

**KAUPTHING BANK HF. CREDITORS' REPORT**

**5 FEBRUARY 2009**

**UPDATE SEPTEMBER 2009**



**KAUPTHING BANK**

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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 the September update of the report

During the nine-month moratorium period, from 13 February to 13 November 2009, the Bank intends to compile a monthly report 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
- 3.3    Main tasks of the Resolution Committee today
- 4.3    Assets restructured to date
- 5      Financial analysis

## 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.
New Kaupthing	Nyi Kaupthing Banki hf.
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 New Kaupthing Bank hf. 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 current 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 UK, the internet banking product of the Bank's UK subsidiary Kaupthing Singer & Friedlander ("KSF").

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 Kaupthing Edge in the United Kingdom, despite the fact that Kaupthing Edge deposits 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 ICB extends EUR 500m loan to the Bank
- 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
- Nyi Kaupthing Banki hf. ("New Kaupthing") is created
- Certain domestic assets and domestic deposits transferred to New Kaupthing 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 New Kaupthing was announced
- On 14 August 2009, the Government capitalized New Kaupthing with appr. ISK 72bn in common equity which will allow New Kaupthing to function as a fully operational bank (see further subchapter 7.4 *Agreement on capitalization, compensation and process*)
- On 3 September 2009, the Bank's Resolution Committee and the Government signed an agreement on settlement between the Bank and New Kaupthing in accordance with the agreement announced on 20 July 2009

### **Next steps**

- **20 October 2009:** The Resolution Committee will call for a creditors' meeting to discuss the agreement between the Resolution Committee and the Government on New Kaupthing. At the meeting, creditors will be provided with latest financial information on the Bank. Also, there will be a discussion on possible extension of moratorium on debt payments. Further information about the meeting, and how to register for it, can be found on the Bank's website [www.kaupthing.com](http://www.kaupthing.com)
- **31 October 2009:** Last day for the Resolution Committee to complete subscription in shares in New Kaupthing if the Resolution Committee decides to do so
- **13 November 2009:** Further hearing at the District Court of Reykjavik to consider the extension of the moratorium of the Bank if the decision is made to apply for an extension
- **30 December 2009:** The formal claim registration process which started on 30 June 2009 ends
- **29 January 2010:** All creditors' meeting held at 10:00 a.m. at Hilton Hotel Nordica
- **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 is currently in the midst of 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 Bank 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

On 30 July 2009 FME requested that members, who formerly held management positions within the three banks at the time of their collapse, should resign from the respective Resolution Committees as their expert knowledge of the banks' operations was no longer needed. Gudni Adalsteinsson subsequently renounced his position as member of Bank's Resolution Committee. His resignation took effect on 15 August 2009.

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. As an entity in Iceland with a banking licence, the Bank is still subject to supervision by the FME.

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 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 New Kaupthing.

*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 New Kaupthing 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 New Kaupthing is now responsible for domestic deposits and, in terms of foreign depositors, has either been completed or final arrangements are being negotiated. 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 deposits prior to regular 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 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 50 specialists now work for the Resolution Committee.

*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.

*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 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. In recent months, the Resolution Committee has therefore focused on maintaining and maximising the value of assets of the Bank with the aim of ensuring as high a recovery rate of claims as possible.

When the Resolution Committee evaluates any of the assets of the Bank, a preliminary valuation of the asset is performed and the scope of associated servicing and monitoring work is evaluated. Assets are valued in respect of two valuation scenarios: Firstly, current market value and secondly the cost and amount of support needed and potential recovery or redemption value if sold at a later stage.

To date, no assets have or will be sold in "fire sales". According to the strategy, assets are only sold if they require support beyond the means of the Bank or if a satisfactory bid price can be achieved for them after taking into account the future funding support needed to maintain these assets. Other assets

should be preserved and protected until market conditions improve with temporary support from the Bank where and when deemed necessary. This should ensure that the maximum value for each asset can be passed on to creditors of the Bank at a later stage.

*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 advise 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.

*Finalizing the Bank's balance sheet.* The aggregate balance sheet has been divided between the Bank and New Kaupthing as at 22 October 2008. Separate balance sheets for the Bank and New Kaupthing had to be prepared. Financial disclosure and financial information is an ongoing process, financial information for the Bank as of 30.06.2009 and 30.12.2008 can be seen in chapter 5 *Financial analysis*.

*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 to review certain 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 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. This sub-committee consists of two members of the Resolution Committee in addition to the former Internal Auditor of Kaupthing Bank.

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 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 valuation of assets and liabilities in this report does not take fully into account the potential 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 200bn. 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.

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.

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, and the United Kingdom and is currently opposing litigation in 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.
- The High Court of England consented to the Bank's request for permission to apply for judicial review of the legitimacy of the decision taken by the UK authorities to transfer to a third party,

without compensation, assets and deposits from Kaupthing Edge accounts at KSF, on 8 October 2008. The court heard the case on 10 July 2009, when evidence and arguments concerning the UK authorities' intervention into the operations of KSF was presented. The Bank contends that the actions of the UK authorities were unjust and illegal. The Resolution Committee expects the court's decision later this year and wishes to underline that the final outcome of the case is still uncertain.

- 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.
- In addition, the Resolution Committee foresees other court cases. 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 the Bank expects to initiate legal proceedings within the next couple of weeks.

*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 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 each subsidiary of the Bank.

<b>Name of subsidiary</b>	<b>Current status</b>
FIH	Operational and owned by the Bank
Kaupthing Bank Sweden	Has been wound down
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 each subsidiary 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 has always been of the opinion that the entity should not be sold in the current market environment because its value is presumably much higher and *FIH* should be worth more in the future, when markets have recovered.

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

*Kaupthing Bank Sweden* is 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 is reasonable and enabled Kaupthing Bank Sweden to pay 100% of subordinated loans to the Bank of some SEK 6bn (through transfer of assets worth some 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 of ISK 9.5bn which are currently with the ICB.

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 appr. EUR 800m at nominal value were retrieved.

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

*KSF* is 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* is 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 each branch 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
Kaupthing EDGE Germany	Is being wound down and is in the process of being deregistered
Kaupthing Bank Norway	In liquidation
Kaupthing Bank Dubai and Qatar	Has been wound down and is in the process of being deregistered

More details on each branch are provided below.

*Kaupthing EDGE Austria* is 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. The asset management operation has been sold as well as a part of the loan portfolio. The remaining part of the loan portfolio has been transferred to the parent company 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 appr. EUR 107m at nominal value were retrieved.

