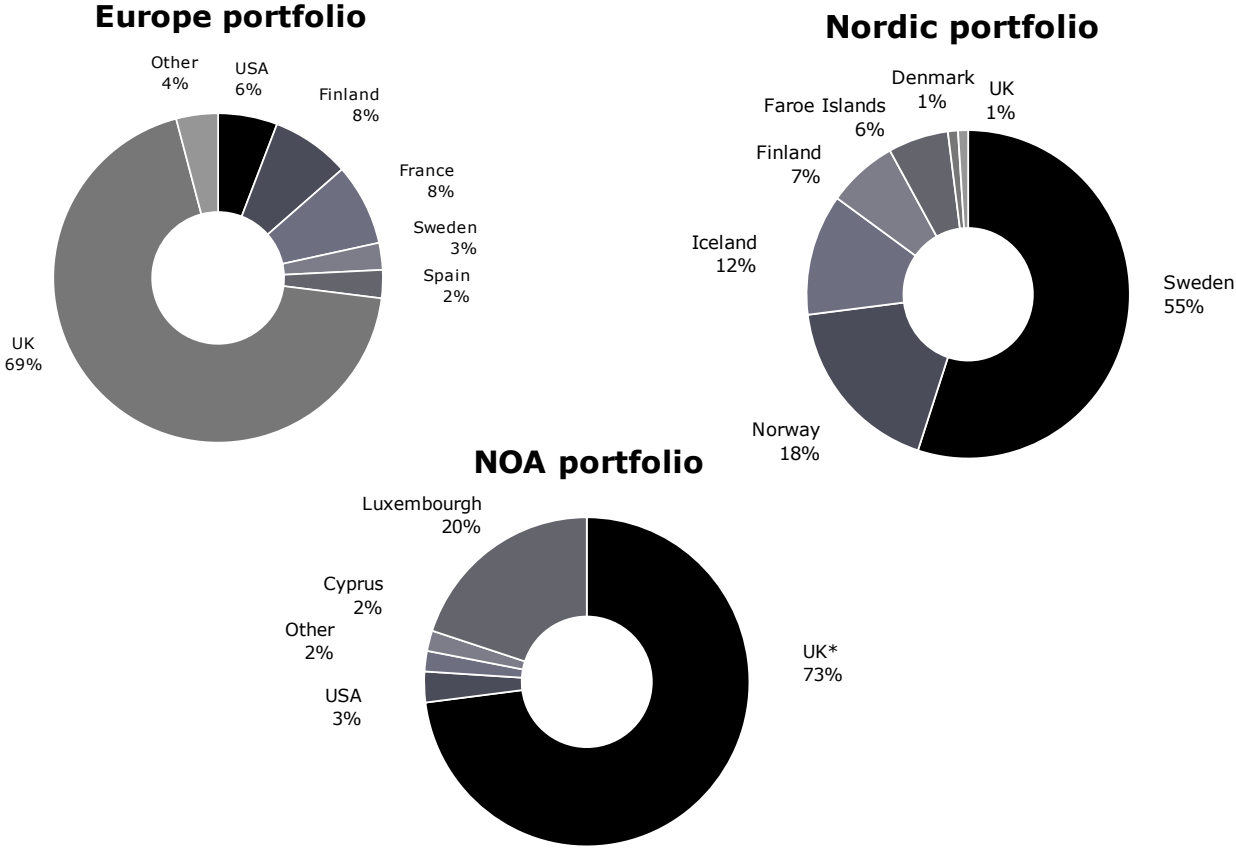
**Nordic portfolio**



**NOA portfolio**

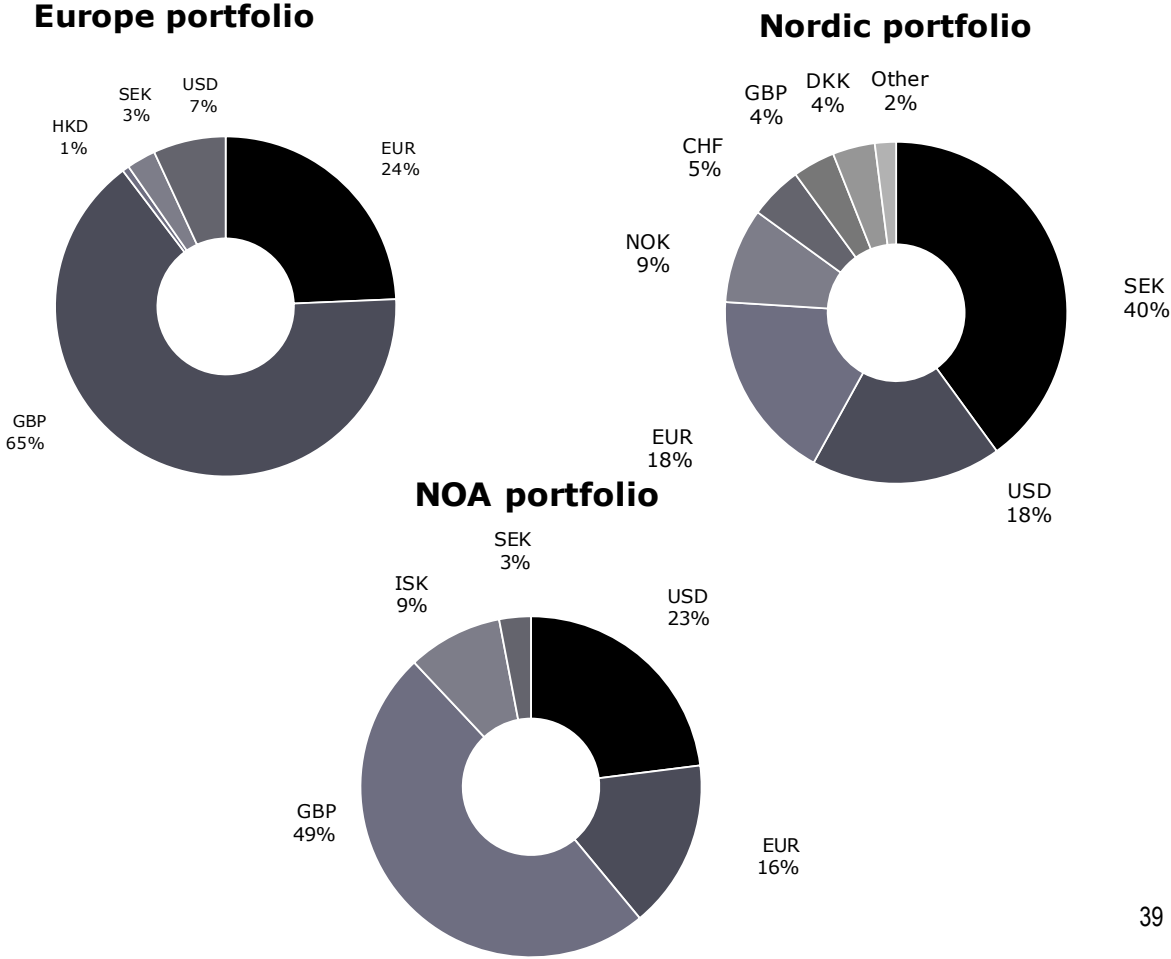


Loans to customers broken down by geography - at nominal value as at 30 June 2009.



\*UK includes UK overseas territories and Crown dependencies

Loans to customers broken down by currency - at nominal value as at 30 June 2009.



***NOA portfolio***

Approx. 85% of the portfolio is holding companies and other SPV's which are mainly foreign entities. The portfolio comprises more than 30 unique borrowers which are all under active supervision by a sub-committee of the Resolution Committee, the Inspection Committee. All loans in this portfolio go through strict and thorough examination where all historical transactions, dealings and documents for each borrower are carefully probed. External legal counsel has been engaged to work with the Committee, along with forensic auditors and internal legal counsel on examining 18 unique borrowers.

The Inspection Committee creates a sub-taskforce to examine and manage each unique debtor. The taskforce can be comprised of internal resources as well as external advisors such as forensic auditor Grant Thornton International and the international law firm Weil, Gotshal & Manges. As all the loans in the portfolio are under review by this committee they are all categorised as being under watch until the Inspection committee has concluded its examination. Legal collection proceedings have commenced for 21 borrowers. Included are actions where pledges have been forced and the Resolution Committee has gained management control of pledged companies.

## 5. Asset sales and restructuring

### 5.1 General approach and rationale

As discussed in the previous chapters, the Resolution Committee is committed to protecting the asset base of the Bank. The committee fully realizes that current market conditions are unlikely to produce acceptable values for many of its assets. Therefore, the Resolution Committee is determined to support the assets of the Bank where practicable to reach maximum value and does not entertain any "fire sale" bids.

The mandate of the asset management division is broken into five steps: stabilization, consolidation, full overview, which leads to the ordinary management of the assets and ends with an exit strategy.

*Stabilization:* The Asset Management team was up against major challenges in the beginning. The main task was to stabilize the situation and to retain value wherever possible by preventing the collapse of different assets and by refusing strongly any fire sale bids.

*Consolidation:* The Bank protected assets in its foreign entities in the Nordic region and finally managed to transfer assets back to the parent company. Assets were transferred from branches and a subsidiary in the Nordic region to the parent company.

*Full overview:* Once the initial challenges had been overcome, a more comprehensive and thorough approach was taken on the asset portfolio. Responsibility was allocated between employees from asset management, portfolio management, finance and legal counsel. Assets were analyzed and prioritized by urgency and size and relevant actions were taken for each assets.

*Management:* With a full overview of the assets, the Bank went into management of the assets. The Bank secured maximum recovery with pro-active management of the assets. Further objectives for each asset are set and when appropriate external advisors and consultants are hired to ensure top class expertise.

