

**Public Information Package  
on  
New Kaupthing**

**12 October 2009**



**KAUPTHING BANK**

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## Table of contents

1.	Executive Summary .....	5
1.1	Objective and information access for creditors .....	5
1.2	Background on transfer of assets and liabilities from the Bank to New Kaupthing .....	5
1.3	Rationale for the negotiated options .....	6
1.4	Negotiated options summary .....	6
1.5	Creditors' consultation .....	7
1.6	Key events and timetable related to New Kaupthing .....	7
2.	Overview of New Kaupthing' transaction .....	9
2.1	Negotiated options .....	9
2.2	Assets used in the capitalization in Option 1 .....	13
2.3	FME conditions for ownership of an Icelandic bank .....	13
2.4	Comparison of the two negotiated options for the Bank .....	14
2.5	Negotiation process summary .....	16
2.6	Creditors' due diligence and consultation .....	18
3.	Valuation of Assets and Liabilities in Opening Accounts .....	20
3.1	Transfer of Assets and Liabilities .....	20
3.2	The Deloitte valuation .....	20
3.3	Management valuation .....	21
3.4	Due diligence carried out by the Resolution Committee .....	23
3.5	Depositor priority .....	25
4.	New Kaupthing information summary .....	26
4.1	New Kaupthing set up and strategy .....	26
4.2	SPM and SPRON transactions .....	26
4.3	Summary of Opening balance sheet .....	27
4.4	Summary of New Kaupthing's business plan .....	27
4.5	Further potential performance improvement levers under the Bank's ownership .....	28
	Appendices .....	29
	Appendix 1. Description of the agreements .....	29
	Appendix 2. New Kaupthing Introduction .....	41
	Appendix 3. Background on the Icelandic Economy .....	42
	Appendix 4. FME framework on the disposal of assets and liabilities of the Bank to New Kaupthing .....	48
	Appendix 5. Meeting overview during negotiation .....	50

## Abbreviations

The following abbreviations are used in this report:

The Bank, Kaupthing	Kaupthing Bank hf.
New Kaupthing, NKB	Nýi Kaupþing banki hf.
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
FME	The Icelandic Financial Supervisory Authority
ICC	Informal Creditors' Committee
Sub-ICC	Sub Committee appointed by the ICC
IMF	The International Monetary Fund
ICB	The Central Bank of Iceland
PwC	PriceWaterhouseCoopers
ISK	The Icelandic krona (currency)
KCA	Kaupthing Capitalization Agreement
ECVRA	Escrow and Contingent Value Right Agreement
FMR	Official Valuation made by the Icelandic Property Registry
PD	Probability of Default
LGD	Loss Given Default
FX	Foreign Exchange
CPI	Consumer Price Index
PDR	Prolonged Deep Recession
SPRON bond	Bond collateralised with all the assets of SPRON

# 1. Executive Summary

## 1.1 Objective and information access for creditors

This report is intended for information purposes for the creditors of Kaupthing Bank hf. ("the Bank") and describes the agreement reached between the Government and the Resolution Committee in relation to the transfer of assets and liabilities from the Bank to Nýi Kaupþing banki hf. ("New Kaupthing", "NKB") in accordance with the Act No. 125/2008 on the Authority for Treasury Disbursements due to Unusual Financial Market Circumstances etc. The main objectives of this report are to provide creditors with:

- An overview of the negotiation process.
- Description of the compensation instruments.
- Summary of the capitalization options.

As before, the Resolution Committee will continue to provide updated information on other matters in its operations to creditors including the overall restructuring of the Bank in the monthly updates of the Creditors' Report which can be found on the Bank's website, [www.kaupthing.com](http://www.kaupthing.com).

### Public Creditors

With regards to information access in relation to New Kaupthing, the creditors are divided into two groups: public creditors and private creditors. As part of the creditor consultation process which has been ongoing, this report, which mainly includes a detailed summary of the options and the terms of the agreement, has been produced and is available on the Bank's website. Additional information on New Kaupthing (*Appendix 2 New Kaupthing Introduction*) which is not included herein consists of a presentation which must be accessed in an on-line public data room. Creditors interested in getting access to this data room must confirm their status as creditors of Kaupthing Bank hf. and send their request by e-mail to [creditorcontact@kaupthing.com](mailto:creditorcontact@kaupthing.com).

### Private Creditor

Private creditors are those who have signed the relevant confidentiality agreements. As previously communicated in the Creditors' Report, creditors interested in becoming private and therefore get a restricted access to more extensive information regarding New Kaupthing in a private online data room, can send e-mail to [creditorcontact@kaupthing.com](mailto:creditorcontact@kaupthing.com) and state their request. Access to the data room is conditional upon signing the relevant confidentiality agreement and a confirmation on their status as creditors of the Bank.

## 1.2 Background on transfer of assets and liabilities from the Bank to New Kaupthing

Under the decision of the FME on the disposal of assets and liabilities of the Bank to New Kaupthing dated 21 October 2008 (the "Transfer Decision") issued by the Icelandic Financial Supervisory Authority (the "FME") on 21 October 2008, New Kaupthing, a newly established bank 100% owned by the Ministry of Finance, took 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. Other assets and liabilities remained in the Bank. In turn the FME initially decided that New Kaupthing would issue a bond to the Bank, equivalent to the surplus of assets over liabilities at fair value. In March 2009 the FME recognized an alternative solution whereby financial instruments, not necessarily a bond, could be issued to compensate for the transfer of assets and liabilities from the Bank to New Kaupthing. The value of the financial instruments should represent the difference between the fair value of the assets and the liabilities transferred. The FME

also ruled that the Ministry of Finance as the owner of New Kaupthing and the Resolution Committee of the Bank should negotiate the terms of such financial instruments. When the negotiation started it was determined by the Government that the value of liabilities transferred to New Kaupthing exceeded the value of assets transferred. This was contrary to the Government's initially stated position.

Starting in June 2009 the Resolution Committee, its advisors and selected financial advisors of creditor groups were allowed to carry out due diligence on New Kaupthing, and subsequently negotiations commenced. A Heads of Terms Agreement with the Government was signed on 17 July 2009 and binding agreements on 3 September 2009.

### **1.3 Rationale for the negotiated 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. The Resolution Committee has always considered the assets transferred to New Kaupthing as being part of the Bank's assets and hence, its aim was to find a feasible solution where the creditors would have the opportunity to retain the majority of the potential upside and that the valuation of transferred assets and liabilities would reflect fair value. Therefore, the Resolution Committee requested Morgan Stanley, as its financial advisor, to assist it to look into structuring solutions which would allow for value maximization for creditors regarding New Kaupthing. The objectives of the restructuring, as well as several structuring options, were outlined and presented to various representatives in the Government together with concerns and views of creditors. The Resolution Committee insisted that all creditors be given appropriate access and sufficient time to review relevant information. The Resolution Committee objected to the valuation of the assets transferred to New Kaupthing initially presented by the Government. The Resolution Committee has entered into agreements with the Government which it believes provide the opportunity to maximize the value of the transferred assets and participate in upside and gives creditors and their various advisors and representatives the opportunity to provide feedback on the negotiated structures.