*Kaupthing EDGE Germany* is 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.

From the outset, the Bank has been committed to paying back all priority claims as quickly as possible and has placed great importance on settling the claims of the depositors of the entity. 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.

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. For efficiency and technical reasons, the repayments have been administered in steps and therefore not all depositors received their payment at the same time. The process is in its final stage with repayments to Edge depositors in Germany now amounting to appr. EUR 322m and just 350 depositors are still remaining due to lack of confirmation or incorrect personal details.

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).

When these repayments have been concluded, Kaupthing Bank will have repaid all deposits defined by Icelandic law as priority claims, i.e. all foreign deposits made at branches belonging to the parent company.

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. There is every indication that this matter will have to be resolved in court but it has not affected the Bank's decision to pay out all Kaupthing Edge Germany deposits.

*Kaupthing Bank Norway* is 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, something which otherwise would have been done to enable it 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 appr. EUR 300m at nominal value.

*Kaupthing Bank Dubai and Qatar* were 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 The current organizational structure of the Bank**

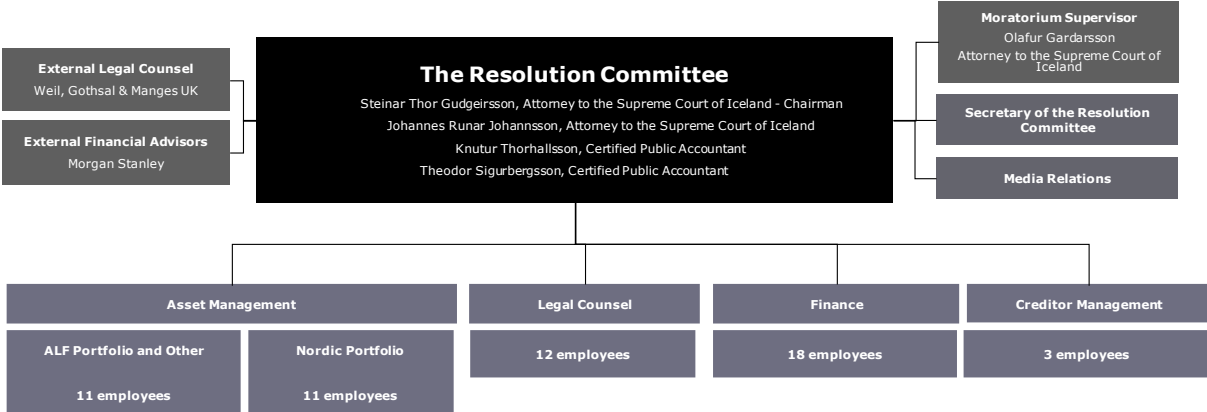
The Resolution Committee shares the creditors' desire to maximize the value of the Bank's estate and recognizes that this may take a significant period of time to achieve. As previously discussed, one of the

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 asset management division is the largest division in the Bank. There are 22 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 purpose of the unit is to develop the Bank's assets 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.

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.

The team has been managing the assets of the Bank in important steps. The initial step, commencing at the collapse of the Bank, was to stabilize the assets which were hit by the sudden change of the Bank's status and to retain their value. Closing down branches and transferring assets to the Bank in Iceland was the second step. This required significant resources and manual work as loans of over 50 borrower groups were transferred to Iceland involving quite complicated legal issues.

As a third step, an overview of the assets was compiled. For this purpose, each asset was analyzed and employees were assigned as responsible persons. Assets were prioritised by size and urgency. The team is now in phase four of developing a strategy and setting objectives for assets to maximize the recovery on behalf of the Bank's creditors.

### ***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 role of the finance division is to supervise the Bank's finances. The division is responsible for executing all aspects of the Bank's finances according to the strategy formulated by the Finance Committee. This implies accounting procedures, financial disclosure and budgetary planning. The division is currently working on internal processes and procedures which are being fine-tuned. Back office and book-keeping tasks have all been outsourced to New Kaupthing. The portfolio management unit is now part of the finance division and it provides support to the asset management team. Further, it analyses the Bank's loan portfolio both on an aggregate level and on individual exposure basis. This entails tasks like collateral analysis, covenant monitoring, cash flow projections, credit risk analysis, etc.

### ***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, four working committees were established early this year. 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 sub-committee consists of two members of the Resolution Committee in addition to the former Internal Auditor of the Bank.

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 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 extensive and regulated. 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 place 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 of the front page 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 1,100,000 page views by 378,000 users.

This report for creditors is currently updated once a month and 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 more than 7,000 queries.

It is the aim of the Resolution Committee to be as transparent as possible. Therefore, the 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.

## **4. Asset sales and restructuring**

### **4.1 General approach and rationale**

As discussed in the previous chapter, 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.

To minor extent, however, the Resolution Committee has disposed of overseas assets. These disposals have been driven by a mix of two things: i) local regulatory authority "freeze of assets" or agreements to prevent the freezing of certain assets; and ii) acceptable bid prices taking into account the future funding support needed for maintaining these assets.

The Resolution Committee has taken measures to ensure that certain foreign assets would not be sold at "fire sale" prices by reaching agreements with three countries in which the Bank had entities in insolvency proceedings – i.e. the Swedish government, the Finnish government and the Norwegian government. The relevant agreements provide that the governments will not sell assets at the current distressed levels but will instead aim to sell assets in such a way that the maximum value possible is obtained for each asset. This arrangement is likely to ensure that the best possible prices will be obtained for the assets and makes it more likely that proceeds will flow back to the Bank and as a result increase proceeds paid to creditors.

### **4.2 Assets sold to date**

The following assets have been sold from the parent company on behalf of the Resolution Committee. This summary is intended to give the reader an update of the asset sales but should not be taken as conclusive and the Resolution Committee accepts no responsibility if some asset sales are not included in this summary.

*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 loan to a UK real estate holding company* was sold a few weeks after 9 October 2008 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.

*A 20% stake in the asset management firm Drake Management* was also sold a few weeks after the fall 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.

Six of the Bank's Swedish assets that were transferred to Kaupthing Bank hf. when Ålandsbanken Abp acquired Kaupthing's Swedish subsidiary, have to date been realized at a 100% recovery rate, implying that value of SEK 545m (appr. EUR 53m) from the Swedish portfolio has already been secured. In addition, three loans in the Nordic region of a total of EUR 12m have been fully repaid; one after several bids below par had been rejected. Finally, partial pre-payments and contractual repayments at par in the amount of EUR 3,4m took place in the Nordic portfolio over the last couple of months.