*Exit strategy:* When previous steps have been completed a solid foundation has been set up for the development of a medium to long term strategy for each asset with the aim of ensuring realization of its maximum value. Assets are developed into more stable and sellable form. The work has been focused on value creation, keeping in mind the eventual realization of the value of its assets but to date the focus has not been on the formalization of exit strategies and very few assets have been sold.

The objective of all restructuring efforts is to maximize the likelihood of recouping the Bank's previous full exposure, protecting the Bank's interests and the company value going forward. Before restructuring the account is analyzed extensively, taking into account various other options, other creditors, collateral position etc.

Common scenarios where restructuring is a real option:

- Insufficient cash flow to service the debt, the company has no real equity and there is a risk of management behaving irrationally.
- Potential equity value and the Bank gains a legal avenue to the asset due to e.g. covenant breaches.

Following are practicalities which the Bank finds important when executing a capital restructuring. Finding the right balance between:

- Operational disruptions and the possible outcome from the financial restructuring.
- The costs associated with the financial restructuring and its complications against future cost savings and how easily the structure will be to manage.
- What incentives to give to other stakeholders: good understanding of the company's future prospects and its value are of utmost importance. Aim to set the debt level not lower than perceived enterprise value at restructuring.

*The ultimate goal is to develop the optimal solution for each asset and thereby maximize recovery value for the creditors of the Bank.*

## **5.2 Assets restructured to date**

The Resolution Committee shares the creditors' desire to maximize the value of the Bank's estate and recognizes that this may take a significant period of time to achieve.

Considerable part of the Nordic and Europe loan portfolio have undergone major restructuring. In December 2008, 76% of Europe portfolio and 44% of the Nordic portfolio (since March 2009) was on the Bank's watch list (or had the risk of getting there). Those are loans whereby cash flow is insufficient to service debt and there are (repeated) covenant breaches. Some of which (a) are in industries badly hit by recession; or (b) had owners that were distressed because of the financial crises and unable to support their assets; or (c) had the wrong capital structure to start with.

Based on the nominal value (post restructuring) as at end of September 2009, the Nordic team has completed actions in cases representing 45% of the value of the portfolio and the Europe team 68%, thereof full restructuring of approx. 40% in Europe and 11% in Nordic.

The Bank has acquired a controlling interest in companies and the Bank has, as an equity holder, made sure that its views are presented by nominating board members while also making sure to retain other board members with industrial know-how and expertise. [The Bank has already started to see equity value being created in some of the restructuring cases, however, the book value of those equity stakes is at zero in the Bank's balance sheet as of 30 June 2009.](#)

In all of the major restructuring exercises the Bank has hired external advisors. Depending on the nature of the restructuring projects, these external parties can be financial advisors, legal counsels, real estate consultants, retail experts, accountants, auditors, etc. The cost of these is in most cases paid by each respective borrower.

The following table shows the actions taken on the portfolios. The portfolios contain 107 accounts. Accounts totalling ISK 162bn at nominal value are currently being restructured; thereof 9 assets with a nominal value of ISK 110bn have been completed. In these figures the Europe portfolio excludes post restructuring debt which is still on Mosaic Fashions (in administration) and the Bank's financing of NoHo Square (real-estate development at standstill) where the Bank also holds all the equity.

A number of key accounts have been fully restructured and are today fully operational.

	Initial Nominal / Pre restructuring Value		Nominal post-restructuring Value*		Full restructuring		Major actions		Minor actions		Operational/ No action taken		Full repayment	
	#	Value	#	Value*	#	Value*	#	Value*	#	Value*	#	Value*	#	Value*
<b>Europe**</b>	308		36	227	10	123	8	62	2	9	16	33	3	21
- % completed end of Q3					70%		98%		77%					
<b>Nordic</b>	220		71	219	15	39	13	61	15	53	28	65	15	13
- % completed end of Q3					59%		81%		51%					

\*Value refers to post-restructuring nominal value as at 30 September 2009. All amounts are in ISKbn.

**Europe portfolio:** ISK 81bn debt to equity conversion in the Europe portfolio explains the difference between the nominal value pre-restructuring and post-restructuring (ISKbn 308 vs. 227).

**Nordic portfolio:** ISK 1bn debt to equity conversion in the Nordic portfolio explains the difference between the nominal value pre-restructuring and post-restructuring (ISKbn 220 vs. 219).

*Full restructuring:* typically includes enforcement procedures, new owners and full restructuring of debt.

*Major action:* major waivers, restructuring of debt and occasional equity injection.

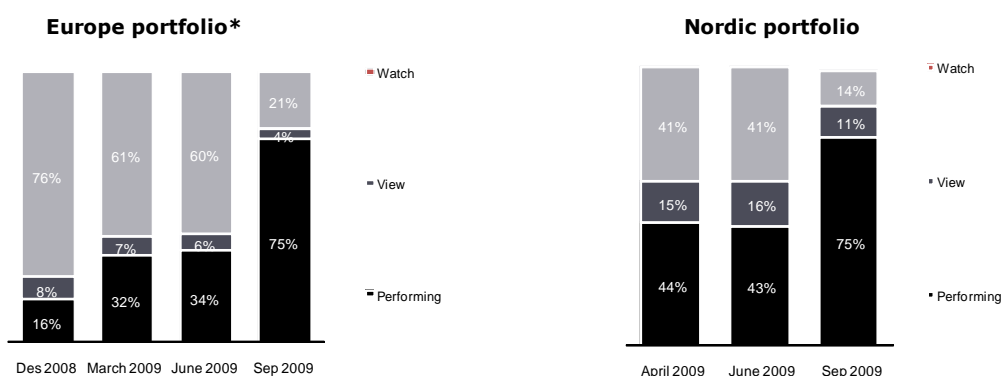
*Minor actions:* minor adjustments or temporary covenant or repayment waivers.

### Progress with restructuring work

The restructuring of the loans progressed substantially in the third quarter of 2009 with only approx. 21% of the Europe and 14% of the Nordic loan balance still on the watch list.

- *Performing loans:* Loans to entities where cash flow is sufficient to service debt, i.e. interest and principal repayments, and no breaches in agreements are foreseeable in the future.
- *Loans on view list:* Loans to entities where cash flow is sufficient to service debt, i.e. interest and principal repayments, but agreements have been breached or are likely to be breached in the foreseeable future. Some banks include this category within performing loans.
- *Loans on watch list:* Loans to entities where cash flow is insufficient to service debt, i.e. interest and principal repayments, and agreements have been breached repeatedly.

The graphs below shows the portfolios based on the nominal value in the respective month.



\* Europe portfolio here excludes post restructuring debt which is still on Mosaic Fashions (in administration) and the Bank's financing of NoHo Square (real-estate development at standstill) where the Bank has also all the equity

Majority of the loans in the Nordic portfolio were transferred from the respective countries in Q1 2009.

Following is list of some restructuring exercises implemented by the Bank. This list cannot be taken as conclusive.

### *Aurora Fashions / Mosaic Fashions*

The Bank and the former senior management of Mosaic Fashions established Aurora Fashions Limited ("Aurora") to take over the retail brands Karen Millen, Coast, Warehouse and Oasis, which all previously belonged to Mosaic Fashions Limited ("Mosaic"). The administrators which were appointed to Mosaic Fashions sold in an asset deal parts of Shoe Studio to Dune and parts of the Principles assets to Debenhams. This operation was completed with considerable efforts from Deloitte, DLA Piper and BDO Stoy Hayward.

Since last autumn Mosaic had been experiencing significantly deteriorating earnings due to the UK recession and financial difficulties because of its balance sheet. After attempts to restructure the business in consultation with key stakeholders, Mosaic's board of directors decided at a meeting on 1 March 2009 to request that the company be put into administration. This step was necessary as it seemed clear that Mosaic would not be able to meet its obligations to its creditors and attempts to restructure the business with a view to securing its continued operations had failed.

Today, Aurora is financially sound with reduced capital requirements and fit to meet the challenges in the retail market. The new structure will strengthen the brands by bringing a greater management focus to operations and providing opportunities to create a more flexible cost structure by reducing fixed expenses.

To date the transaction has proved successful although the UK retail environment still remains challenging. The aim has been on further stabilizing the operation, continue focusing on de-leveraging the business but also preserve the upside if and when the retail market recovers. Once the benefits of Aurora's strategy become evident, the Resolution Committee is confident that there will be a significant recovery for the Bank.

### *All Saints*

To project the Bank's exposure to a shareholder loan, the Bank reached an agreement with the main shareholders of the British retail chain All Saints, which will consolidate the company's position as the leading design led brand on the British market. All Saints was founded in 1994 and in 2003 was acquired by Kevin Stanford when its sales were less than GBP 5m. Since then the company has been transformed into a brand that occupies a strong position on the British High Street. The company has demonstrated robust growth in both revenues and strong LFL performance in very challenging market conditions. All Saints current management team, led by Kevin Stanford as chairman and Stephen Craig as CEO, will continue to lead the business going forward. The Bank rates the company's prospects positive going forward despite the difficult conditions in the UK retail market. Furthermore, this enabled the company to secure GBP 30m refinancing of its debt and further grow its business in the UK and internationally. These agreements remove the uncertainty over the company's shareholding and funding, and will allow it to continue its rapid growth.

### *Former Middlesex Hospital Site*

Kaupthing is currently engaged in exclusive discussions with Stanhope PLC, one of Britain's leading property developers, regarding the development of the former Middlesex Hospital site. If an agreement is reached, Stanhope will oversee the development, design and reorganisation of the site with the aim of maximising its value. Should it go ahead, Stanhope will also inject new capital into the project. No agreement has yet been signed but the Resolution Committee of Kaupthing Bank wishes to clearly state that the site has not been sold and that if a partnership agreement is reached with Stanhope, the Bank will retain majority control of the site. This is in line with the Resolution Committee's policy of maximising the value of the Bank's assets.