### **1.4 Negotiated options summary**

The Resolution Committee has negotiated two options with the Government. Further information on the negotiated options can be found in chapter 2 *Overview of the New Kaupthing transaction* and in *Appendix 1 Description of the agreements* of this report. A brief overview is provided below.

#### **Option 1: The Bank to capitalize and retain the majority of New Kaupthing shares**

The Bank contributes 65% of the overall capitalization of New Kaupthing for which it will receive 87% of the share capital. The Bank provides assets, mainly ISK cash and Icelandic related assets, for its share of the capitalization of New Kaupthing. 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 Government's contribution is in the form of Government bonds. This solution effectively gives the Bank back the assets and liabilities that were transferred to New Kaupthing on the basis of the FME decision from October 2008. The assessed initial shortfall from the transfer of assets and liabilities from the Bank to New Kaupthing is ISK 38 billion.

#### **Option 2: Government to capitalize and have ownership of New Kaupthing**

The Government capitalizes 100% of New Kaupthing through the contribution of Government bonds. The Bank is granted a call option on 90% of the initial share capital in New Kaupthing owned by the Government. This solution also provides that assets from the Bank are put in escrow to cover for the

assessed ISK 38 billion initial shortfall. This shortfall was assessed at ISK 38 billion on which an agreed interest rate is payable. In addition, the Bank receives a Contingent Value Right ("CVR") on a portfolio of the largest loans of New Kaupthing. The upside beyond a customary return on the assets will be shared between New Kaupthing and the Bank as follows: the Bank will receive 80% of the upside until full recovery of the shortfall of ISK 38 billion and 50% of the next ISK 10 billion in recovery. The upside will be credited against the initial shortfall of ISK 38 billion from the transfer of the net assets to New Kaupthing.

### **Interim Period between Signing and Implementation of *Option 1* or *Option 2***

On 14 August 2009, the Government capitalized New Kaupthing with approximately ISK 72 billion in common equity through contribution of Government bonds. New Kaupthing will earn interest on the Government bond from the transfer date of 22 October 2008. This capital contribution allows New Kaupthing to function as a fully operational bank in the interim until either *Option 1* or *Option 2* is implemented. From 3 September 2009, the date of the signing the binding agreements, until an option is implemented, the Bank and the Government jointly control New Kaupthing, with each party having an equivalent number of votes on the Board of New Kaupthing.

## **1.5 Creditors' consultation**

The Resolution Committee has signed agreements with the Government which provide for two different options as outlined in *Appendix 1 Description of the agreements* and briefly described above. Furthermore, the agreements allow for a process which gives creditors and selected advisors the opportunity to review information regarding New Kaupthing and to provide feedback on the negotiated structures. However, the Resolution Committee, and in accordance with its responsibilities under Icelandic law, will decide which the preferred option is.

The Moratorium Supervisor and the Resolution Committee have called a meeting on 20 October 2009 which will be open to all creditors of the Bank. The main purpose of this meeting is: a) to provide creditors with an overview of the process and summary of the capitalization options with respect to New Kaupthing; b) to provide creditors with information of the Bank's operations and an update of key events since last meeting in February 2009; c) to discuss the possible extension of moratorium on debt payments. During this meeting, creditors will have the opportunity to raise questions and provide feedback on the capitalization options. However, no binding decisions will be made at this meeting. A registration form, which must be completed before 17 October 2009, is available on the Bank's website, [www.kaupthing.com](http://www.kaupthing.com).

In addition, the Resolution Committee appreciates all feedback from the Bank's creditors. The Resolution Committee would like to give creditors the opportunity to state their views and send feedback to [creditorcontact@kaupthing.com](mailto:creditorcontact@kaupthing.com). Further information on creditors' consultation can be found in chapter 2.6 *Creditors' due diligence and consultation*.

## **1.6 Key events and timetable related to New Kaupthing**

**20 July 2009:** The non-binding agreement, signed on 17 July, between the Resolution Committee and the Government with regards to New Kaupthing announced.

**14 August 2009:** The Government capitalized New Kaupthing with approximately ISK 72 billion in common equity which allows New Kaupthing to function as a fully operational bank during the interim period.

**3 September 2009:** All documentation with regards to New Kaupthing signed by the Resolution Committee and the Government.

**20 October 2009:** The Resolution Committee will hold a creditors' meeting to provide creditors with an overview of the process and a summary of the capitalization options with respect to New Kaupthing. Also, at the meeting, there will be a discussion on possible extension of moratorium on debt payments.

**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.

A more comprehensive timeline of events for the Bank can be found in Chapter 2 of the Bank's Creditors' Report, available on the Bank's website [www.kaupthing.com](http://www.kaupthing.com).

## 2. Overview of New Kaupthing' transaction

### 2.1 *Negotiated options*

The Bank and the Government have entered into a set of agreements that allow for two different options to be implemented:

- The Bank to capitalize and retain the majority of New Kaupthing shares (**Option 1**)
- The Government to capitalize and have ownership of New Kaupthing (**Option 2**)

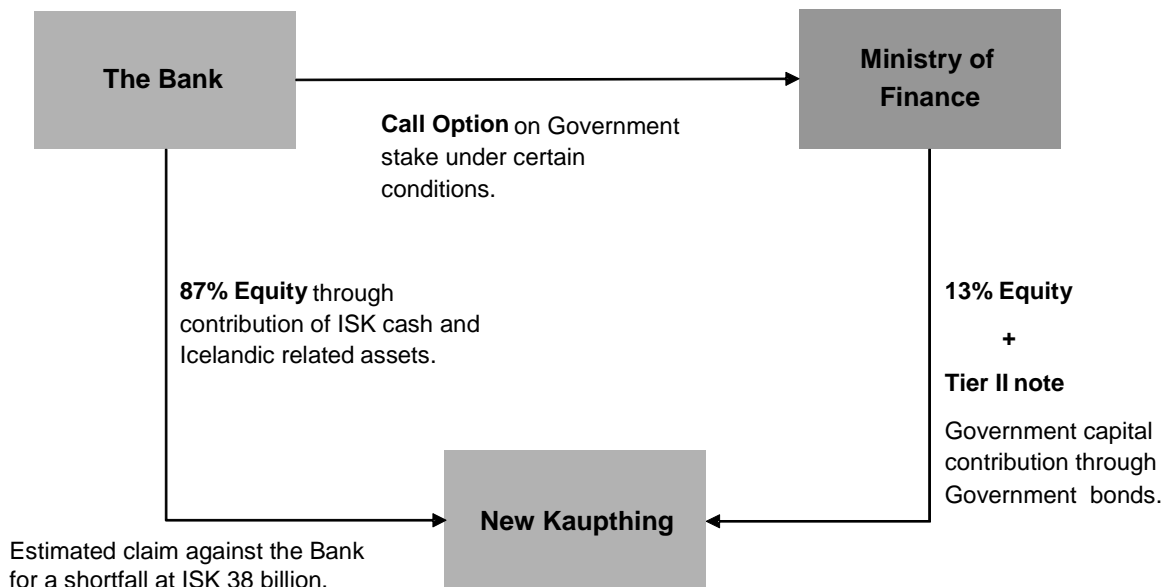
In *Option 1*, the Bank contributes approximately ISK 66 billion, equivalent to 65% of the overall capitalization of New Kaupthing for which it will receive 87% of the share capital. The Bank provides mainly ISK cash and Icelandic related assets for its share of the capitalization of New Kaupthing. The Government contributes approximately ISK 35 billion or 35% to the overall capitalization for which it will receive 13% of the share capital and a Tier II subordinated note for approximately ISK 25 billion. The Government's contribution is in the form of Government bonds. The actual amounts and the respective sizes of the instruments may change depending on the capitalization finally approved by the FME, the type of the assets contributed by the Bank and any tax structuring requirements. This option effectively gives the Bank back the assets and liabilities that were transferred to New Kaupthing on the basis of the FME decision in October 2008. Technically this option will be implemented as a conditional capital increase. The Bank has the option to reduce the Government stake to 10% either before the capitalization by contributing more assets and the Government contributing fewer assets or after the capitalization through a purchase of Government held shares or a capital increase.