*A loan to a US hosiery wholesaler* was sold in the spring for a price significantly higher than its perceived market value. The company has been under strain and is performing significantly under budget. The company was in breach of covenants and was certain to default on its payments this fall. Transaction was preceded by a financial and operational due diligence performed by independent financial consultants engaged by the Bank.

The following assets have been sold from the branches of the Bank.

*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.

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

*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*.

The aggregate book value of the assets sold by the Resolution Committee from the parent company and its branches in voluntary sales is less than EUR 100m but in addition, some forced assets sales have taken place to pay back deposits.

### **4.3 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. Assets are only sold if they require support beyond the means of the Bank or if a satisfactory bid price can be achieved for them after taking into account the future funding support needed to maintain these assets. Other assets should be preserved and protected until market conditions improve with temporary support from the Bank when and where deemed necessary. This should ensure that the maximum value for each asset can be passed on to creditors of the Bank at a later stage.

The Bank implements pro-active management to ensure maximum recovery for the Bank's assets. The Bank's loan portfolio consists of more than 113 borrower groups and the total outstanding notional was around ISK 440bn at fair value as at 30 June 2009. The Bank monitors several borrowers in its loan book very closely and has been or is currently working on restructuring several groups. When appropriate, the Resolution Committee appoints external advisors and consultants to ensure expertise in every case. Depending on the nature of the project, these external parties can be financial advisors, legal counsels, real estate consultants, accountants, auditors, etc. The cost of these is in most cases paid by each respective borrower. The Bank has acquired a controlling interest in companies and nominated board members were it deems necessary. If a debt facility in the Bank's books needs capital restructuring or a debt equity conversion, the Bank will analyse the case and then execute if it makes sense from a commercial point of view. To date, the Bank has had few cases where capital restructuring

or a debt equity conversion is necessary action to protect asset values. The below summary of the Bank's restructuring cases should not be taken as conclusive.

#### *Aurora Fashions / Mosaic Fashions*

The Bank and the former senior management of Mosaic Fashions established Aurora Fashions to take over the retail chains Karen Millen, Coast, Warehouse and Oasis, which all previously belonged to Mosaic Fashions. 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 Fashions 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, the company'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 the company 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 have failed.

Aurora Fashions is financially sound, moderately leveraged, with reduced capital requirements and fits to meet the challenges of the current market. The new structure will strengthen these brands by reducing debt, bringing a greater focus to operations, increasing liquidity 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 approximately 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. Financial analysis**

### **5.1 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. 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 at this time to assess the possible future value of assets, nor to estimate likely recovery of creditors' claims.

The valuation of assets and liabilities does not take fully into account the impact of set-off. The preliminary estimated impact of set-off has been included where possible in the report but the figures herein can by no means be taken as conclusive since the formal claim process has not been concluded. Additional 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 with 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
Borrowings .....	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 FMEs transfer decision from 21 October 2008, all cash balances were transferred to New Kaupthing, 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>

### 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:

	30.6.2009	31.12.2008
	Carrying value	Carrying value
This specification includes pledged positions.		
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

11. Shares and instruments with variable income are specified as follows:	30.6.2009		31.12.2008	
	Unpledged	Pledged	Total	Total
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.

12. Ten largest positions:	30.6.2009		31.12.2008	
	Unpledged	Pledged	Total	Total
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

13. Derivatives and unpaid derivatives are specified as follows by status:	30.6.2009		31.12.2008	
	Gross fair value	Provisions	Net fair value	Net fair value
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

14. Derivatives and unpaid derivatives are specified as follows by type:	30.6.2009		31.12.2008	
	Gross fair value	Provisions	Net fair value	Net fair value
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.

## 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> .....			<b>109.485</b>	<b>135.562</b>	<b>129.464</b>

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> .....	<b>9.102</b>	<b>13.361</b>

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> .....	<b>151.808</b>	<b>173.892</b>

## Deposits

18. Deposits are specified as follows:

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

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 posted to 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 posted to 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 FMEs 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 fully 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.

## **5.2 The Bank/New Kaupthing 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 New Kaupthing, which is owned by the Icelandic government. According to the FME, these actions were taken to secure the continuation of vitally important domestic banking and payment services.

Under the Transfer Decision, New Kaupthing takes over all of the 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. In turn the FME initially decided that New Kaupthing shall issue a bond to the Bank, equivalent to the surplus of assets over liabilities at fair value. In a more recent statement, the FME recognizes that a different solution may be found for each bank and that not necessarily a bond but financial instruments will be defined to compensate for the net asset transfer between the banks.

PwC has established a preliminary statement of net assets for New Kaupthing at the date of its establishment and conducted a valuation of the assets that remained in the Bank. Any currently released information on balance sheet numbers for the Bank and New Kaupthing should be regarded as preliminary only and may well change based on this process.

The FME appointed Deloitte to prepare an independent net asset valuation for New Kaupthing 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 New Kaupthing 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 New Kaupthing 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 appr. ISK 190bn in assets at book value were transferred back, thereof appr. 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 New Kaupthing in October 2008. In light of the FME ruling to agree on compensation for the transfer of assets and liabilities by 17 July 2009 and the pressure by the IMF to complete the bank restructuring in Iceland, the Icelandic Government was focused on reaching an agreement on that date and to complete the capitalization of the Icelandic banks in the short term. The Resolution Committee entered into a Heads of Terms Agreement with the Government on 17 July 2009. Further information on this agreement can be found in subchapter *7.4 Agreement on capitalization, compensation and process*.

## **6. The moratorium**

### **6.1 Introduction**

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 payments until 13 February 2009.

The Moratorium Supervisor convened the Bank's creditors to a meeting on 5 February 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 February 2009 where a petition was filed by the Resolution Committee's petition for a nine-month extension to the moratorium on payments. On 19 February 2009 the District Court of Reykjavik agreed to the request for the extension of the moratorium on payments until 13 November 2009. On that date a new hearing will be held to consider the matter and decide on whether a further extension of the moratorium will be granted. The hearing will be an open one.

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 scheme of arrangement between the Bank and its creditors.

While under the moratorium, the ICC continues to work as an informal forum for creditors. The ICC has no formal powers under Icelandic law.