### *Huurre Group Oy*

The Bank supported a major restructuring of one of North-Europe's leading commercial refrigeration companies, Huurre Group Oy (HQ in Finland) to strengthen the Group's financial position in the current challenging economical climate. As a result of this, the equity ratio of the Group has been substantially improved. Simultaneously, the loan facilities have been extended, having now a maturity of three years securing the Group's financing to mid 2012. Following the restructuring, Kaupthing Bank now owns 100% of the Group's equity. For the restructuring, PwC participated in the valuation and regarding business sensitivity study. Deloitte advised on tax and structuring and Olswang and Borenus gave advice on legal issues and documentation.

### *Bay Restaurant Holdings Limited and Town & City Pub Company Limited*

Plato Company 3 Limited, is the 100% holding company of Bay Restaurant Group Limited and Town & City Pub Company Limited. The combined group was highly leveraged and the Bank owned a substantial part of its debts or close to 60%. The rest of the debt was owned by a single bank. The group agreed with its banks, on a partial debt-for-equity swap conversion which has reduced its debt by approx. GBP 90m. The capital restructuring has enabled the two operating companies to focus on its operations in tough market conditions. The restructuring resulted in the Bank becoming a major shareholder of the combined group. Both companies have done well in this fiscal year and are outperforming budget. For this transaction, PwC gave advice on tax and restructuring and Slaughters & May on legal issues and documentation.

### *PMS properties*

The Bank has finished the restructuring of a SEK 1,1bn portfolio of twelve properties in Sweden. Eleven out of the twelve properties were refinanced in cooperation with the previous owners, the P.M.S. Group Ltd. in Israel, while one of the assets was refinanced through a bankruptcy process. A proactive approach taken by the Bank has secured a considerable equity injection by the owners in both processes and a profit sharing structure. The loans mature in less than five years time and include prepayment incentives for the borrowers.

### *Celsius portfolio*

The Bank has agreed with the shareholders of the Celsius property portfolio to extend the maturity of the EUR 142m facility for 24 months. This is a portfolio of French properties on long term lease contracts to the likes of Carrefour and Arriva. The portfolio benefits from a strong rental income that enables full payment of interest and some amortisation of principal over the term. The Bank believes the extension is a good result for both the Bank and the shareholders as asset values are likely to improve in the near future.

### **5.3 Repayments & exits**

26 loans have been realised to date with a total cash flow amounting to approx. ISK 59bn from October 2008, thereof 21 loans have been paid in full amounting to approx. ISK 44bn. The other five loans were partially repaid amounting to ISK 15bn.

Furthermore, out of the 26 loans four loans have been sold, thereof 3 somewhat below par. The loans sold are:

- One at marginal discount.
- Transaction in October 2008 to secure the liquidity position of the Bank.
- Subordinated mezzanine position in a highly leveraged distressed company sold above fair value as enterprise value broke in the senior debt.
- Loan sold in the spring for a price significantly higher than its otherwise perceived market value. The company had been under strain and performing poorly.

#### *Full repayment of ADP loan*

In March 2007, the Bank underwrote a GBP 60m Senior and GBP 8m Mezzanine debt facilities in relation to the acquisition of Associated Dental Practises (“ADP”). Part of the senior facility was syndicated to 3 other banks but the Mezzanine was entirely held by the Bank. In February 2009, due to covenant breaches, the facilities were restructured with a significant increase in margins and fees. The facilities have now been fully repaid, with the Bank’s share being over GBP 38m. The increase in margin and fees negotiated in the February restructuring have generated over GBP 2m of additional income for the Bank during the period. ADP repayment is included in the statistics above.

The following assets sales are not included in the statistics above.

#### *Storebrand*

Kaupthing Bank has sold its 24,700,000 shares in Storebrand ASA representing an aggregate of 5.5% of the share capital of the company. The selling price was determined in an accelerated bookbuilt offering. The shares were sold to institutional investors. Following the transaction, the Bank and its affiliates do not own any further shares in Storebrand.

*Kaupthing Bank Dubai and Qatar* was primarily an investment banking services operation based on human capital and fees from mandates. It became evident that it would be expensive to close down the operations and it was therefore more economic to sell the assets and liabilities of the branches to its employees. The proceeds from the sale are held by the Bank.

A 20% stake in the asset management firm *Drake Management* was also sold a few weeks after the collapse of the Bank. This asset was easily marketable and was sold at a fair price. The Bank needed cash to support other assets and since the bid price was considered fair, it was accepted.

### **5.4 Assets sold to date from branches and subsidiaries**

The following assets have been sold from the branches and subsidiaries of the Bank as far as the Resolution Committee is aware.

A loan to a Norwegian equipment manufacturer was sold to repay the Norwegian Banks' Guarantee Fund which paid Kaupthing Norway depositors.

*Kaupthing Bank Asset Management* operations in Finland and certain loans from the loan book in Finland that received satisfactory bids were sold to pay back part of a loan from the Finnish government.

*Kaupthing Pension Consulting* and *Kaupthing Finans AB* have been sold as these business lines did not constitute a core business for Kaupthing Bank Sweden and the latter would have required continued financial support. The proceeds were used to pay back part of a loan from the Swedish Central Bank which was granted to Kaupthing Sweden on 8 October.

At the end of March, the Resolution Committee closed a transaction with Ålandsbanken Abp where the latter acquired the private banking, capital markets and asset management assets of Kaupthing Bank Sweden. More details on the transaction can be found in subchapter 3.4 *Current status of the Bank's subsidiaries*.

## **6. Legal status**

### **6.1 *Moratorium***

On 21 November 2008 the Resolution Committee filed an application with the District Court of Reykjavik, pursuant to Bankruptcy Act to stay creditor actions in order to facilitate the financial reorganization of the Bank. On 24 November 2008 the Bank was first granted a moratorium on debt payments until 13 February 2009. Later an extension was granted from 13 February 2009 until 13 November 2009. Furthermore, on 13 November 2009, the Bank's Resolution Committee and the Moratorium Supervisor requested a further extension, and on 19 November the District Court of Reykjavik granted the Bank an extension of moratorium until 13 August 2010.

The Moratorium Supervisor convened the Bank's creditors to a meeting on 20 October 2009 and sought the opinion of the attendees regarding the Bank's position but matters were not voted on nor were any formal decisions made as such actions are not provided for under the Bankruptcy Act. The meeting was thus held for informational purposes for creditors in light of the court hearing of 13 November 2009 where a petition was filed by the Resolution Committee's petition for a nine-month extension to the moratorium on debt payments.

The moratorium is a procedure under Icelandic law which has provided the Bank with appropriate protection from legal actions, such as the freezing of assets, and ensures that it is able to maintain a banking license sufficient to support its assets.

The maximum time period for the moratorium is 24 months. According to a new Act no. 44/2009 amending Act no. 161/2002 on Financial Undertakings the moratorium can effectively end in three ways; i) a winding up process, ii) an insolvent liquidation or iii) a composition of creditors (scheme of arrangement).

### **6.2 *Rationale for the moratorium***

One of the main tasks of the Resolution Committee and its employees has been to protect assets and safeguard the interests of creditors. The Bank's Resolution Committee believes that the interests of the creditors are best served by restructuring the Bank's operations.

Applying for the moratorium in November 2008 was, in the opinion of the Resolution Committee, a necessary step to ensure that all creditors of the Bank are treated fairly and appropriately in accordance with Icelandic law through the protection of the Bank's assets.

The Resolution Committee is committed to protecting the interests of creditors by preventing the provisional attachment or freezing of assets. The moratorium has provided the Bank with appropriate protection from legal actions, such as the freezing of assets, and ensured that it maintains a banking licence sufficient to support its assets. In the European Economic Area the Bank seeks recognition of the moratorium on a case-by-case basis on grounds of the EU Winding-Up Directive No. 2001/24/EC. The Bank has also been granted recognition and injunctive relief under Chapter 15 of the United States Bankruptcy Code. This has provided the Bank with protection for its assets in the United States. The Resolution Committee has successfully opposed freezing orders in the United States, Luxembourg, Germany, Finland, Austria and the Netherlands. Without the moratorium, preventing proposed freezing orders could be considerably more difficult for the Bank.

The moratorium has and will continue to provide the “breathing space” needed for the Resolution Committee to concentrate on the tasks at hand within the Bank so that it can achieve its objectives to protect creditors’ interests, maximise the recovery rate of claims and ensure equal treatment of creditors.

While protecting the Bank from certain actions by creditors, restrictions are also placed on the Bank in regards to its authorization to dispose of assets, to discharge liabilities and to assume new liabilities.

### 6.3 The Moratorium Supervisor

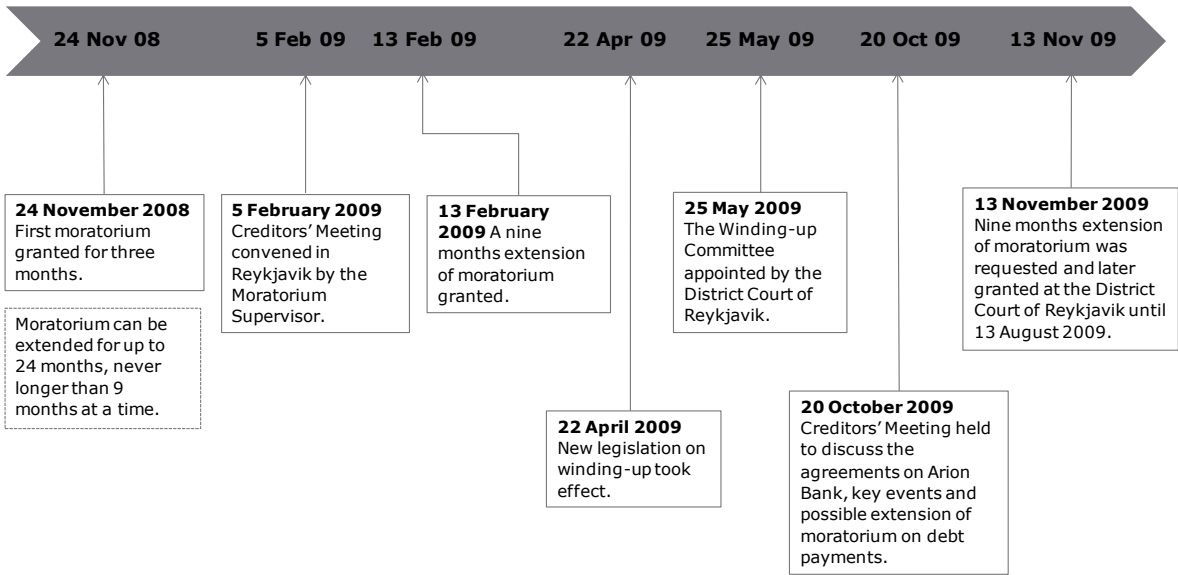
In November 2008, Olafur Gardarsson, Attorney to the Supreme Court of Iceland and a partner of the Reykjavik Law Firm, was appointed as the Moratorium Supervisor. He has been a Supreme Court Attorney since 1992 and his areas of expertise include mergers and acquisitions, corporate and telecommunications law.