On 14 August the Government capitalized New Kaupthing with approximately ISK 72 billion in common equity through contribution of Government bonds earning interest starting at the transfer date of 22 October 2008. The capital contribution by the Government will largely be reversed in case *Option 1* is implemented. The capital contribution by the Government in the interim period was implemented to enable New Kaupthing to function as a fully operational bank until a final option is implemented. From 3 September 2009, the date of signing of the binding agreements, the Bank and the Government will jointly control New Kaupthing, with each party having an equal number of votes in the Board of New Kaupthing. The interim period ends when either *Option 1* or *Option 2* is implemented. If the conditions for *Option 1* are not fulfilled by 31 October 2009 or the Resolution Committee declares earlier that it will not approve the capital increase, *Option 2* will be implemented and New Kaupthing will remain capitalized by the Government as implemented in the interim period.

It should be noted that in neither option is the Resolution Committee agreeing to the shortfall, i.e. that the value of the assets transferred to New Kaupthing is less than the value of liabilities. Therefore, a solution which allows for value realization of the assets over time has been implemented.

### Option 1: The Bank to capitalize and retain the majority of New Kaupthing shares

A structure of the option where the Bank retains New Kaupthing is shown below. For simplification purposes, a holding company for New Kaupthing is omitted.



#### The Bank:

- 65% of total capitalization for which it receives 87% of the share capital. The FME has assessed on a preliminary basis that a 12% Tier I ratio and a 16% capital ratio needs to be maintained. Based on the assessment, the Bank needs to provide ISK 66 billion for the capitalization. The exact amounts are subject to change depending on the capitalization finally approved by the FME, the type of assets contributed by the Bank and any tax structuring requirements. If *Option 1* is deemed preferable by the Resolution Committee, it intends to use mainly ISK cash and Icelandic related assets for capitalization, but has full flexibility on the use of assets. Further details on the composition of the assets intended to be used in the capitalization can be found in chapter 2.2 *Assets used in the capitalization in Option 1* of this report. It should be noted that the Bank also has the option to increase its stake up to 90% of the share capital and reducing the Government stake to 10%.
- The Bank has a call option on the 13% Government's common equity stake. The call option purchase price allows for an equity like return for the Government, fixed at ISK risk free rate +5% against which any dividends or other payments received by the Government will be credited.

#### Government:

- Approximately ISK 35 billion contribution representing 35% of the total capitalization for which the Government receives 13% in common equity and a Tier II subordinated note.

Key terms of the subordinated note include:

- Size: ISK 25 billion
- Denomination: Euro (or any other currency selected by New Kaupthing)
- Term: 10 years

- Coupon: 1m EURIBOR +400 bps for the first 5 years; step up to 1m EURIBOR +500 bps after 5 years
  - Accrual option: New Kaupthing can defer interest payments for the first two years
  - New Kaupthing has the option to convert the Tier II note into a Tier I note or share capital based on agreed conditions; as part of the conversion the Government can choose whether to take ordinary shares or Tier I note under the agreed terms.
- Shareholders' Agreement gives the Government entitlement to one board seat. For certain decisions e.g. for winding-up, disposal of all assets, transactions with the Bank and companies related to the Bank, and dividend payments in the first three years all members of the boards need to agree.
  - Net Income generated during Government ownership period starting 22 October 2008 and ending 30 September 2009 will be paid to the Government. In case of negative Net Income for this period the Government will compensate New Kaupthing for any losses which occurred during this period.
  - Liquidity Facility established of up to ISK 75 billion under which a bond collateralised with all the assets of SPRON, as further described in chapter 4.2 *SPM and SPRON transactions*, or assets of similar quality can be exchanged for Government bonds against payment of an agreed fee to provide liquidity. The Government bonds received by New Kaupthing in exchange for the SPRON bond are eligible for repo transactions under standard market terms with the Central Bank of Iceland ("ICB") thereby giving New Kaupthing the opportunity to create additional liquidity. The facility has a term until 2014 and decreases in line with the reduction of the SPRON bond in the meantime.
  - The initial shortfall is assessed at ISK 38 billion.

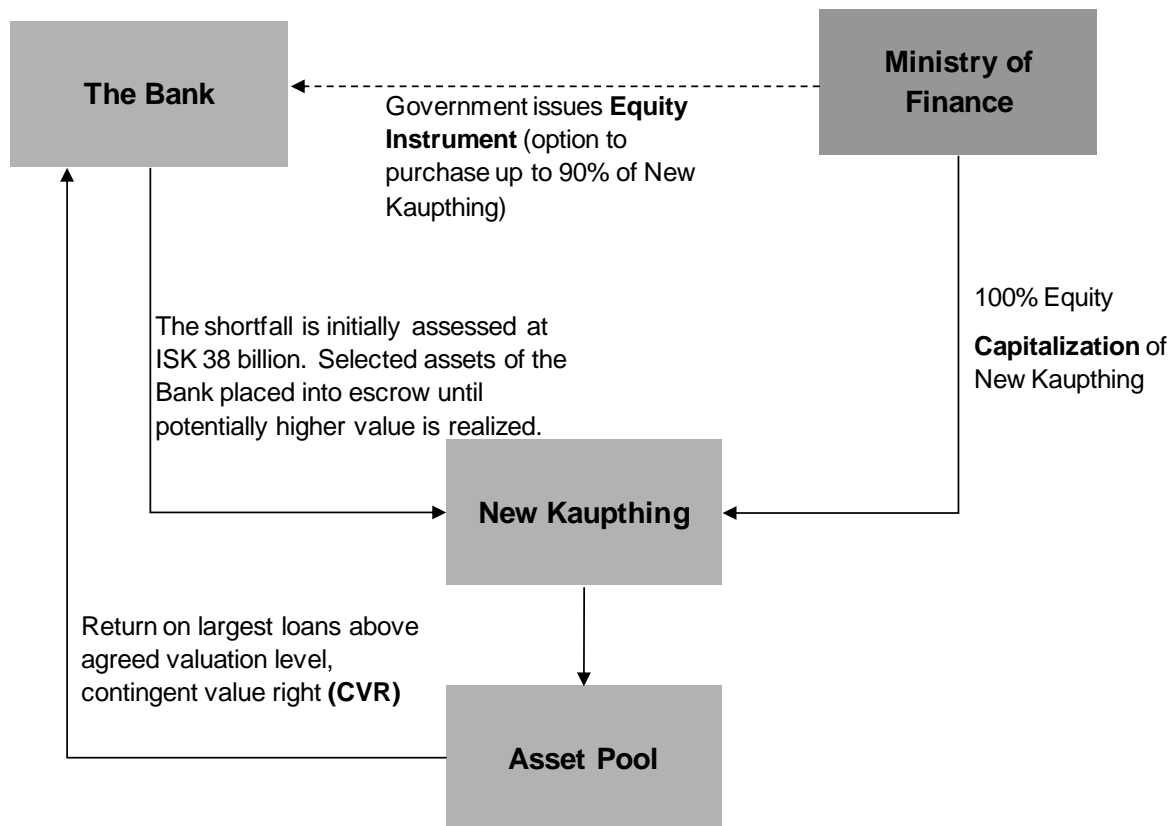
In this option, the Government reduces its capital commitment and the interests of creditors are aligned with the success of New Kaupthing. If *Option 1* is chosen, it is the intention of the Resolution Committee to ensure value maximization within New Kaupthing on behalf of its creditors by operating New Kaupthing as a profitable Icelandic bank focused on building its domestic operations and maximizing the value and recovery of its assets.