### **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 and delaying the sale of assets until the market conditions improve. This is in accordance with the wishes of the creditors which have expressed their views to the Moratorium Supervisor and Resolution Committee. The committee is of the opinion that a sale of assets is a poor option under the current circumstances, since there are few potential buyers as a result of the economic downturn and difficulties affecting most western economies. The value of the Bank's assets is at a historical all-time low, access to credit for potential buyers is heavily restricted, to name but a few reasons. The Resolution Committee believes that the interests of the creditors are best served if the Bank's assets are held to maturity or sold over a longer period. The creditors and the experts consulted by the Resolution Committee are in agreement over this approach. This should mean that creditors recover a higher proportion of the claims than they would if assets were sold under the present circumstances.

Applying for the moratorium 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 and Luxembourg. Further freezing orders are being opposed in the Netherlands and Luxembourg. Without the moratorium, preventing proposed freezing orders would be considerably more difficult for the Bank, if not impossible.

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***

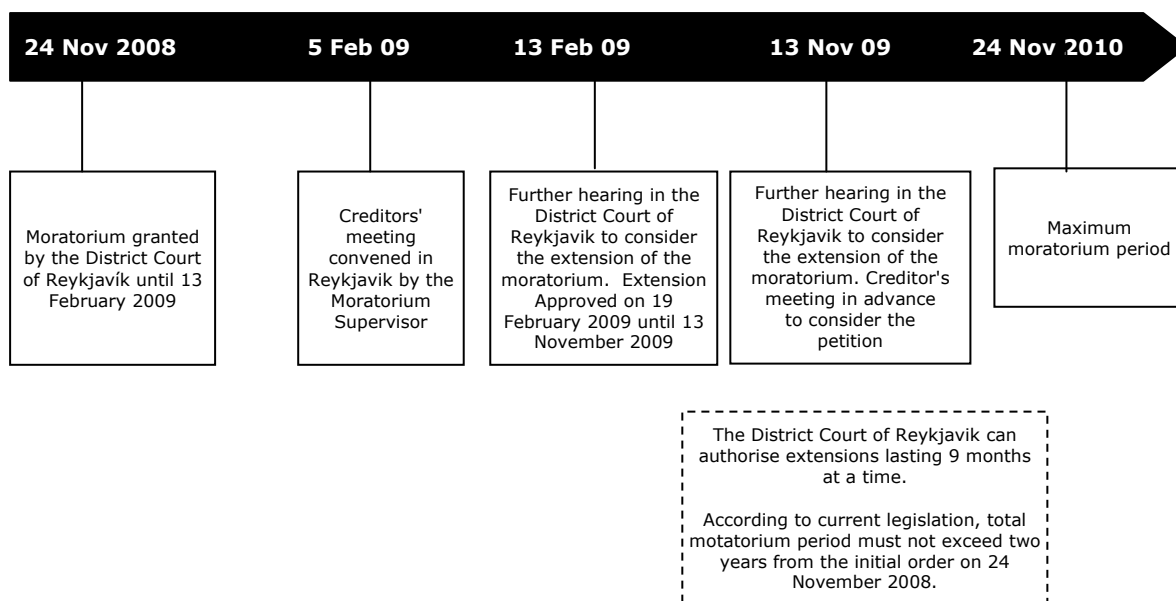
As discussed above, Olafur Gardarsson, Attorney to the Supreme Court of Iceland and a partner of the Reykjavik Law Firm, was appointed as the Moratorium Supervisor. He has been a Supreme Court Attorney since 1992 and his areas of expertise include mergers and acquisitions, corporate and telecommunications 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 November 2009 when a court session shall be held again to consider the matter.

At that time, further extension will be requested by the Resolution Committee as the Resolution Committee believes that it will be in the best interests of creditors to extend the moratorium. The Moratorium Supervisor is obligated to summon the Bank's creditors to another meeting which is to be held no later than three days prior to 13 November 2009. 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 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.

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. 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.

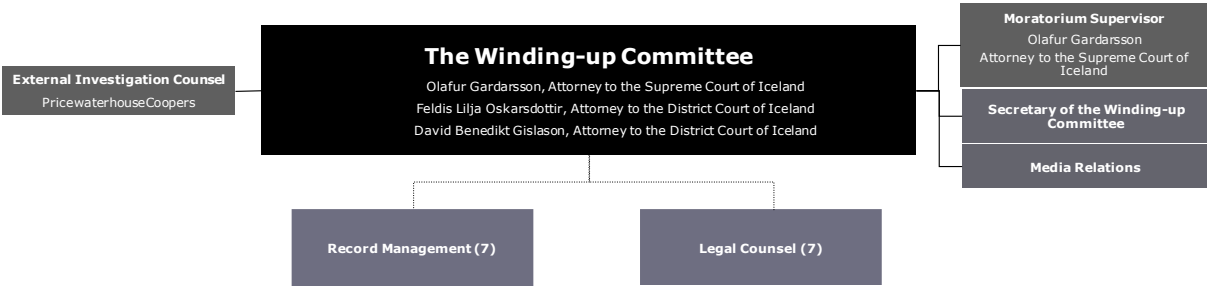
The Resolution Committee can convene creditors' meetings as appropriate to introduce measures taken in regard to the Bank's interests. In such meetings suggestions or decisions may be sought from creditors in regard to measures which have yet to be taken and suggestions may be sought on matters regarding 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 the envisaged 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*, the Resolution Committee had already engaged PwC to investigate the Bank's decisions in the weeks before the collapse in October. A detailed report was submitted to the FME at the end of the year 2008. The Special Prosecutor's office and a parliamentary investigation committee have also 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 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.

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. 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 gauge 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, the Winding-up Committee is authorised to pay the 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. 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 Reykjavík. 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 Reykjavík 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.

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.

According to Act no. 44/2009, there are two possibilities to conclude the Bank's operations if the assets of the Bank are found to be of less value than the amount of its liabilities. This applies both while in the moratorium or winding-up process:

The moratorium process of the Bank would most likely conclude by means of either of the following:

- i) Insolvent liquidation

If the moratorium period is not extended on 13 November 2009 and the Bank is forced into insolvent liquidation, the Moratorium Supervisor and the Resolution Committee firmly believe that further value will be lost.

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 and delaying the sale of assets until the market conditions improve. 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.

## ii) Scheme of Arrangement

A scheme of arrangement 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 scheme of arrangement, potential restructuring options of the Bank can be considered and evaluated. Further discussions on potential restructuring options can be found in chapter 7. *Potential restructuring options.*

As discussed in subchapter 6.9 *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 would reduce the value of assets.

## **6.10 Icelandic composition legislation overview**

Composition (scheme of arrangement) 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 equally 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 a wind-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.