The Moratorium Supervisor has the power to oversee the distribution of assets of the Bank and the payment of claims during the moratorium. He will work with the Resolution Committee, which will continue to wield the powers of the Board of Directors of Kaupthing and will as such continue to have decision-making powers in accordance with Icelandic law. His aims are consistent with those of the Resolution Committee, namely to preserve assets and to optimize recoveries for the creditor body. He assists the Bank in its efforts to restructure its finances and to decide how best to achieve any reorganization.

### 6.4 Timeline for the moratorium

According to Act No. 161/2002 on Financial Undertakings, the District Court can currently not authorize a moratorium lasting longer than a total of 24 months from the court hearing of 24 November 2008 and can only be extended for a maximum of 9 months each time an extension is granted. The Bank has been granted extension until 13 August 2010 when a court session shall be held again to consider the matter.

The development of the moratorium process so far, can be seen below.



## **6.5 Analysis of the moratorium legislation**

The provisions governing the moratorium have been amended by Act no. 44/2009 which came into force on 22 April 2009. The Bank remains under the direction of the Resolution Committee which is responsible for the daily operations of the Bank in accordance with Act no. 44/2009 but remains also under the supervision of the Moratorium Supervisor. The Resolution Committee holds the powers of the board of directors as well as the powers of the Bank's shareholders' meeting according to new provisions. Formerly the Resolution Committee held only the powers of the board of directors on the grounds of the decision of the FME of 8 October 2008. The Bank remains subject to Act No. 161/2002 on Financial Undertakings and the general supervision of the FME. The District Court of Reykjavik however has exclusive jurisdiction over the enforcement of the moratorium, its extension and termination etc.

The provisions of Act no. 44/2009 stipulate that the Resolution Committee shall manage the interests of the Bank according to the same rules as a trustee would be subject to according to the Bankruptcy Act, although with some exceptions. The exceptions mainly concern the objective for the Resolution Committee to maximise the value of the Bank's assets which includes waiting for the Bank's outstanding claims to mature, instead of realising them immediately. To this end, the Resolution Committee is allowed to disregard a decision of a creditors' meeting if the Resolution Committee deems such a decision contrary to its objective of maximizing asset value. This means that the Resolution Committee has ample time to safeguard the interests of the Bank and its creditors.

The reference to provisions governing the actions of a trustee under the Bankruptcy Act entail that the Resolution Committee has the capacity to manage the Bank's assets and it alone can dispose of its assets and answer for its obligations. The Resolution Committee acts for the Bank in court and executes agreements on behalf of the Bank as before. The Resolution Committee shall make sure that all assets are disposed of in the most efficient manner possible and shall enforce all claims owned by the Bank. The Resolution Committee furthermore takes such actions as necessary to prevent damage to the Bank.

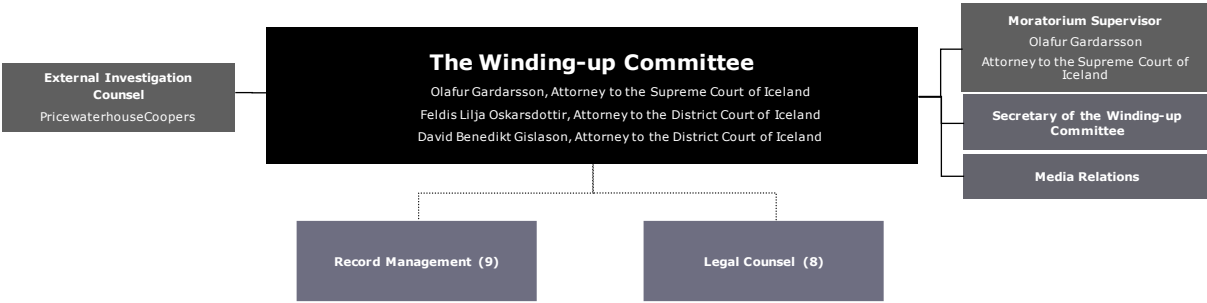
The Resolution Committee can convene creditors' meetings as appropriate to introduce measures taken in regard to the Bank's interests. In such meetings suggestions or decisions may be sought from creditors in regard to measures which have yet to be taken and suggestions may be sought on matters regarding the management of the Bank's interests. The creditors' meeting cannot influence measures which have already been taken by the Resolution Committee, only such measures which have yet to be realised. The Resolution Committee is allowed to consult with individual creditors in matters concerning the relevant creditor's interests.

A petition for the Bank to enter insolvent liquidation cannot be filed nor can its assets become subject to an attachment, an execution or a forced sale while the moratorium remains in effect. No law suit can be commenced against the Bank while the moratorium is in effect unless such action is specifically provided for by law or relates to criminal proceedings.

## **6.6 The Winding-up Committee**

According to the new Act no. 44/2009 amending the Act no. 161/2002 on Financial Undertakings, a Winding-up Committee shall be appointed to handle various matters of the Bank while the moratorium is in effect. In accordance with the provisions of Act no. 44/2009, the District Court of Reykjavik appointed a Winding-up Committee for the Bank. The Winding-up Committee comprises Olafur Gardarsson, attorney to the Supreme Court and the Bank's Moratorium Supervisor, Feldis L. Oskarsdottir, attorney to the District Court and David B. Gislason, attorney to the District Court. The Winding-up Committee does not hold any power over the Resolution Committee or vice-versa. Both are however committed to work

together in the best interests of the Bank and its creditors. Below is an organization chart for the Winding-up Committee.



The role of the Winding-up Committee is to, among other things, call upon any creditors who have a claim against the Bank and take a position regarding their recognition. The Winding-up Committee shall call for claims and set the deadline for filing claims, which can be no longer than six months, counting from the day when a call for claims is announced. The Winding-up Committee makes a register of filed claims and decides how they are ranked in the order of priority of payment of claims. It also deals with possible payment of claims following the first creditors' meeting, which will be held upon expiry of the time limit for the filing of claims.

The Bank's Winding-up Committee has engaged PwC to investigate measures taken by the Bank before it was granted a moratorium, focusing particularly on the possible rescission, on the basis of the Icelandic bankruptcy act, of measures taken by a bankrupt party.

As discussed in subchapter 3.3 *Main tasks of the Resolution Committee today*, last autumn the Resolution Committee, at the request of the FME, engaged PwC to investigate whether the bank, or parties connected to it, had in the weeks before the collapse of the bank deviated from internal rules or violated rules governing financial undertakings in Iceland. The Committee submitted a detailed report to the FME at year-end 2008. The Special Prosecutor's office and a parliamentary investigation Committee have been granted access to the report. In addition to the aforementioned report, the Resolution Committee and its employees have worked extensively to gather information which will be used in the preparation of the Winding-up Committee's rescission action.

It will be an extensive investigation in which the Bank's accounts, involving several million transactions a month, and legal agreements dating back up to two years will be examined. The chief measures being examined will be: loans, deposits, derivative transactions, securities transactions, inter-company and cross-border movements of capital, complex financial structures, employee-related payments and transactions. There will be a particular focus on transactions with related parties as defined by the bankruptcy act, the Bank's main shareholders, key managers, insiders and other parties.

The investigation is expected to involve a large number of people from PwC and employees of the Winding-up Committee and the Resolution Committee. A team of forensic accountants from PwC in the United Kingdom will be involved in the investigation from the outset.

**6.7 The claim process**

The Bank's Winding-up Committee has now published time limits to file claims against the Bank. Creditors have been invited to submit their claims in writing within six months as of 30 June 2009 when the formal claims notice was published in the Icelandic Legal Gazette (*Lögbirtingablaðið*). Therefore, the deadline for submitting claims is 30 December 2009. In accordance with the provisions of Act no. 44/2009, the claim must be itemised as of 22 April 2009. The filed claim must be in accordance with para. 2 and 3 of art. 117 of the Bankruptcy Act. I.e. claims must be precise and among other things,

specify the amount being claimed, along with an itemised list of the principal of the claim, interest and costs. Creditors shall supply information on what forms the basis of their rights, along with documents to support their case. General rules of the Icelandic law regarding proof of claims shall apply.

If a claim is not filed within the abovementioned timeframe, it will be regarded as cancelled with respect to the Bank, unless the requirements for an exception are fulfilled (cf. art. 118 of the Bankruptcy Act).

The notice to file claims has also been published in Icelandic newspapers and in local media in countries where the Bank had established branches. A notice was also published in the *Official Journal of the European Union* and in world-wide media to reach as many creditors as possible. A form for filing claims is accessible on the Bank's website. Further information on the claiming process can be found on [www.kaupthing.com](http://www.kaupthing.com) under "Claiming process" and in the FAQ section.