Status of fulfilment of conditions to implement *Option 1*:

- 1) Documentation: All agreements have been signed by the Resolution Committee on 3 September 2009
- 2) Satisfactory completion of due diligence: The Resolution Committee and its advisors continue their ongoing due diligence and monitor trading and liquidity updates throughout the interim period
- 3) Regulatory approval:
  - a. FME: The application was filed to the FME and decision is expected soon. Further details on regulatory requirements and FME conditions can be found in chapter 2.3 *FME conditions for ownership of an Icelandic bank*.
  - b. Competition Authority: The application has been filed and decision is expected soon.
- 4) Approval by the Resolution Committee: The decision will be taken after creditors' consultation and no later than 31 October 2009

## Option 2: Government to capitalize and have ownership of New Kaupthing

If conditions to implement *Option 1* have not been fulfilled by 31 October 2009 the following structure will be implemented under the signed agreements:



Government:

- Provides 100% of capital for the capitalization.

The Bank:

- The Bank has a call option on 90% of the initial share capital owned by the Government subject to standard anti dilution terms. The option can be exercised between the beginning of 2011, 2012, 2013, 2014, and 2015 or ahead of any Government disposal of New Kaupthing. The option purchase price is equivalent to the capital provided under the capitalization by the Government compounded by the ISK risk free rate equivalent to the interest paid on the Government bonds injected by the Government into New Kaupthing + 5%.
- The Bank provides selected assets in an escrow account to cover for the assessed initial shortfall arising from the transfer of assets and liabilities from the Bank to New Kaupthing; this shortfall has been assessed at ISK 38 billion. The value of the escrow assets is guaranteed by the Bank for the time period of the agreement which ends on 30 June 2012. 50% of the shortfall is agreed as ISK debt with an interest charge of 15bps above the average rate paid by New Kaupthing on the Bank's deposits with New Kaupthing; the other 50% is agreed as euro debt with interest charge of 1 month EURIBOR +175 bps
- The Bank has Contingent Value Right on a portfolio of the largest loans of New Kaupthing representing approximately 67% of the transfer value of the total loans to customers (pre FX discount) and 54% of total initial balance sheet at transfer value excluding the assets from

capitalization. The upside beyond the anticipated return on the assets based on management current valuation will be shared between New Kaupthing and the Bank as follows: the Bank will receive 80% of the upside until full recovery of the shortfall of ISK 38 billion and 50% of the next ISK 10 billion in recovery. The upside will be credited against the initial shortfall of ISK 38 billion. The agreement will run until 30 June 2012. The Contingent Value Right Agreement ends on 30 June 2012.

- A representative of the Bank can participate in credit meetings and monitor ring fenced assets. Representative has proposal rights but not veto rights. Material decisions can be transferred to an arbitrator in case of dispute.
- The Bank as the holder of the call option receives a board seat during the option period and veto rights for certain decisions including among others any material change to constitutional documents, winding-up, any material change in the nature of the business including acquisitions and disposals, any material transactions with the shareholder other than on an arm's length basis and unless in the ordinary course of business, dividend payments and capital measures with similar effects, new material borrowings and other material new liabilities other than in the normal course of business; in addition the representative is entitled to receive any information on material restructurings, to comment and object without veto rights on major restructurings and has the right to participate in committee meetings

No fairness opinions or valuation opinions regarding the valuations or reached settlement agreements have been given by any party.

## **2.2 Assets used in the capitalization in Option 1**

A preliminary version of a specialized report from an independent auditor, as per article 6 of Act No. 2/1995 on Limited Liability Companies, confirms the valuation of the assets to be used for the Kaupthing Capitalization. It has assessed the value of these assets to be at least ISK 66.6 billion.

The Bank has identified the following assets as feasible for capitalization of New Kaupthing:

- ISK 17.5 billion cash in hand.
- Icelandic related corporate loans valued at ISK 30.6 billion.
- A portfolio of mortgages and loans to Government related entities, which has been repo-ed to the ICB valued at 18.5 billion (the amount represents the net position after the corresponding liability has been fulfilled).

## **2.3 FME conditions for ownership of an Icelandic bank**

If and before *Option 1* would be chosen the FME needs to approve the ownership of New Kaupthing by the Bank. As such the below are key conditions that have been communicated by the FME:

- Capital reserves: Tier 1 of 12% and a total capital ratio of 16% (only 12% needed if owned by the Government)
- Sufficient financial strength of owner
- Liquidity reserve
  - The bank needs to maintain 5% of on demand deposits
  - Sufficient liquidity to withstand a stress test scenario for a deposit outflow as defined by the ICB and the FME
- Risk Management and governance:

- Compliance with risk management standards of the FME and implementation of required improvements
- Fit and proper examination of all Board members and executive committee team members.
- Update and disclosure obligation to the FME regarding incentive schemes, restructuring strategy and progress and impact on risk profile of the bank
- Transactions with affiliates: loans to significant shareholders or related entities require prior FME approval

## 2.4 Comparison of the two negotiated options for the Bank

As previously outlined, the Bank and the Government have entered into a set of agreements that allow for two different options to be implemented. The table below shows the comparison of the upside participation for creditors, control, incentivisation and key risk factors/ downside considerations for each option.