If the Winding-up Committee decides to seek composition, it prepares 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 a court order has been issued granting a debtor licence to seek composition;
- Claims for performance other than payment of money, which can be performed in substance;
- Claims that would be ranked as provided for in Articles 109, 110 or 112 of Act no. 21/1991 on insolvency etc. if the debtor had been declared bankrupt at the date when a court order providing the debtor with a licence to seek composition was issued;
- Claims that could have been settled by set-off had the debtor been declared bankrupt, 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. 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. 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 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 be declared bankrupt. 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. Potential restructuring options**

***Please note that a Public Information Package containing comprehensive information on the Capitalisation Agreement on New Kaupthing is available on the Bank's website.***

In accordance with the FME's Transfer Decision, Kaupthing was divided into the Bank and New Kaupthing on 22 October 2008. As previously discussed in subchapter 5.2 *The Bank/New Kaupthing Split*, New Kaupthing primarily consists of the domestic operations funded by local deposits. With the assistance of PwC, Iceland, a preliminary balance sheet statement of New Kaupthing was prepared.

### ***7.1 Valuation of assets and liabilities transferred to New Kaupthing and the financial instrument***

According to the FME, a financial instrument will be issued to compensate for the transfer of assets and liabilities from the Bank to New Kaupthing. The value of the financial instrument should represent the difference between fair value of the assets and the liabilities. The type and the terms of the financial instrument will be of great significance for the Bank.

The FME appointed Deloitte, UK, to prepare an independent net asset valuation for New Kaupthing and Oliver Wyman was appointed to co-ordinate the valuation process and review the valuation. According to the FME, the methods used should aim at "fair value measurement based on orderly transactions between market participants on the measurement date and not the price that would be achieved in a forced liquidation or distressed sale". The valuation criteria should seek to consider the long-term economic environment in Iceland and not the immediate market value of Icelandic loans. Part I of the Deloitte report and the Oliver Wyman report were made available to the Bank and Morgan Stanley, its financial advisor, on 23 April 2009. However, the Deloitte report does not reflect the final separation decision by the FME between the Bank and New Kaupthing as a list of assets and liabilities were transferred back to the Bank. Based on the FME decision the Bank and Morgan Stanley were granted access after signing the relevant confidentiality agreements and hold harmless letters to part II of the Deloitte report from 12 June and had a separation and question and answers sessions on both reports with Oliver Wyman and Deloitte. Creditors have read only access to part I of the Deloitte report and the Oliver Wyman report in a separate data room provided the respective confidentiality agreements and hold harmless letters are signed. Unfortunately, the valuation provided by Deloitte did not provide sufficient clarity of the net asset value to serve as basis for an agreement with the Government. Creditors interested in accessing these reports, can find further instructions on how to do so in the FAQ section of the Bank's website, [www.kaupthing.com](http://www.kaupthing.com).

### ***7.2 Other restructuring methods***

The creditors have stressed the importance of the Resolution Committee's protecting their interests during the current appraisal process. The Resolution Committee, as requested by representatives of the creditors, appointed Morgan Stanley to advise on this process and to come up with ideas and proposals to resolve issues concerning New Kaupthing and the restructuring of the Bank. The Resolution Committee and Morgan Stanley have learned via discussions with creditors that they have several principal issues with the initial proposal presented by the FME in the initial Transfer Decision, where creditors were to be compensated for the forced net asset transfer to New Kaupthing with a bond issue and suggested that consideration should be given to alternative options for structuring ownership of New Kaupthing.

Creditors would e.g. like to see the following objectives carefully looked into:

- Avoid relying solely on the methodology suggested in the initial Transfer Decision in valuing the assets transferred to New Kaupthing as it is subject to various debatable assumptions
- Most of the potential future upside of the assets in New Kaupthing should flow back to creditors of the Bank
- If the government injects capital into New Kaupthing, some upside sharing with the government should be considered

### **7.3 *The relationship between the Bank and New Kaupthing***

Rather than New Kaupthing paying the Bank for the transferred assets with just a bond issue and the Icelandic government as the sole owner of New Kaupthing as suggested in the initial transfer decision, a series of alternative ideas were explored and developed by Morgan Stanley which took the above guiding principles for the mutual benefits of the Icelandic government and creditors into account. The objective was to devise solutions acceptable to all parties involved, including Icelandic and foreign creditors, the Icelandic government as owner of New Kaupthing and the Icelandic supervisory authorities. In the opinion of the Resolution Committee it is not only in the interest of the Bank and its creditors to find a solution, but it is also in the interest of New Kaupthing, the Icelandic government and the general public. Reaching a positive agreement with creditors of the Bank may be a critical step towards re-establishing normal banking relationships between Iceland and the international community.

Concerns of creditors, objectives in the restructuring as well as several structuring options were outlined to various representatives in the government.

On 12 March 2009, the Ministry of Finance issued a press release with its objectives in the negotiations regarding compensation instruments to creditors:

- “To ensure appropriate treatment of creditors in all three old banks including transparency and timely flow of information in the negotiation process.
- The application of international best practices.
- To secure a stable post-settlement Icelandic banking system that will be able to fulfil its obligations under the compensation instruments to be issued by the new banks.
- To engage in regular consultation and cooperation with the old banks’ Resolution Committees and their advisors to take account of their views.
- To seek an agreement that secures approval of the creditors and will facilitate regaining access to the international capital markets for the Government of Iceland and the new banks.”

As part of this process Hawkpoint, the appointed financial advisor to the government, worked with New Kaupthing on addressing key issues identified and prepared a customary information package for review by the Bank and Morgan Stanley before negotiations of the structure and terms of a financial instrument could commence.

The negotiation process started on 4 June, when New Kaupthing management presented to the Resolution Committee and Morgan Stanley its preliminary business plan and opening balance sheet as well as its solution to any imbalances in the assets and liabilities transferred. On the same day, Thorsteinn Thorsteinsson and Hawkpoint presented to the Resolution Committee and Morgan Stanley, the Government’s proposal on compensation. It was agreed in the meeting that any negotiation of any

proposal could only commence once the separation of the banks was completed and due diligence had been carried out.

Accordingly, on 11 June the FME finalized the separation of the banks. Due diligence commenced with New Kaupthing's management being available for questions in various expert sessions regarding identified due diligence topics including but not limited to the presented asset valuation, business plan including imbalances and the SPM and SPRON transactions, liquidity analysis and outflow, profit improvement measures. The due diligence process is still ongoing. The remaining due diligence is focused on actual results based on ongoing audit of the financial accounts of New Kaupthing and resulting impact up until signing date, business plan model and assumptions, and continued monitoring of New Kaupthing's profitability development and liquidity position.