[The Winding-up Committee has released, on the Bank's website, new and updated documents regarding the filing of certain claims.](#)

[The Bank's Winding-up Committee has been working with its appointed claim agent, Epiq Systems, Inc. on updating the claim filing procedure in relation to Kaupthing bonds. A special Notice was sent to holders of Kaupthing bonds through relevant securities depositories and several updated documents have been published on the website. They are as follows:](#)

- [Guidelines: How to file a claim - FAQ](#)
- [Special Notice applicable for bond claims.](#)
- [ISIN codes for Kaupthing bonds](#)
- [Debt Programmes](#)
- [Claim form - Bonds - English](#)
- [The updated and new documents can be found on: <http://www.kaupthing.com/Pages/4147>.](#)

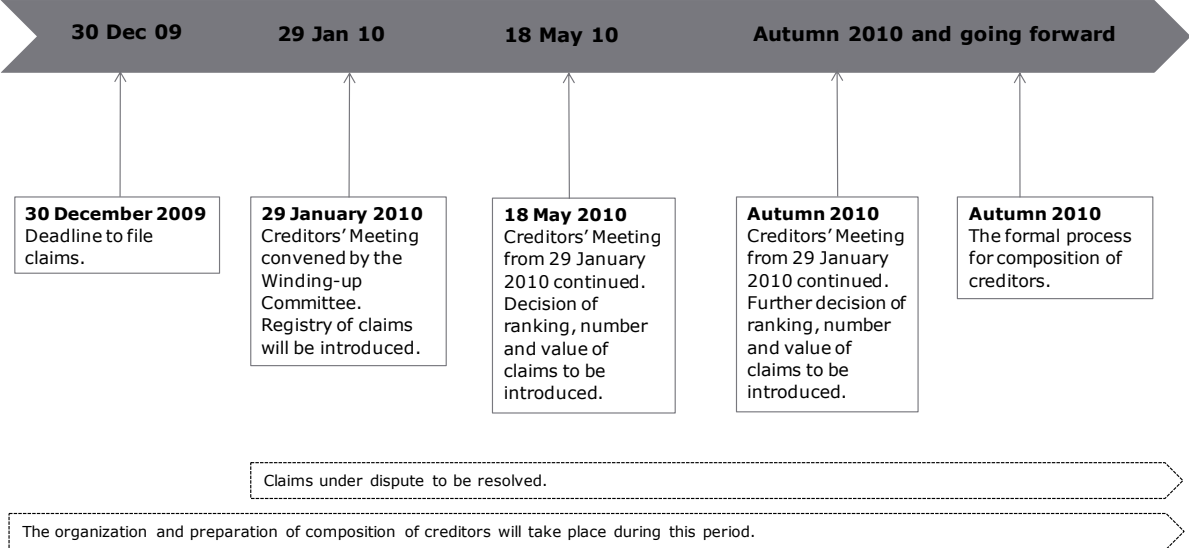
At the end of the deadline for the filing of claims, the Winding-up Committee shall prepare a register of claims, i.e. a register of the claims received in which it shall state its opinion on whether and, if so, how each claim should be recognised. If the Winding-up Committee does not recognise a claim exactly as it has been filed by a creditor, it shall notify the creditor at least one week prior to the creditors' meeting.

At the end of set time limit for the filing of claims, the Winding-up Committee shall hold a creditors' meeting. The meeting will be held on Friday 29 January 2010 at Hilton Hotel Nordica, Sudurlandsbraut 2, Reykjavik, Iceland. One week prior to the meeting a claim register will be available to creditors. A creditor, who is unwilling to accept the Winding-up Committee's position as regards the recognition of his/her claim against the Bank, shall state his objections at a creditors' meeting or notify the Winding-up Committee in a letter received by it no later than at that meeting. In the same manner, a creditor may object to the Winding-up Committee's position on the recognition of a claim filed by another creditor if the conclusion regarding the claim affects the interests of the objecting party. Insofar as no objection is raised against the Winding-up Committee's position on the recognition of a claim, its position shall be regarded as approved.

The claims register shall be presented at the creditors' meeting, as well as any objections that may have been made. At the creditors' meeting, the Winding-up Committee shall provide those in attendance with the explanations they require regarding the subject matter of individual claims, as well as the reasons for its position towards the recognition of those claims. If an objection is raised at the meeting against the Winding-up Committee's position on the recognition of a claim, the Winding-up Committee shall endeavour to settle the dispute. If this is not successful, the parties concerned shall be called to a

separate meeting for this purpose. If the dispute cannot be settled in this manner, the Winding-up Committee shall refer the matter to the District Court of Reykjavik.

It is difficult to estimate how long it will take to complete the process of taking a position on the filed claims, both because of the vast amount of creditors involved and because the process of taking a position on many of the claims may be complex and time-consuming.



At the end of the first creditors' meeting 29 January 2010, the Winding-up Committee is authorised to pay recognised claims in one lump sum or several payments and in part or in whole. If this is done, care shall be taken to ensure that the Bank's assets are sufficient to at least equally cover all the other claims, which are included in the same rank and which have not been rejected in the winding-up process. The Winding-up Committee shall also ensure that all creditors with recognised claims in the same rank are paid at the same time, although it is possible to deviate from this with the approval of those who do not get paid or by a decision made by the Winding-up Committee if a creditor offers to relinquish a claim in exchange for a partial payment, which is deemed to be a proportionally lower amount than that which other claimants in the same rank would ultimately receive, taking into consideration, among other things, whether the claim bears interest until payment. One of the underlying principles of the Bankruptcy Act is the principle of equality of creditors. The Winding-up Committee shall, however, also have to consider certain exceptions to that principle, such as the order of priority of payment of claims.

The Winding-up Committee may not make any decisions regarding the sale of assets for the payment of claims. It is only the Resolution Committee that may make decisions regarding the sale of the Bank's assets, in accordance with Act no. 161/2002 on Financial Undertakings and subsequent amendments in Act no. 44/2009.

The Winding-up Committee can also challenge and claim rescission of actions of the Bank in accordance with the rules on rescission in the Bankruptcy Act. This entails, with some simplification, that the Winding-up Committee can rescind certain unusual actions of the Bank which took place prior to 15 November 2008 and can claim damages or repayment from parties benefiting from such actions.

The Winding-up Committee shall also oversee possible composition negotiations, following an evaluation of the Resolution Committee on whether the Bank has sufficient assets to meet its obligations. This entails, among other things, the Winding-up Committee having to prepare a composition proposal, submitting it to a creditors' meeting and obtaining the creditors' approval of it and

having the composition agreement confirmed by the District Court of Reykjavik if it has been approved by the required number of creditors. If the composition proposal is approved by the creditors and it is confirmed by the District Court of Reykjavik, the Winding-up Committee must ensure that the agreement is performed.

## **6.8 Creditors' meetings**

According to the new Act no. 44/2009 the matters considered at creditors' meetings are mainly twofold, firstly there are matters concerning the management of the Resolution Committee of the interests of the Bank and secondly, the recognition of claims by the Winding-up Committee.

The Resolution Committee can convene creditors' meetings, as it deems appropriate, to introduce measures taken in regard to the Bank's interests. The Resolution Committee may seek proposals or decisions regarding measures that have yet to be taken, and provide for opportunities for making such proposals. The creditors' meeting cannot affect measures already carried out by the Resolution Committee. The Resolution Committee is allowed to confer with individual creditors in matters concerning the relevant creditors' interests.

A creditor is entitled to attend a creditors' meeting if the creditor has filed a claim against the Bank with the Winding-up Committee and if such claim has not been finally dismissed by the Winding-up Committee. Creditors' meetings regarding the management of the Bank's interests and the recognition claims will not be held until the deadline for filing claims has passed. If a creditor does not attend a meeting, the relevant creditor may lose the right to oppose matters or present claims regarding matters which were decided or presented at the meeting.

Voting rights are determined by the amount of each creditors claim if matters regarding the management of the Bank's interests are put to a vote. For a creditors' meeting to be quorate, creditors holding at least a third of the total voting rights must be present at the meeting. To disregard a decision of the majority of creditors, the Resolution Committee must in most cases have specific reasons for doing so. The Resolution Committee can thus disregard decisions of a creditors' meeting if they are contrary to law, dishonest, cannot be executed, contrary to interests of creditors not attending, discriminate against the minority or if the decisions are contrary to the goal of maximising the value of the Bank's assets.

The Winding-up Committee handles the aspect of the creditors' meetings which has to do with the recognition of claims. The Winding-up Committee shall submit its registry of claims to the creditors' meeting as well as any objections which the Winding-up Committee may have received in regard to submitted claims. The Winding-up Committee shall offer explanations as to the recognition of claims and any objections which have been made against recognition of specific claims. If a protest is made in regard to the recognition of claims at a creditors' meeting, the Winding-up Committee will endeavour to resolve the dispute. If such a dispute cannot be resolved at the creditors' meeting, the Winding-up Committee shall convene a separate meeting between the disputing parties. If the dispute cannot be resolved at such separate meetings, then the dispute will be referred to the District Court of Reykjavik. As far as protests are not made against the recognition of claims, then such recognition shall be considered accepted.

In addition, the moratorium supervisor shall convene meetings as appropriate to consider applications to the District Court of Reykjavik for the extension of the moratorium.

## **6.9 Potential closing of the moratorium process**

As previously outlined, the Bank was first granted a moratorium on debt payments and a license for financial reorganization in a court hearing on 24 November 2008. The District Court can currently not authorize a moratorium lasting longer than a total of 24 months from the court hearing, i.e. until 24 November 2010.