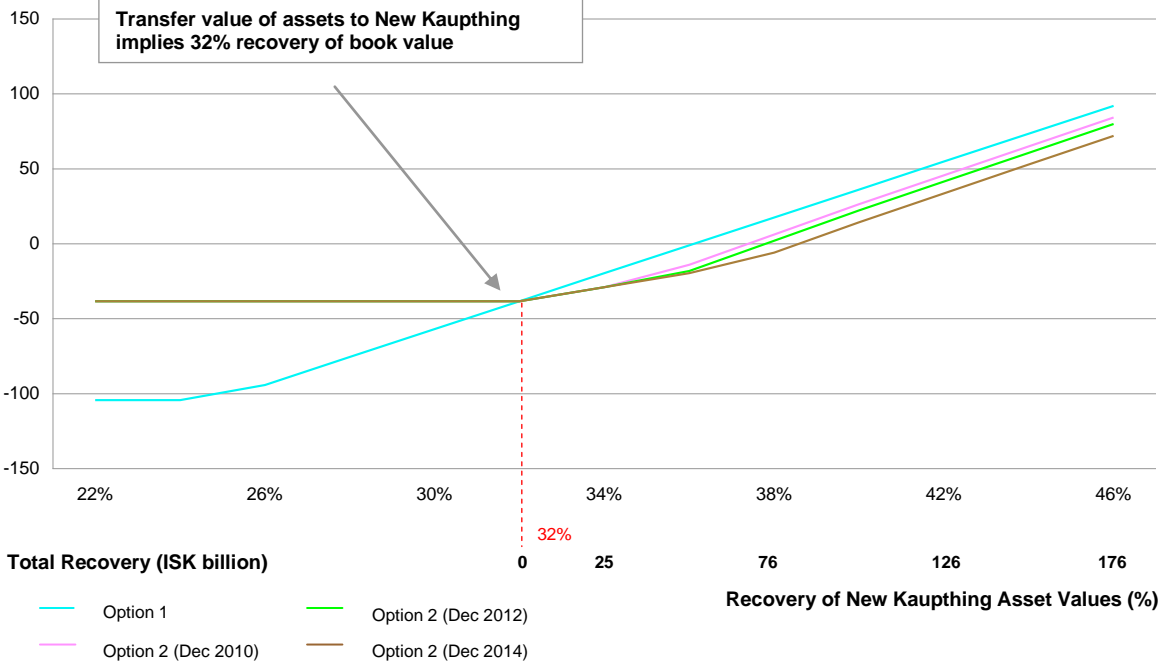
	<b>Option 1: The Bank to capitalize and retain the majority of New Kaupthing shares</b>	<b>Option 2: Government to capitalize and have ownership of New Kaupthing</b>
Upside participation for the Bank	<ul style="list-style-type: none"> <li>• The Bank receives upside through respective shareholding in New Kaupthing (dividends, exit through sale/IPO of New Kaupthing) including a revaluation of the transferred assets.</li> <li>• Profit improvement measures can be defined and implemented.</li> <li>• Agreement between the Bank and New Kaupthing on shortfall can be defined.</li> </ul>	<ul style="list-style-type: none"> <li>• Asset level: Contingent value right allows for 80% of upside after agreed return on defined asset pool until recovery of initial shortfall from transfer and 50% participation in the next ISK 10 billion value increase.</li> <li>• Company level: Potential participation in upside after the Government receives an agreed return of ISK risk free rate + 5% on the injected capital through option to acquire 90% of initial share capital at agreed price formula. Defined escrow agreement on the Bank's assets.</li> </ul>
Control	<ul style="list-style-type: none"> <li>• Better control of New Kaupthing based on controlling shareholding position (including timing of exit); limited veto rights for the Government.</li> <li>• Potential for accelerated restructuring and more commercial focus.</li> </ul>	<ul style="list-style-type: none"> <li>• No direct control; board seat and veto rights in board during equity option period.</li> </ul>
Incentivisation	<ul style="list-style-type: none"> <li>• Set by the Board appointed by the shareholders for management and employees.</li> </ul>	<ul style="list-style-type: none"> <li>• Set through Board for management and employees in line with limitations due to standards under Government ownership.</li> </ul>
General upside drivers	<ul style="list-style-type: none"> <li>• Macroeconomic improvements resulting in substantial decrease in ISK policy rates, increase in FX rates</li> </ul>	<ul style="list-style-type: none"> <li>• Same as <i>Option 1</i>, but participation only on asset level and if equity option is exercised after Government</li> </ul>

	<p>and improved loan losses vs. book value in opening accounts.</p> <ul style="list-style-type: none"> <li>• Entry to EU/ adoption of euro.</li> <li>• Consolidation opportunities in Iceland.</li> <li>• Profitable re-investment of profits.</li> </ul>	has made its return.
<b>Key Risks/ General Downside Considerations</b>		
General	<ul style="list-style-type: none"> <li>• Further recession impacting asset values and liquidity possible resulting in further capital/ liquidity need.</li> </ul>	<ul style="list-style-type: none"> <li>• Same as <i>Option 1</i> (impact limited to shortfall of ISK 38 billion plus interest and currency fluctuations and no upside from CVR); Government as shareholder is likely first source for providing additional capital.</li> <li>• Potential reluctance to push through cost optimization and synergies.</li> </ul>
Asset value downside participation	<ul style="list-style-type: none"> <li>• Capital at risk through contribution of assets in capitalization and potentially assets for initial shortfall.</li> </ul>	<ul style="list-style-type: none"> <li>• Limited to ISK 38 billion plus interest and currency fluctuations through contribution of assets into escrow.</li> </ul>
Liquidity	<ul style="list-style-type: none"> <li>• Operational risks of a running bank, mainly liquidity due to private ownership, ability to raise funds in wholesale market in medium to long-term and liquidity needs in case of further deterioration of assets (however, risk is partially mitigated through the agreed liquidity line of up to ISK 75 billion and potential further Government support).</li> </ul>	<ul style="list-style-type: none"> <li>• Same as <i>Option 1</i> except the agreed liquidity line of up to ISK 25 billion (impact limited to shortfall of ISK 38 billion plus interest and currency fluctuations and no upside from CVR); Government as shareholder is likely first source for providing additional liquidity or capital.</li> </ul>
Restructuring		<ul style="list-style-type: none"> <li>• Potential inability and reluctance to push through loan restructuring due to Government ownership.</li> </ul>

# Illustrative Return Profile from Upsides/ Downsides to Transfer Values

## Returns Profiles: Option 1 vs. Option 2

Recovery of All Assets  
Value Uplift to Kaupthing Bank hf, ISK billion



Please note that the potential differences through ownership and restructuring effort implemented have not been reflected in this illustration.

The graph above is an illustration of potential recoveries or incremental losses in value of all transferred assets. There is no certainty that any recoveries will be achieved or that the agreed transfer values can be realized. In the calculation of these profiles the signed agreements have been taken into account. In general, the recovery is the incremental return achieved by New Kaupthing above an assumed return customary for an asset of its class (e.g. market interest rate on loans, equity return on shares) which is reflected in New Kaupthing’s latest available business plan. The return profile is shown after tax for which the Icelandic tax rate of 15% has been assumed. The pay-off profiles assumes the same incremental recovery rates across all asset classes. *Option 1* assumes 87% ownership. For *Option 2*, exercise of the call option has been assumed at the end of 2010, 2012 and 2014 entitling the Government to preferred return for the respective period starting 22 October 2008 until exercise date. For calculation purposes a 15% preferred return has been assumed for the Government for which any return achieved in the business plan of New Kaupthing under Government’s ownership has been accredited.

## 2.5 Negotiation process summary

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 would be owned by the Icelandic Government. The disposal of assets and liabilities of the Bank to New Kaupthing was a complicated task, which was more extensive than originally anticipated. Therefore,

amendments to this decision have been made by the FME. Further information on the FME framework provided can be found in *Appendix 4 FME framework on the disposal of assets and liabilities of the Bank to New Kaupthing* of this report.