#### **7.4 Agreement on capitalization, compensation and process**

This summer the Resolution Committee has, together with Morgan Stanley and creditors' representatives, been negotiating with the Government on the disposition of the assets and liabilities taken over by New Kaupthing in October 2008. In light of the FME ruling to agree on compensation for the transfer of assets and liabilities by 17 July 2009 and the pressure by the IMF to complete the Bank restructuring in Iceland, the Icelandic Government was focused on reaching an agreement on that date and to complete the capitalization of the Icelandic banks in the short term. The Resolution Committee entered into a Heads of Terms Agreement with the Government on 17 July 2009.

The Heads of Terms Agreement in line with the Resolutions Committee's strategy which is based on creditor feedback not to enter into transactions in a fire sale and to maximize the value of the Bank's assets. The agreed solution is also in line with the Resolution Committee's adopted strategy in the Nordic countries to object to enforced transfer of assets of the Bank and to retain the assets until market prices have recovered.

During the discussions with the Government the Resolution Committee repeatedly communicated to the Government that its short timetable does not necessarily allow for a suitable solution for the creditors of the Bank. The Resolution Committee insisted that all creditors require appropriate access and sufficient time to review relevant information. The Committee objected to the valuation of the assets transferred to New Kaupthing proposed by the Government which indicated negative balance as it believes that assets transferred were sufficient to cover the liabilities transferred to New Kaupthing.

Whilst the Resolution Committee objected to the tight deadline of 17 July 2009, the Committee has entered into a solution with the Government which it believes will maximise the value of the Bank's assets and allows for an acceptable process which gives creditors the opportunity to provide feedback on the negotiated structures.

##### **Summary Highlights of the Solution**

The Bank and the Government have entered into a conditional capitalization under which the Bank contributes 65% to the overall capitalization of New Kaupthing for which it will receive 87% of the share capital while the Government contributes 35% to the overall capitalization for which it will receive 13% of the share capital and a tier II subordinated note. The respective sizes of the instruments may change depending on the capitalization finally approved by the FME and any tax structuring requirements. This solution effectively gives the Bank back the value of the assets and liabilities that were transferred to New Kaupthing on the basis of the FME decision from October 2008.

The capital increase is subject to the following: documentation, satisfactory completion of due diligence; regulatory approval; and approval by the Resolution Committee for which it intends to take creditor

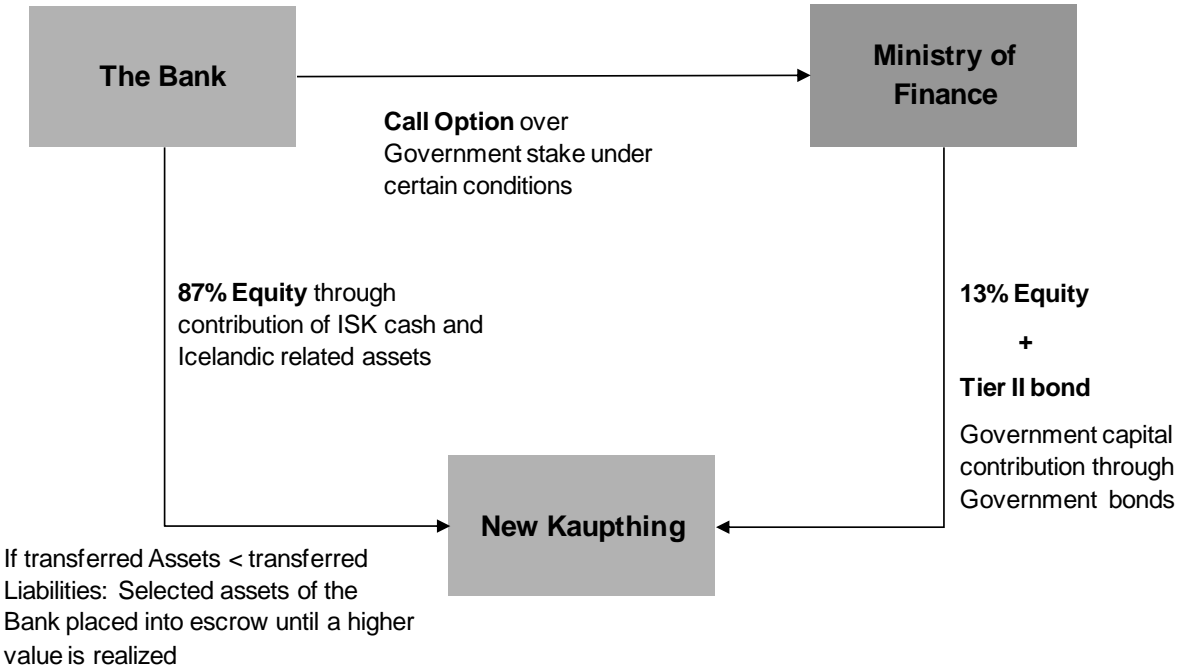
feedback into account. On 14 August the Government capitalized New Kaupthing with appr. ISK 72bn in common equity until the capital increase agreed on through the solution is unconditional which will allow New Kaupthing to function as a fully operational bank in the interim.

From the time of signing of the binding agreements, the Bank and the Government will jointly manage New Kaupthing until the capital increase is unconditional or declared failure to complete.

If the conditions of the capital increase are not fulfilled by 31 October 2009 or the Resolution Committee declares earlier that it will not approve the capital increase, New Kaupthing will remain capitalized by the Government as implemented in the interim period. This will trigger a different set of negotiated compensation instruments to be implemented.

For the interim period, a process is agreed to allow creditors willing to be bound by the required confidentiality agreements to review information on New Kaupthing. Public side creditors will have access to an abbreviated public information package which will be distributed by the Resolution Committee.

**The Bank Retains New Kaupthing under Conditional Capital Increase**



For simplification purposes, a holding company for New Kaupthing is omitted.