The moratorium process of the Bank shall conclude by means of one of the following:

### **i) Winding-up proceedings**

When an authorisation for moratorium concludes, a financial undertaking shall enter a winding-up process according to Act no. 44/2009 amending Act no. 161/2002 on Financial Undertakings. Many of the rules governing the moratorium, and which are mentioned above, would continue to apply in a winding-up process. The Resolution Committee continues to operate under a winding-up process with the same aim as before to maximise the value of assets. That includes waiting for the maturity of assets rather than disposing of them immediately.

If in the winding-up process, the assets of the Bank are found to be of less value than the amount of its liabilities there are two possibilities to conclude the Bank's operations, i.e. insolvent liquidation or a composition of creditors as described below. Act no. 44/2009 also provides for the conclusion of the Bank's operations through insolvent liquidation or a composition of creditors without an intermediate winding-up process. This applies if the Resolution Committee and the Winding-up Committee can decide whether, and if so to what extent, the assets of the Bank are found to be of less value than the amount of its liabilities, before the moratorium expires.

### **ii) Insolvent liquidation**

If the moratorium period had not been requested on 13 November 2009 and granted on 19 November 2009, and the Bank would be forced into a winding-up proceedings, the Moratorium Supervisor and the Resolution Committee firmly believe that its resources to counter legal actions and actions by individual creditors could have been compromised. Furthermore, the Resolution Committee believes that it has stronger arguments to maintain a banking license while in moratorium, than in winding-up process.

In a state of insolvency liquidation, the management of the assets of the Bank would vest in a liquidator. Claims against a bankruptcy estate denominated in foreign currency shall be converted into the Icelandic currency at the selling rate posted on the day when the bankruptcy order was issued and it is very likely that a trustee in bankruptcy will convert all liquid assets into the Icelandic currency in the event of insolvency in order to transfer the currency risk from the estate to the Bank's creditors. Such a measure would be understandable from the point of view of the trustee of the estate, but it may not be in the interests of the Bank's creditors.

According to the Bankruptcy Act, the trustee in bankruptcy shall ensure that the winding-up is concluded without undue delay. As stated above the Resolution Committee and the Moratorium Supervisor believe that the interests of the creditors are best served by restructuring the Bank's operations. It is therefore clear that the obligations of the trustee in bankruptcy according to the article may prevent this from happening. In addition, a Bank in insolvent liquidation would forfeit its banking license, face forced asset sales, and have less flexibility to support its assets. It is likely that performing loans to customers as well as listed and unlisted assets would be sold at a substantial discount.

It is the opinion of the Moratorium Supervisor and the Resolution Committee that this option would minimize debt recovery for the creditors of the Bank and it would not be in their best interests.

### iii) Composition with Creditors (Scheme of Arrangement)

A composition with creditors seeks to solve a debtor's financial difficulties by proportionally reducing creditors' claims but at the same time allows the debtor to stay solvent. This arrangement endeavours to maximize debt recovery and preserves creditors' interest by granting the debtor the opportunity to be restructured and support assets instead of being forced into an immediate sale of assets. If the moratorium process of the Bank were to be concluded by arrangement composition with creditors, potential restructuring options of the Bank can be considered and evaluated. Further discussions on potential restructuring options can be found in chapter 7. *Overall restructuring.*

As discussed in subchapter 6.10 *Icelandic composition legislation overview*, the minimum creditor support required for a scheme of arrangement is 60% in terms of value and the number of creditors voting. Claims are converted into Icelandic krona as of 22 April 2009 but distributions can be in any currency specified under the scheme.

It should be pointed out that the Resolution Committee and the Moratorium Supervisor are working towards a solution whereby the restructuring of the Bank will be completed by a scheme of arrangement with creditors in order to prevent the Bank from entering insolvency proceedings, which could reduce the value of assets.

#### **6.10 Icelandic composition legislation overview**

Composition with creditors has the same objective as a moratorium: to react to financial difficulties of a debtor. Unlike composition, a moratorium gives the debtor a certain grace period for financial reorganisation with the long term goal of increasing, or at least preserving the value of the debtor's financial interests. Composition on the other hand, seeks to redress the negative asset position or insolvency of a debtor through an agreement with his creditors with general terms that apply to all creditors that have composition claims against the debtor.

The new Act no. 44/2009 amending Act no. 161/2002 on Financial Undertakings, which came into effect last April, contains rules governing composition negotiations for financial undertakings that are in moratorium or winding-up process. According to these rules, the Winding-up Committee of a financial undertaking may seek composition if it considers that the assets of the undertaking are not sufficient to fully satisfy all claims, that have not been finally rejected in the winding-up process. The general rule is that prior to seeking composition, a request must be submitted to a district court for its approval. However, that does not apply to financial undertakings in a winding-up process. When a financial undertaking in a winding-up process seeks composition, the Winding-up Committee serves the same role as a supervisor of composition negotiations or a liquidator of an estate would normally do and is responsible for holding creditor meetings.

The Resolution Committee and the Moratorium Supervisor are working towards a solution whereby the restructuring of the Bank will be completed by a composition with creditors. This is being done by finalizing the composition with creditors as soon as possible given the Icelandic legal framework.

The Winding-up Committee will prepare a composition proposal. It must state to what extent the debtor offers payment of the composition claims and the form of payments, the dates of the payments, whether interest, and if so, at what rate, will be paid on the composition claims from the date a composition agreement is concluded and until the date of payment, if deferred payment is envisaged, whether security, and if so of what kind, will be placed to secure performance of the composition agreement.

Composition agreement only affects claims against the debtor which are referred to as composition claims. The term is defined in a negative manner and applies to all the claims against the debtor which are not exempted from the composition. Composition agreement does not affect the following claims:

- Claims originating after 22 April 2009;
- Claims for performance other than payment of money, which can be performed in substance;
- Claims that on 22 April 2009 ranked according to Articles 109, 110 or 112 of Act on Bankruptcy etc. – this includes proprietary claims, claims for costs of the moratorium proceedings and priority claims;
- Secured claims insofar the security covers the secured liability. The part of the liability which the security does not cover shall be composition claim.
- Claims that could have been settled by way of set-off according to Article 100 of the Act on Bankruptcy etc, and
- Any claims particularly exempted from composition under the terms of the composition agreement by reason of their full payment, cf. Paragraph 2 of Article 36 of Act no. 21/1991 on insolvency etc.
- A creditor, who has claims against the debtor which the composition agreement does not affect, can relinquish that right, so that the composition agreement does affect its claims.
- Composition also cancels any debts that would be ranked as provided for in Article 114 of Act no. 21/1991 on insolvency etc. if the debtor's estate had been declared bankrupt.

When a Winding-up Committee decides that voting shall take place on the composition proposal, it convenes a meeting of creditors for that purpose at a time it deems appropriate. The meeting shall be convened with a notification in the "Legal Gazette" with at least two weeks' notice. The Winding-up Committee shall prepare a register of the rights to vote on the proposal, specifying the voting rights attached to each claim, both by number of creditors and by the value of their claims. The register shall include only the claims that have been recognised and to which voting rights are attached in the opinion of the Winding-up Committee. Each creditor with a composition claim against the debtor shall have one vote in number and a voting power proportionate to the value of his composition claim against the total value of all the composition claims. If a creditor has two composition claims or more, they shall be added together and counted as one claim and one vote in number will be attached to the claims as a whole. One vote in number can also be divided between more than one creditor, if an assignment of a composition claim has taken place in the three months prior to the reference date. Voting creditors may vote on a composition proposal in writing, and such votes shall be taken into account if received by the Winding-up Committee no later than when the voting is completed and no one is in attendance on the relevant creditor's behalf. A vote in writing shall only be valid if it expresses the stand the voting creditor has taken with respect to the proposal unequivocally and unconditionally, and the creditor's signature is confirmed by two witnesses, a district court or Supreme Court lawyer, or a public notary.

A composition proposal shall be deemed approved if supported by the same proportion of votes by creditors in number and by value of their claims, as the proportion of composition claims to be relinquished according to the proposal, provided this reaches 60 per cent at a minimum by vote and amount. If the composition agreement stipulates something other than relinquishment, e.g. the exchange of debt claims for shares, it requires approval of 60 per cent of the creditors in number and by value of their claims. If the result of the vote can be decided by a creditor with a disputed claim then the result of the vote is postponed until the dispute has been solved before the relevant Court of law.

If the composition proposal is approved by the creditors, the Winding-up Committee must obtain a confirmation of the District Court of Reykjavik of the composition agreement. If it obtains this confirmation a composition settlement is considered to be concluded. The settlement will only be binding for creditors that have composition claims as defined above. If the composition settlement is confirmed, the Winding-up Committee shall, as necessary, fulfil any obligations to creditors in

accordance with the settlement and then conclude the winding-up proceedings. The settlement of a composition claim shall have the same effect as its settlement in its original form.

If, on the other hand, the composition proposal is not approved by the creditors or its confirmation has been rejected, the Winding-up Committee shall request that the undertaking enters into an insolvent liquidation. A creditor may do the same if its claim has been recognised in the winding-up proceedings and either the composition negotiations have not yielded any results or the creditor demonstrates that the legal requirements for composition negotiations to take place are not fulfilled or that such a large number of creditors are opposed to composition that there is no possibility of achieving composition based on available information on the undertaking's financial situation. In order to uphold this claim, the creditor must, however, establish a legitimate interest for the insolvency proceedings to go ahead rather than continuing the winding-up proceedings.