It is the main duty of the Resolution Committee to protect the creditors' interest and aim for maximizing the value of the Bank's assets. The Resolution Committee has always considered the assets that were transferred to New Kaupthing as part of the Bank's assets and hence, a feasible solution where the creditors would have the opportunity to retain the majority of the potential upside needed to be achieved.

Creditors of the Bank have always stressed the importance of the Resolution Committee to protect their interests during the appraisal process. The Resolution Committee and Morgan Stanley learned via discussions with creditors that they had several principal issues with the initial proposal presented by the FME in the initial Transfer Decision, whereby creditors were to be compensated for the 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. Therefore, the Resolution Committee asked Morgan Stanley, as its financial advisor, to assist it to look into structuring solutions which allow for value maximization regarding New Kaupthing.

The 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 the appropriate treatment of creditors in all three old banks including transparency and the 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 the regaining of access to the international capital markets for the Government of Iceland and the new banks."

The Resolution Committee, together with Morgan Stanley and creditors' representatives, has been negotiating with the Government on the transfer of assets and liabilities to New Kaupthing in October 2008. The negotiation process started on 4 June 2009, when New Kaupthing's 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. The Resolution Committee entered into a Heads of Terms Agreement with the Government on 17 July 2009 and signed the agreements on 3 September 2009.

The Heads of Terms Agreement is in line with the Resolutions Committee's strategy 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 conditions have improved.

During the discussions with the Government the Resolution Committee repeatedly communicated to the Government that its short timetable did not necessarily allow for a suitable solution for the creditors of the Bank. The Resolution Committee repeatedly conveyed the view that all creditors require appropriate

access and sufficient time to review relevant information. The Committee objected to the initial management valuation of the assets transferred to New Kaupthing proposed by the Government.

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 give the opportunity to maximize 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.

The Resolution Committee must decide which alternative it wishes to pursue by 31 October 2009. Until then, the creditors have the opportunity to carry out due diligence regarding New Kaupthing and the transaction agreements. The Resolution Committee will reach a decision after consultation with the creditors.

## **2.6 Creditors' due diligence and consultation**

The agreements signed by the Resolution Committee and the Government allow for a process which gives creditors and selected advisors the opportunity to review information regarding New Kaupthing and to provide feedback on the negotiated structures. However, the Resolution Committee, in accordance with its responsibilities under Icelandic law, will decide which the preferred option is.

The Resolution Committee insisted that the Bank and its advisors would need to have sufficient time to review relevant information and perform their due diligence. New Kaupthing and the Government agreed that during the time period from the date of the Bank signing the agreements until the decision is made by the Resolution Committee, the two parties shall continue to allow the Bank and its advisors to conduct financial, commercial, legal and technical due diligence reviews on New Kaupthing as they may require in connection with the Kaupthing Capitalization. This includes reasonable access to any key employees, advisers, records, agreements, licenses, etc. of New Kaupthing or the Government which the Bank considers necessary in order to duly complete the due diligence review.

The Informal Creditors' Committee ("ICC") is composed of representatives of the Bank's largest creditors and includes a broad cross section of financial institutions. The members of the ICC were chosen in co-operation with the Committee's former advisor Deloitte LLP. The selection was primarily based on the value and the nature of the creditors' claims as well as geography. The ICC does not have formal powers or duties under Icelandic law and is consultative in nature. The ICC, which was established to have a set up for creditors to provide direct feedback to the Resolution Committee, was kept closely informed regarding the progress of the due diligence and negotiations with the Government via several meetings, numerous conference calls and update emails where the committee were given opportunity to give their feedback on the process. Furthermore, the ICC was allowed to review and comment on all the draft agreements. Members of the ICC received and submitted helpful comments throughout the process.

In addition, a sub-committee of the ICC ("sub-ICC"), which was chosen by the members of the ICC, was formed to enable the Bank to consult with creditors more closely throughout the negotiation process. The sub-ICC members sat at the negotiation table and participated actively in the formal negotiation process. Although the sub-ICC is not a formal representative body of the creditors, its direct involvement and contribution in the negotiation with the Government was important and very helpful for the Resolution Committee as it, among other things, enabled the Resolution Committee to receive first hand feedback from creditors throughout the process. Furthermore, the sub-ICC provided creditors with the opportunity to have their views directly heard during the negotiation.

Other creditors are divided into 2 groups: private creditors and public creditors according to the different amount of information available to each group. Furthermore, two independent financial advisors have been appointed by many of the largest creditors of the Bank. One was appointed by a group of financial institutions, which includes some of the largest creditors of the Bank, and another appointed by some of the Bank's largest bondholders. These advisors have received special permission from the FME to conduct a more thorough due diligence review on New Kaupthing and get detailed non-public customer information on a name by name basis. These advisors, ICC members and other private creditors are all bound by strict confidentiality agreements. In addition, creditors' appointed advisors have had several meetings with the management of New Kaupthing. Creditors' appointed advisors got also access to Morgan Stanley, the Resolution Committees financial advisor, and its working papers.

### **Private Creditors**

Private creditors are those who have signed the relevant confidentiality agreements. These creditors and creditors' advisors who have signed necessary confidentiality agreements shall continue to have the right to conduct financial, commercial, legal and technical due diligence reviews of New Kaupthing through the following data information services, until the decision has been taken by the Resolution Committee on which option is chosen:

- Restricted access to a data room as mutually decided between the parties.
- Full access to the Deloitte LLP Net Asset Valuation Report Part 1, subject to the creditors and their advisors signing a standard hold harmless letters and confidentiality agreements for access to the report.
- Restricted access to New Kaupthing's management as mutually decided between the parties. New Kaupthing shall in any event offer a meeting for the private creditors with the management of New Kaupthing where the private creditors can put forward questions to be answered by management of New Kaupthing.

### **How to become a Private Creditor**

As previously communicated in the Creditors' Report, creditors interested in becoming private and therefore get a restricted access to more extensive information regarding New Kaupthing in an online data room, can send e-mail to [creditorcontact@kaupthing.com](mailto:creditorcontact@kaupthing.com) and state their request. Access to the data room is conditional upon signing the relevant confidentiality agreement and a confirmation on their status as creditors of Kaupthing Bank hf.

### **Public Creditors**

The creditors, who have neither received special permission from the FME, nor signed confidentiality agreements as private creditors, are defined as public creditors. The public creditors have access to this report which mainly includes a detailed summary of the options and terms in addition to other material published on the Bank's and New Kaupthing's website. Additional information on New Kaupthing (*Appendix 2 New Kaupthing Introduction*) which is not included herein consists of a presentation which must be accessed in an on-line public data room. All creditors interested in getting access to this data room must confirm their status as creditors of Kaupthing Bank hf. and send their request by e-mail to [creditorcontact@kaupthing.com](mailto:creditorcontact@kaupthing.com).

In addition, the Resolution Committee appreciates all feedback from the Bank's creditors. The Resolution Committee would like to give creditors the opportunity to state their views and send feedback to [creditorcontact@kaupthing.com](mailto:creditorcontact@kaupthing.com).