**The Bank:**

- 65% of total capitalization for which it receives 87% under the preliminary capitalization concept. The Bank intends to use ISK cash deposits and Icelandic related assets, but has full flexibility on usage of assets
- Call option on 13% Government stake in common equity under certain conditions

**Government:**

- 35% of total capitalization for which it receives 13% in common equity under the preliminary capitalization concept and a tier II subordinated note
- Shareholder agreement giving entitlement to one Board seat

The Resolution Committee believes that proposed joint ownership of New Kaupthing provides the Government as well as the Bank and its creditors with mutual benefits. The Government reduces its capital commitment and with this agreement the interests of international parties are linked with the

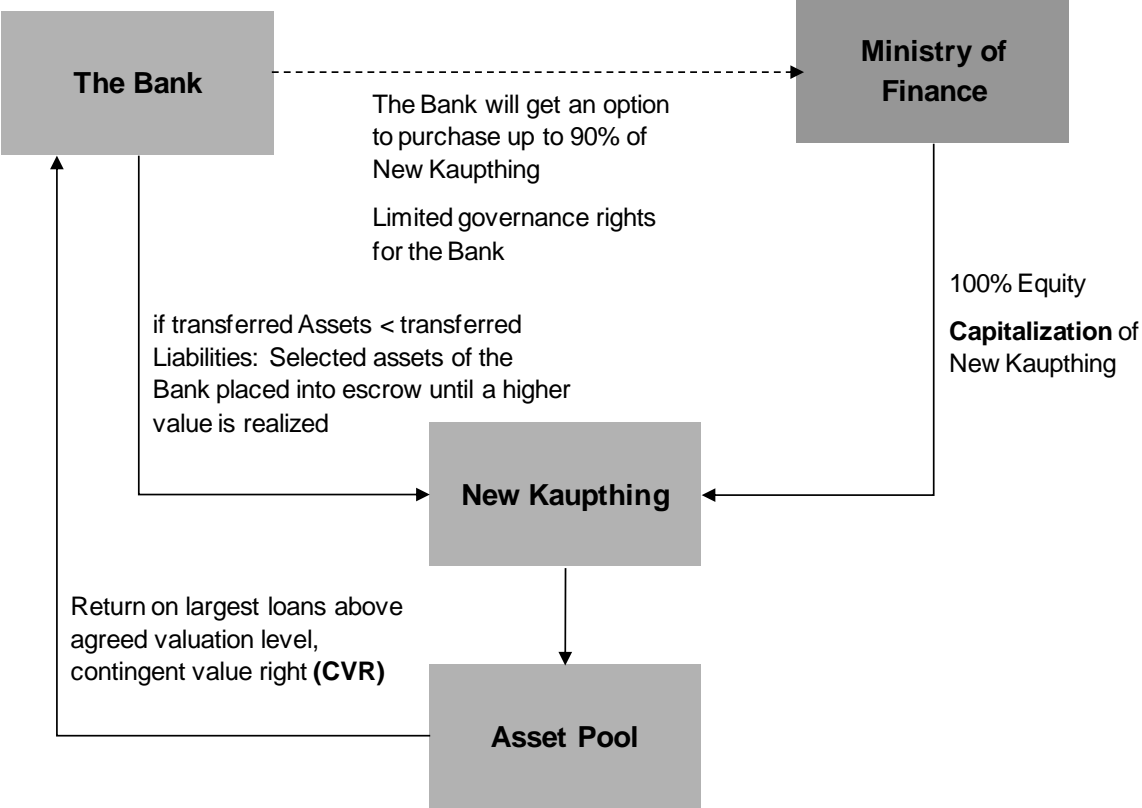
success of New Kaupthing, while it's the intention of the Resolution Committee to ensure value maximization within New Kaupthing on behalf of its creditors by running New Kaupthing as a profitable Icelandic bank focused on building its Icelandic operations and maximize the value and recovery of its assets.

There will be no changes to the status of depositors under Icelandic law as a result of these arrangements. New Kaupthing will through the capitalisation and further liquidity support as part of the agreement, be in a very strong liquidity position.

During the next weeks the opening accounts of New Kaupthing will be finalized which will serve as the basis to determine the amount of selected assets of the Bank placed into escrow to compensate for the assessed negative balance.

**Government Retains New Kaupthing**

If the conditional capital increase is not completed the following structure will be implemented under the currently agreed solution:



For simplification purposes, a holding company for New Kaupthing is omitted.

The Bank:

- Call option over 90% of the share capital owned by the Government. The option can be exercised between 2011 - 2015
- Provides assets selected by the Bank into escrow to cover for any negative initial value from the transfer of assets and liabilities to New Kaupthing
- Receives a contingent value right on a portfolio of loans of New Kaupthing for which any upside beyond any agreed return will be credited against any potential initial negative balance from the transfer of the assets and liabilities to New Kaupthing
- Receives a Board seat during the option period and veto rights for certain decisions

Government:

- Provides 100% of capital for the capitalization

### ***Preliminary Assessment Summary***

It is the current view of the Resolution Committee that under the option under which the Bank retains New Kaupthing it can retain the undervalued assets transferred to New Kaupthing, control New Kaupthing and focus the bank on value maximization. The Bank on the other hand needs to contribute from its existing asset pool to the capitalization, but from assets it would need to hold for some time in any event with the returns now being generated within New Kaupthing and not in the Bank directly. It is the current intention of the Resolution Committee to use all most exclusively ISK cash and Icelandic related assets for the capitalization, however a final selection of assets will only be made at the time of the capitalization.

In the other solution in which the Government retains New Kaupthing and capitalizes the bank, the Bank has limited influence through certain negative control rights associated with its Board seat, participates in any value upside to a limited extent from the loan portfolio and in addition on corporate level only after the Government has made its agreed return.

A more detailed summary of these options and terms, based on the agreement signed on 3 September, will be communicated before the Creditors' Meeting which will be held on 20 October, please visit the Bank's website for further update.

Creditors interested in becoming private and therefore get access to information regarding New Kaupthing in a private data room, can send email to [creditorcontact@kaupthing.com](mailto:creditorcontact@kaupthing.com) and state their request. Access to this data room is conditional upon signing a confidentiality agreement and fulfilling certain requirements set by the Bank and New Kaupthing.

## ***7.5 The Bank's co-ordination group and other government appointed parties***

As some of the structuring ideas required an input and acceptance from other parties than the Bank's creditors, the Resolution Committee asked for a special co-ordination group to be set up for the Bank, between the Resolution Committee, ministries and the ICB. This group does not have formal powers and is consultative in nature.

The members of the co-ordination group are Thorsteinn Thorsteinsson - a senior advisor employed temporarily by the ministry of finance, Steinar Thor Gudgeirsson - Chairman of the Resolution Committee of the Bank, Thorhallur Arason - representative of the Ministry of Finance, Helga Oskarsdottir - representative of the Ministry of Commerce and Jon Sigurgeirsson - representative of the ICB.