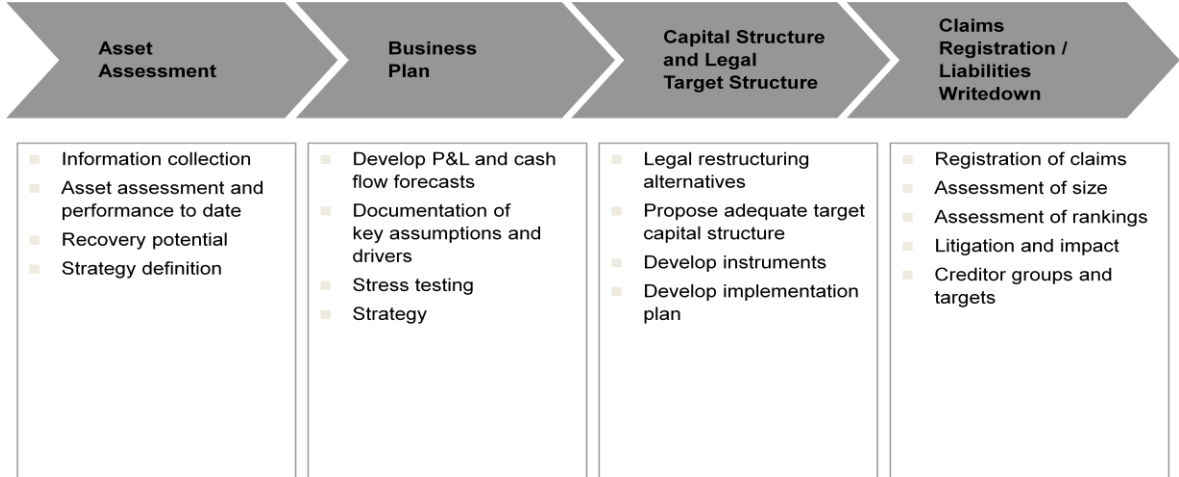
# 7. Overall restructuring

## 7.1 Overall restructuring of the Bank

It is the ultimate role of the Resolution Committee to maximize the value of the Bank's assets and pass on the value to its creditors.. Therefore, according to creditors' requests, the Resolution Committee have been working on solutions to preserve and increase the value of the assets. In many cases, the assets need to be held for some time for them to be redeemed at acceptable value. The moratorium or the winding-up process following the moratorium will end either through scheme of arrangement or insolvent liquidation of the Bank. Therefore, the Resolution Committee has also asked Morgan Stanley, its financial advisor, to assist in developing structuring ideas on how the assets can be passed over to creditors at a later stage. All these ideas should aim at providing ongoing support to the assets and building a structure where creditors can exit their holdings over time.

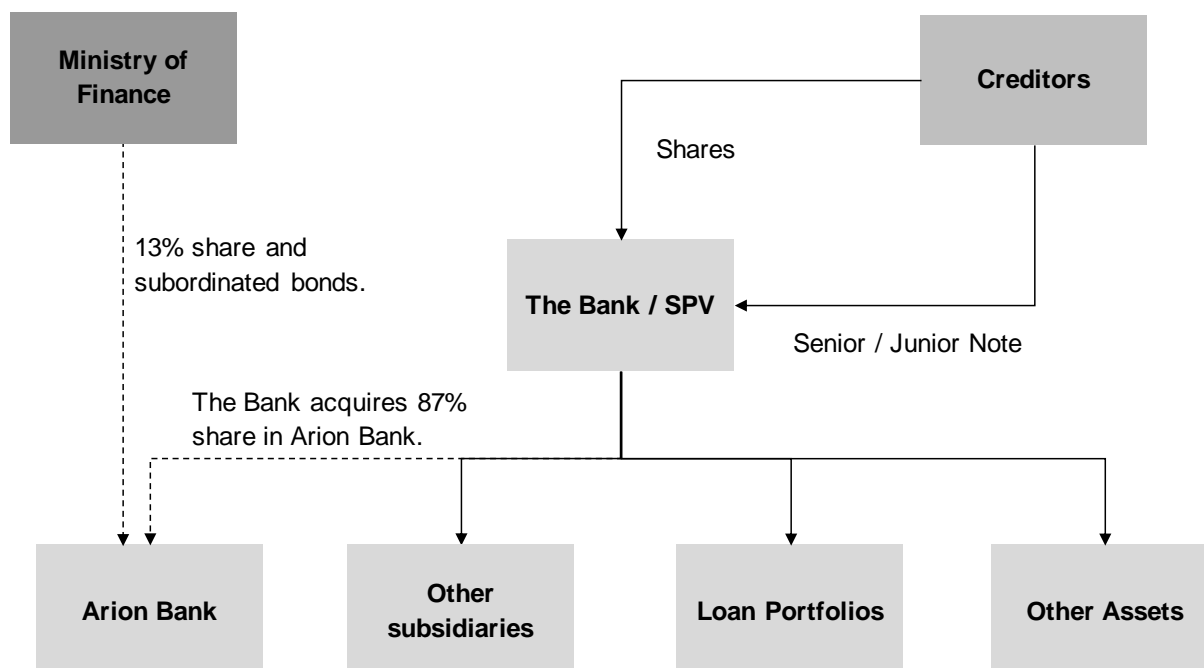
### Work streams

Work has commenced on the various parts of the restructuring (see work streams below) with the objective of having preliminary results in the first quarter of 2010. A more detailed timetable for the restructuring milestones will be published in due course.



### **Target structure for the Bank**

- After scheme of arrangement the Bank operates as a parent company or as new SPV as ongoing asset management company.
- Value realization for creditors through convergence of claims into cash distribution and issuance of instruments.
- Strategy focused on value maximization through cash collection, separate monetization of holdings and work out of other assets.



The Resolution Committee, on behalf of creditors, will own Arion Bank through a holding company and Arion Bank becomes an independent operating subsidiary of the Bank such as other subsidiaries.

### **Moratorium**

As discussed in subchapter 6.9 *Potential closing of the moratorium process*, the moratorium on debt payments could be ended through a scheme of arrangements with composition of creditors, winding-up status of the Bank or insolvent liquidation of the Bank. The decision on the most suitable legal route will only be taken after the registration of the claims process as part of the overall restructuring. The currently granted moratorium ends 13 August 2010.

### **Claims**

As discussed in subchapter 6.7 *The claim process*, the registration period ends 30 December 2009 at the latest. Thereafter, the validity, rank and quantum of claims against the Bank will be determined. That process will determine the total value of claims against the Bank, the identity and number of creditors and their proportion and rank in the total value of claims which in turn forms the basis for voting at creditors' meetings and for the overall restructuring process. [The Winding-up Committee will hold an all creditors' meeting on 29 January 2010, the next meeting thereafter has already been scheduled on 18 May 2010.](#)

### **The Bank's overall restructuring and key decisions**

Final restructuring plan will be voted on based on registered claims by creditors at an all creditors' meeting. Such meeting can only be held after the finalization of the claims registration process, i.e. the

earliest in 2010. The finalization of the claims registration process depends on how substantial the disputes in respect of the claims will be. The claims registration process has to be finished in order to allocate possible voting rights at creditors' meetings.

## **Appendix 1 Meeting minutes: Creditors' Meeting held 5 February 2009**

**Minutes recorded by Kaupthing Bank's Moratorium Supervisor at a creditors' meeting, cf. Art. 14 of the Icelandic Act no. 21/1991 on Bankruptcy etc.**

A meeting was held on Thursday 5 February 2009 at 10:00 a.m. at Hilton Reykjavík Nordica, Sudurlandsbraut 2 in Reykjavík, with the creditors of Kaupthing Bank hf., Borgartún 19, 105 Reykjavík, ID-No. 560882-0419, concerning the bank's authorisation for a moratorium.

Ólafur Gardarsson, Attorney to the Supreme Court of Iceland, Moratorium Supervisor, chaired the meeting and recorded the minutes, cf. Art. 14 paragraph 2 of Icelandic Act no. 21/1991. The meeting was called in accordance with the provisions of Article 98, paragraph 3 of the Act no.161/2002 on Financial Undertakings, cf. Act no 129/2008.

The meeting was attended by representatives of the bank's creditors, a total of 250 people. Given that the majority of those present did not speak Icelandic it was decided that the main section of the meeting would be held in English. Tomas Jonsson, Attorney to the Supreme Court of Iceland, helped the Moratorium Supervisor chair the meeting. The Bank's resolution committee was also present to answer questions.

The Moratorium Supervisor gave a report on the assets and liabilities as of the reference date, explained how he believed the debtor's finances could be reorganised and described what measures had already been taken in this respect. Those attending the meeting received a copy of a presentation, and a detailed summary in English and Icelandic by the Moratorium Supervisor was also distributed.

The Moratorium Supervisor announced his proposal that an application be made to extend the moratorium by nine months at the next hearing of the Reykjavík District Court which is to be held on 13 February at 2:00 p.m.

The Moratorium Supervisor then sought the views of the creditors on his actions and proposals for action. When the Moratorium Supervisor had finished, creditors were given the opportunity to ask questions and put across their points of view. Twenty-one people raised questions.

Questions were raised concerning various topics which had been discussed in the Moratorium Supervisor's presentation and the Moratorium Supervisor and members of the resolution committee answered these questions as far as they were able. A summary of the questions raised and the committee members' replies is enclosed with these minutes. A German investor speaking on behalf of more than 800 German deposit holders declared the group's support for the extension of the bank's moratorium. A letter was also presented from two creditors in which they agreed to the extension but only for a further three months.

No objections were raised to the extension of the moratorium. The Moratorium Supervisor asked the meeting twice whether anybody objected to applying for an extension to the moratorium. No objections were raised.

At the end of the meeting the Moratorium Supervisor presented the main points from the minutes to the meeting and invited those present to add any remarks they may have. The minutes were approved in their current form.

The meeting was adjourned at 12.15 p.m.  
Ólafur Gardarsson

## Appendix 2 Meeting minutes: Creditors' Meeting held 20 October 2009

registration no. of Kaupthing Bank hf. 560882-0419;

meeting jointly held by

i) *Kaupthing Bank's Resolution Committee*, according to Article 103, Paragraph 3 of Act no. 161/2002 on Financial Undertakings, cf. Act no. 44/2009 and Temporary Provisions to Act no. 44/2009;

ii) and *Kaupthing Bank's Moratorium Supervisor* cf. Chapter 2 of Act no. 21/1991 on Bankruptcy etc., cf. Article 2 and 4 of Act no. 129/2008, still in effect according to the provisions of Article 10, Paragraph 2, of Act no. 44/2009 (both Acts amending Act no. 161/2002 on Financial Undertakings).