### **3. Valuation of Assets and Liabilities in Opening Accounts**

#### **3.1 Transfer of Assets and Liabilities**

At the request of the FME, PriceWaterhouseCoopers ("PwC") established a preliminary statement of net assets for New Kaupthing at the date of its establishment. This statement was included in the Creditors' Report published by the Bank on its website. PwC also 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 concluded that some assets that were initially moved to New Kaupthing should have stayed with the Bank. Hence, this was corrected and these assets increased the size of the corporate loan portfolio of the Bank and hence lowered the asset base of New Kaupthing and thereby had a significant impact on the compensation instrument. A total of approximately ISK 190 billion in assets at book value were transferred back, approximately ISK 90 billion of which were unpledged. The liabilities related to the pledged assets had remained within the Bank based on the preliminary balance sheet. It should be added that all cash flows to and from the assets since the FME transfer decision took effect, have been compiled and corrected as between the two banks. The Resolution Committee supports these amendments as they are in full accordance with the FME transfer decision and the committee considers these assets to be above average quality compared with the Bank's other assets. Further less sizable amendments were made during the process based on additional findings in the PwC audit process.

#### **3.2 The Deloitte valuation**

At the beginning of the process, in early 2009, the FME envisaged that the Bank would be compensated for the transfer of assets and liabilities to New Kaupthing based on a valuation performed by an independent valuation party. For this task 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 were completed towards the end of April 2009.

According to the FME, creditors of the Bank can get readers' access to a physical copy of the report upon certain conditions being met. These are:

- Signing Hold Harmless Letters with Deloitte and Oliver Wyman
- Signing Confirmation of Confidentiality with FME
- Signing Confidentiality Agreement with New Kaupthing

All parties listed above have reserved their right to validate the reasons put forward by the creditors to view the reports. Creditors interested in accessing these reports can send an e-mail to [creditorcontact@kaupthing.com](mailto:creditorcontact@kaupthing.com) stating the name of the entity and the reasons behind the request.

For further information regarding the usage of the Deloitte reports in the process and negotiations please see chapter 3.4 *Due diligence carried out by the Resolution Committee*.

### 3.3 Management valuation

#### Corporate loan book

New Kaupthing prepared and carried out a fair value assessment of all assets transferred to New Kaupthing. The largest asset class is the corporate loan portfolio. There are extraordinary conditions in the Icelandic economy and great uncertainty concerning the recoveries from the corporate loan portfolio, both in terms of value and time of recovery. A large portion of corporate loans are either in default or are having a payment holiday. The ability of corporate borrowers to service their debt has deteriorated due to the fact that Icelandic companies generally had a high level of leverage and a large share of their borrowings was in foreign currencies. The collapse of the ISK has therefore dramatically increased corporate debt levels but at the same time high interest rates and some other economic conditions, such as a sharp decrease in demand, have made the operating environment in Iceland extremely challenging for many companies. In the next 12 to 18 months, the portfolio has to a large degree to be restructured, new terms and conditions agreed with borrowers, debt to equity swaps made and loans redenominated from foreign currencies to ISK. New Kaupthing's management deems that its calculations are in line with fair value calculation reflecting a medium-term recovery instead of valuing companies in line with the current market situation which is illiquid and depressed. New Kaupthing does though take into account that revenues and margins are likely to decrease, that some sectors will never return to previous activity and operational recovery will be slow and most likely in line with the macroeconomic projections made by the Central Bank.

Different valuation methods were used depending on the nature of the underlying assets and collateral. In the table below, the loan portfolio has been categorized in accordance with the valuation methods used by the management of New Kaupthing. The last two columns indicate how much weight each valuation method has in terms of book value and fair value results.

Category	Description (D) / Valuation method (V)	Book Value	Fair Value
Higher discount factor	D: Loans where New Kaupthing expects a full recovery and the contractual cash flow is used V: Present value of discounted contractual cash flows at market interest rates	12%	37%
Collateral value	D: Loans where the underlying collateral value is greater than the value of future expected cash flow V: Assessment of underlying collateral	58%	24%
Real estate companies	D: Real estate companies V: The Iceland Property Registry rate with a discount of approximately 8%	8%	15%
EV/EBITDA multiples	D: Operating companies that generate positive cash flow, but are currently unable or are estimated to be unable to service their debt, and estimated value is greater than underlying collateral value V: EV/EBITDA multiples	15%	15%
Currently in recovery	D: Borrowers that are currently in a recovery and restructuring process V: Individual assessment using discounted cash flow, collateral value, multiples and other methods available	7%	8%
<b>Total</b>		<b>100%</b>	<b>100%</b>

#### Higher discount factor

A provision based on net present value is made when no, or limited, provision is necessary due to inability to service debt. This category therefore includes loans which are not expected to require restructuring but might have deteriorated in value due to mispricing of the loan. Interest on these loans

is below current market rates as credit spreads were at a historic low when the loans were granted. The funding cost of the bank has increased and in order to estimate the value of the loans, the contractual cash flows are discounted at the market interest rates which the bank would be able to grant those companies the loans today. In order to minimize the discount applied, it is assumed that the interest charge is raised at the first available opportunity.

### **Collateral value**

This method is used to value loans where the underlying collateral value is greater than the value of future expected cash flows. The reason this method is used for a large portion of the loan book can in part be traced to the fact that the Bank granted many loans to holding companies with shares in Icelandic financial companies as underlying collateral. Those assets are now in many instances worthless and hence expected recoverability is low. Examples of other common types of collateral are fishing quotas, properties, inventory and receivables.

### **Real estate**

Real estate companies are facing considerable uncertainty over future rental rates. Vacancy rates have been increasing rapidly and it is difficult to estimate a normalized occupancy and rental rate in the future. Many tenants are in default and corporate bankruptcies are increasing. Due to this uncertainty New Kaupthing uses the FMR rates with a 20% discount as a prime method to value real estate properties. The ICB has issued a forecast assuming FMR prices to reduce by 30% in real terms by the end of 2011, which supports the estimated reduction in real estate prices. For most real estate properties, New Kaupthing also used discounted cash flow calculations and predicted vacancy and rental rates. Combining the two methods resulted in a discount of approximately 8% from FMR rates for those properties.

It is stated in the Land Registry Act (no. 6/2001) that tax values should be based on the market value of the property. The FMR rates are therefore estimated market values, updated every year taking into account the price-level changes for registered sales contracts. The values used by New Kaupthing are market prices according to FMR from November 2008.

### **EV/EBITDA multiples**

The EV/EBITDA multiples method was used for operating companies that generate positive cash flows and the estimated value is greater than the underlying collateral value. The enterprise value of the borrower in question is estimated by looking at average EV/EBITDA multiples of comparable companies across Europe, sourced from Bloomberg as there is no active stock market in Iceland. The multiples were adjusted to capture the fact that Icelandic companies have much higher weighted cost of capital than their peers in Europe due to higher interest rate and a country specific risk. The valuation of the four largest companies in this category (which make up over 50% of the value of all loans valued using the EV/EBITDA method), was however increased to reflect their market leading positions and resilient operations as they could as such be estimated to be trading at the upper range of their respective peer group. No discount or premium was applied due to illiquidity or control for the purpose of this valuation exercise as they were assumed to offset each other.