The ministry of finance also appointed Hawkpoint, the UK corporate finance advisory firm, as their financial advisor. They will work under the supervision of Icelandic authorities. Thorsteinn Thorsteinsson is in charge of the negotiation process between the new banks and the old banks regarding the net assets acquired by the new banks. The main parties involved in the restructuring process of New Kaupthing are the Resolution Committee, Morgan Stanley, Mr. Thorsteinsson and Hawkpoint.

The Prime Minister's Office has enlisted the services of Swedish banking expert Mats Josefsson, on a temporary basis as advisor on rebuilding Iceland's banking system. He is also the chairman of the co-ordination committee which has the overall responsibility of developing, implementing and communicating a comprehensive strategy for bank restructuring. Other members of this committee are representatives of entities within the administration. For the avoidance of doubt, the co-ordination group is not the same as the co-ordination committee.

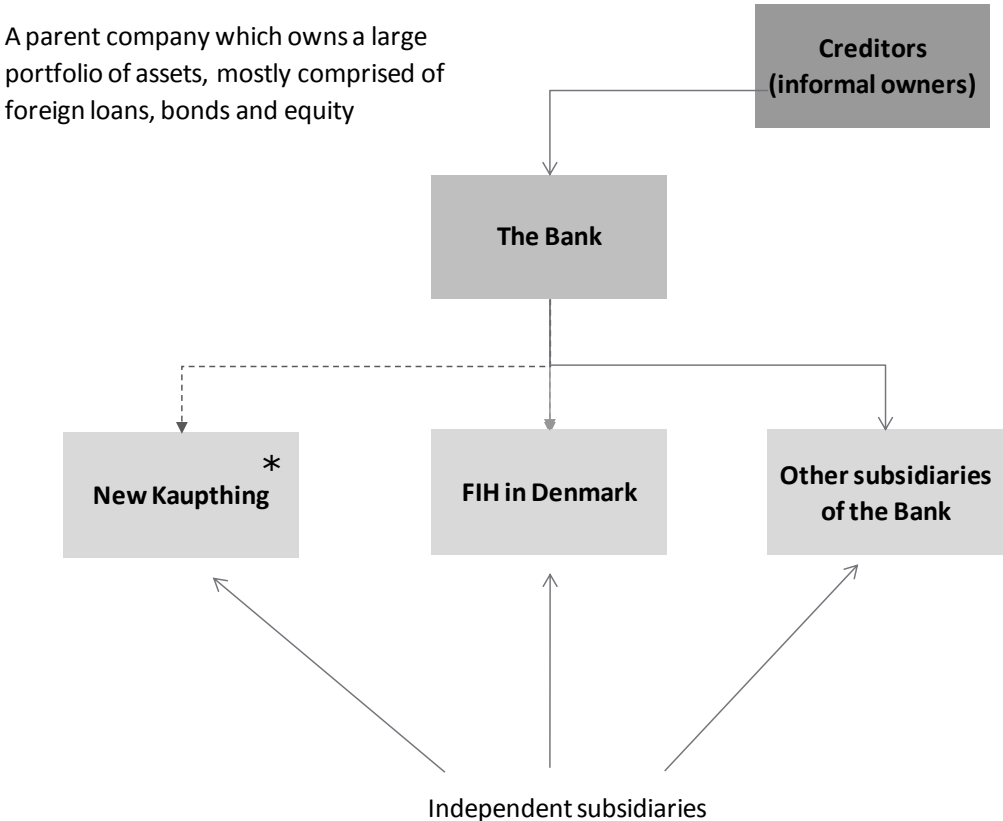
In addition, Kaarlo Jännäri, former Director General of the Finnish FSA, who has extensive experience in a collapsed financial sector environment, has been engaged by the government to assess the regulatory framework and supervisory practices and to propose necessary changes to strengthen safeguards against potential new crises.

**7.6 Overview of legal status and restructuring options**

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. Creditors have expressed their views that the maximum value of the assets would not be reached via asset sales under current market conditions. Therefore, according to creditors' requests, the Resolution Committee have been working on other solutions to preserve the value of these assets until the markets recover. In many cases, the assets need to be held for some time for them to be redeemed at full value. According to the Bank's strategy, assets are only sold if they require support beyond the means of the Bank or if a satisfactory bid price can be achieved for them after taking into account the future funding support needed to maintain these assets. 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.

**General**

Under the current structure, the Bank owns several subsidiaries including FIH. If New Kaupthing is retained by the Bank, then it would be another independent subsidiary of the Bank.



\* Provided that New Kaupthing will be retained by the Bank

For simplification purposes, holding companies for FIH and New Kaupthing are omitted. Provided that the conditional capital increase will be completed, New Kaupthing would be an independent subsidiary of the Bank. However, the future ownership of New Kaupthing would not be decided at this point in time.

Shares in New Kaupthing could be continued to be owned by the Bank, could be sold to a third party or be put into an Initial Public Offering process. After a sale or an IPO process, the received cash and/or the remaining shares in New Kaupthing, could be distributed to the owners of the Bank.

For the avoidance of doubt, any general distribution to creditors will only take place after the creditors' meeting to be held on 29 January 2010 and then only through i) possible proportional payment of claims by the Winding-up Committee or ii) possible payment in accordance to the terms of a scheme of arrangement. Creditors will therefore not become owners of New Kaupthing simply on subscription by the Bank for shares in New Kaupthing.

Provided that the conditional capital increase by the Bank does not take place, the Government will own New Kaupthing but the Bank will receive call option for 90% of the share capital owned by the Government as discussed in details in subchapter 7.4 *Agreement on capitalization, compensation and process*.

### ***New Kaupthing Restructuring***

The Resolution Committee has entered into an agreement with the Government which it believes will maximize the value of the Bank's assets and allows for a more acceptable process which gives creditors the opportunity to provide feedback on the negotiated structures. However, the Resolution Committee has the sole decision power regarding which solution is preferential as further stated in subchapter 7.4 *Agreement on capitalization, compensation and process*.

### ***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 November 2009. A further extension of 9 months can be granted by the District Court of Reykjavik based on similar procedures as in February 2009.

### ***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 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 Meeting minutes from the 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 Reykjavik 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

## 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.

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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

It is not intended that the information contained herein should be relied upon by any person in connection with trading decisions relating to the Bank. Neither the Bank nor the Moratorium Supervisor accepts any responsibility for any such reliance.

This report is published in English and Icelandic. In case of any discrepancies between the content of the English and Icelandic version the English language version takes precedence.

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