The meeting was held at Hilton Reykjavik Nordica, Suðurlandsbraut 2 in Reykjavík, on October 20, 2009, and commenced at 10 am.

Registered at the meeting were 104 representatives of creditors.

Members of the panel at the meeting were:

- Tómas Jónsson, Attorney to the Supreme Court, Chairman of the meeting.
- Ólafur Gardarsson, the Moratorium Supervisor and member of Kaupthing's Bank Winding-up Committee.
- Steinar Thór Gudgeirsson, Chairman of the Resolution Committee.
- Knútur Thórhallsson, Deputy Chairman of the Resolution Committee (during items 1, 2)
- Theodór Sigurbergsson, member of the Resolution Committee.
- Eva Sóley Guðbjörnsdóttir, Managing Director of Finance, Kaupthing Bank.
- Kolbeinn Árnason, Managing Director of Legal, Kaupthing Bank.
- Dieter Turowski, representative of Kaupthing's exclusive financial advisor Morgan Stanley.
- Karsten Hofacker, representative of Kaupthing's exclusive financial advisor Morgan Stanley.
- Halldór Bjarkar Lúdvígsson, Managing Director of Asset Management – Nordic Portfolio, Kaupthing Bank (during items 1-2, 6).
- Dominic McCahill, representative of Weil Gotshal & Manges, legal advisors to Kaupthing (during items 1-2, 4-6).
- Finnur Sveinbjörnsson, CEO of Arion Bank (during items 3-6).
- Björk Thórarinsdóttir, Managing Director of Credit, Arion Bank (during item 4-6).

### 1. Introduction

Ólafur Gardarsson welcomed the creditors.

The main purpose of the meeting is to provide creditors with an update on key events and activities since the last meeting in February, to provide creditors with the latest financial information on the Bank, to provide creditors with an overview of the processes and a summary of the Capitalization Agreement on Arion Bank, to outline the next steps and restructuring options of the Bank and to discuss the possible extension of the Bank's moratorium on debt payments. According to Icelandic law, no binding decisions can be made at the meeting.

Tómas Jónsson, Attorney to the Supreme Court of Iceland, was asked to serve as chairman of the meeting. He assumed the duties of the chairman and confirmed that the meeting was called as prescribed by law. Given that the majority of those present did not speak Icelandic it was decided that the meeting would be held in English.

### 2. Key Events and Progress during the Moratorium

#### 2.A. Key Milestones

Steinar Thór Gudgeirsson presented key milestones. Steinar discussed the general approach of the Resolution Committee, which ultimate task and duty is to maximize the value of the Bank's assets and pass on the value to its creditors. Steinar presented a summary of the Bank's balance sheet and the status of maximizing the value of the assets. Steinar furthermore discussed the status of the Bank's subsidiaries and branches and the organizational structure of the Bank.

## **2.B. Loan Restructuring / Europe and Nordic**

Halldór Bjarkar Lúdvígsson presented an overview of the loan restructuring in the Europe portfolio (fair value as at 30 June 2009 approx. 140 bn ISK) and Nordic portfolio (fair value as at 30 June 2009 approx. 170 bn ISK). The mandate of the asset management division can be broken into five steps, which were discussed: *stabilization, consolidation, full overview*, which leads to *management* of the assets and ends with *value optimization and exit strategy*. Halldór presented an overview of loans to customers by portfolio and sector, as well as a past cash-flow analysis. According to his presentation, a considerable part of the Nordic and Europe portfolios has undergone major restructuring and Halldór discussed the Bank's restructuring principles and core values. In all major cases the Bank has relied on valuation work or input by third party advisors. Halldór furthermore discussed actions taken on the portfolios and the progress with the restructuring work, as well as giving an overview of full repayments and exits.

## **2.C. Financial Information Update**

Eva Sóley Guðbjörnsdóttir presented an update on the financial information of the Bank, including information on the Bank's balance sheet, cash in hand, development of loans to customers at fair value and information on derivatives.

## **3. Capitalisation Agreement on Arion Bank**

### **3.A. Overview of Agreements with the Government**

Kolbeinn Árnason presented an overview of the agreements with the Government relating to Arion Bank and discussed the two options available to the Bank. The Resolution Committee has the sole power to decide whether to choose option 1 (Kaupthing to acquire Arion Bank) or option 2 (Government retains Arion Bank). Kolbeinn presented a summary of the key terms of both options. According to option 1, Kaupthing would receive an 87% ownership following a capitalization contribution of 65% (ISK Cash and Icelandic related assets), approx. equalling 66 bn ISK (ownership might possibly be increased to 90% under option 1). According to option 2, Kaupthing would have the right to repurchase 90% of the equity from the Government during the exercise period of one month following the publication of the annual report for the years 2010-2014. Kolbeinn also discussed Kaupthing's consultation with creditors and creditors' due diligence. For further details, reference is made to Kolbeinn's presentation and further publicly available information.

### **3.B. Presentation of Arion Bank**

Finnur Sveinbjörnsson presented an overview of Arion Bank. Finnur presented the balance sheet and income statement of Arion Bank, as well as a cash flow analysis. He also discussed Arion Bank's five year business plan and presented an analysis of the loan portfolio. Finnur furthermore discussed the recovery process within Arion Bank, including a breakdown of recovery cases by sectors. Finnur discussed the current liquidity position of Arion Bank and the FX imbalance. Finally Finnur discussed the upside potential of Arion Bank and the importance of ownership for the next few months.

### **3.C. Due diligence and Summary / Review of Capitalisation Options**

Karsten Hofacker presented a summary of due diligence on Arion Bank carried out by Kaupthing and its advisors. Due diligence is ongoing, as audit of financials is not yet completed. Due diligence to date has focused on balance sheet analysis / net asset valuation of Arion Bank, detailed analysis of the business plan, liquidity risk and profit improvement measures. Karsten discussed a summary of the valuation and a returns profile with regards to the two options.

Dieter Turowski presented an overview of the pros and cons with regards to the two options.

### **3.D. Creditor Consultation Process**

Max Ziff, representative of Houlihan Lokey, discussed the due diligence on Arion Bank assets and the choice between the two options previously presented (option 1 and option 2).

Chip Fisher from Bingham McCutchen, representing a group of bond holders, and a member of the Informal Creditors' Committee (ICC) and the ICC Sub-Committee, discussed Kaupthing Bank's creditor consultation process. Chip expressed his view that he was happy with the work of the Resolution Committee with respect to guarding the interests of creditors.

A lunch break was made at 12.45 pm.

*During the lunch break creditors were invited to submit written questions for the following Q&A session.*

The meeting commenced again at 1.20 pm.

### **4. Morgan Stanley overview**

John Hepburn, from Morgan Stanley, discussed the role of Morgan Stanley with regards to the work of the Resolution Committee.

### **5. Next Steps and Restructuring Options**

#### **5.A. Legal Overview**

Ólafur Gardarsson discussed the Bank's moratorium and gave a legal overview of the moratorium process. The first moratorium was granted from 24 November 2008 until 13 February 2009. According to the Icelandic legislation, the moratorium can be granted for up to 24 months. An extension was granted from 13 February 2009 until 13 November 2009 and another extension of 9 months will be requested on 13 November 2009. The moratorium can be concluded in the following ways, which were discussed by Olafur: (1) Winding-up process pursuant to Act no. 44/2009; (2) Composition of creditors (Scheme of arrangement); (3) Insolvent liquidation.

#### **5.B. Overall Restructuring**

Dieter Turowski discussed the work streams of the restructuring process of Kaupthing Bank.

Karsten Hofacker discussed the target structure for the Bank, the current legal paths for restructuring as well as the liability restructuring.

#### **5.C. Moratorium Extension**

Ólafur Gardarsson announced his proposal that an application be made to extend the moratorium by nine months at the next hearing of the Reykjavik District Court which is to be held on 13 November 2009. The arguments presented included the fact that a Chapter 15 protection in the USA might be terminated should the moratorium not be extended. Ólafur then sought the views of the creditors on this proposal, in accordance with the Act on Bankruptcy etc.

Arnar Thór Jónsson from the law firm Réttur, acting on behalf of more than twenty bank creditors, presented concerns and objections to the capitalisation agreement. A formal letter to the Resolution Committee was also received by the chairman from the law firm, detailing the concerns and objections further.

No objections were made to the extension of the moratorium.

### **6. Q&A**

Questions submitted during the lunch break were addressed by panellists (one question was also addressed by Gisli Óttarsson, Managing Director of Risk Management at Arion Bank). Any remaining

questions will be dealt with in due course and published on the website. Unanswered questions directed to Arion Bank regarding SPM will be dealt with by Arion Bank.

Following this Dominic McCahill discussed the ruling of the High Court of England today, relating to Kaupthing's application for judicial review of the legitimacy of the decision taken by the UK Treasury to transfer assets and deposits from Kaupthing Edge accounts at Kaupthing Singer and Friedlander in October 2008. The Court held that the UK Treasury had acted within its statutory powers and there had been no error in its decision-making process.

The chairman of the meeting presented the main points from the minutes to the meeting and invited those present to comment on them. No comments were made.

Steinar Thór Gudgeirsson adjourned the meeting.

*The meeting was adjourned at 3 pm.*

*Minutes recorded by Kaupthing Bank's Moratorium Supervisor, cf. Act no. 21/1991 on Bankruptcy etc.*

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- (b) Additional claims being made against the Bank
- (c) The realisation method(s) used over time
- (d) The impact of set off and netting including in connection with derivative contracts
- (e) Movements in currency exchange rates and interest rates
- (f) Prevailing market conditions when assets are sold

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