### **Recovery**

The loan book has been analyzed and specific cases have been formally submitted to the recovery process by the appropriate credit committee within the Bank. This category only includes those companies which were already in the recovery process at the time of the valuation, and where a valuation had been performed by the recovery team. Each company has been valued on a case by case basis and the valuation methods vary from company to company. The fair value estimate can therefore

be based on market value, discounted cash flows, assessment of collateral value, break-up value and other methods.

### **Retail loan book**

Retail loans to individuals and SMEs were valued on a homogenous pool basis. The pools were divided into segments based on product type and sector, and for each segment a fair value pricing simulation was performed. The simulation uses the Bank's funding cost as a discount rate and a segment-average Probability of Default ("PD") and Loss Given Default ("LGD"), to take into account the credit risk inherent in the portfolio. The PDs are found using the Bank's internal models whereas LGDs are based on Loan-To-Value for mortgage loans and standard Basel II values for other types. For each time-period the cash flow is divided into a performing and non-performing part using the segment-average PD. A fraction of the non-performing cash flow is assumed recovered at the end of the period, added to the performing cash flow and the result discounted. After summing up the discounted cash flows for each period New Kaupthing arrives at the fair value of the segment. For all segments, except mortgage loans in ISK, the valuation was done for the following 3 years – the assumption being that at that point the loans will have been negotiated onto sustainable terms and rates. For ISK mortgages, the valuation was extended to maturity.

### **Other assets**

Other assets were valued with a combination of various methods. Financial assets and loans to credit institutions were valued with many of the same methods as the corporate loan book. Subsidiaries and associates were valued at fair value with appropriate method in each case – taking into account an estimation of intangible assets where applicable. Property and equipment was valued with a combination of valuation from internal specialists and third party estimations.

## **3.4 Due diligence carried out by the Resolution Committee**

The due diligence and valuation exercises carried out by the Bank and its advisors have been mainly based on the following separate channels of information:

- Review of information provided in an online data room by New Kaupthing
- Detailed discussions with New Kaupthing's management throughout the process including senior management and core teams involved in the various aspects of the due diligence
- Review of Deloitte report I and II and discussions with Deloitte which have provided their independent valuation report as commissioned by the FME
- Review of Oliver Wyman Report and discussions with Oliver Wyman

Throughout the due diligence and negotiation process the Bank used advisors as deemed necessary including financial, accounting, tax and legal advisors. While certain selected information was available earlier, the due diligence period only commenced on 4 June 2009 and can continue until the end of October 2009 under the current agreements. The Resolution Committee used this period with regard to further assessments of the loan book, actual results in financial statement of New Kaupthing based on management accounts as audit procedures are still ongoing and business plan model and assumptions including cash flow generation, profitability improvement measures to be implemented if *Option 1* would be chosen and continued monitoring of New Kaupthing's profitability development and liquidity position. The time period will allow private creditors to carry out due diligence.

Within the due diligence process to date, the Bank focused its attention on the following areas:

- i) Balance Sheet Analysis / Net asset Valuation of New Kaupthing
- ii) Detailed analysis of the business plan
- iii) Liquidity risk from deposit outflow
- iv) Profit improvement measures

Within the Balance Sheet Analysis / NAV, the initial focus of the due diligence has been on the management valuation of the large loan portfolio, which accounts for approximately 80% of the gross value for the total loan portfolio and subsequently on the remaining loan assets and non-loan items (e.g. shares and bonds, subsidiaries and associated companies, receivables and others). Overall all balance sheet items were reviewed. In addition, general information was given on off balance sheet items. Given the relative size of the corporate loan book and available time frame, the discussions with management have primarily focused on the large corporate loan valuation methodology and its application in general and suitability on a case by case basis. Another focus was on understanding any differences in management's valuation vs. the Deloitte's valuation performed as well as on specific adjustments made.

In the due diligence the Bank has relied on the information as provided in the data room by New Kaupthing and no direct access was provided to the loan files or the Deloitte working papers and models for the valuation of the SME/ retail assessment. Overall the requested material information was eventually provided within the process as requested, but the timeframe available for review and discussions was limited.

### **Valuation**

Any compensation agreement between the two Parties was intended to be negotiated between the two Parties and not directly based on the Deloitte valuation report. The Government informed the Bank at the beginning of the due diligence process that any compensation was to be based on management's accounts as the Government is not willing to provide any direct compensation to the Bank above or below management's valuation as this would lead to an immediate gain or loss of the Government's capital ("Zero Capitalization Principle"). In addition, the value of the transferred assets in the accounts of New Kaupthing need to be signed off and approved by New Kaupthing's management and Board.

As discussed in *Appendix 1 Description of the agreements*, the Capitalization Agreement entails that the negotiating parties disagree on the valuation as such and structures were developed to capture further upside in the valuation of the assets in the future. For more details and description of the instruments see chapter 2 *Overview of New Kaupthing transaction*.

### **Result of the valuation assessment**

On a starting basis prior to any due diligence discussions, management presented a valuation shortfall for the Bank from the transfer of the assets and liabilities of ISK 86 billion. The reduction of ISK 258 billion from a positive fair value for the Bank of ISK 172 billion published by the FME based on preliminary statements for the net asset transfer to a negative fair value of a ISK 86 billion was driven by two main factors: a) audit by PwC on behalf of the FME for the correct reflection of the transfer decision which resulted in assets of ISK 190 billion and liabilities of approximately ISK 22 billion based on a FME ruling being transferred back from New Kaupthing to the Bank and b) detailed review of the asset portfolio by management and application of above described valuation principles. The Bank challenged the assumptions applied in management's valuation and factual correctness of certain positions. These different views were discussed with management over several weeks and the values agreed between management of New Kaupthing and the Bank were increased by ISK 48 billion to reduce the shortfall from the transfer to ISK 38 billion.

Based on the performed due diligence and respective findings, the Bank believes that higher asset values could potentially be realized in the future and New Kaupthing can be run as a profitable Icelandic commercial bank. However, the realization of the upside is uncertain and subject to certain assumptions. Potential catalysts for higher asset valuations include, among others, implementation of restructuring a general recovery in the current economic environment in Iceland, successful restructuring of the assets and their profitability as well as general market valuation levels. To reflect this potential upside and participation for the Bank, structural mechanisms were negotiated with the Government. For further details see *Appendix 1 Description of the agreement*. No fairness opinions or valuations opinions have been granted by any party regarding the transfer values, recovery values or settlement agreements.

### **Legal due diligence**

Weil, Gotsal & Manges acted as the Bank's UK counsel in drafting the agreements and they provided input through reviewing and amending the text as well as participating in drafting sessions with the Government. The Icelandic law firm Lex conducted a legal due diligence on New Kaupthing.

### **3.5 Depositor priority**

During the process with relation to the transfer of assets and liabilities from the Bank to New Kaupthing, there has been no representation by the Bank regarding the Government's decision to prioritize deposits over other creditors' claims. Compensation in this regard was not part of this negotiating process with the Government.

## **4. New Kaupthing information summary**

### **4.1 *New Kaupthing set up and strategy***

New Kaupthing was founded on 22 October 2008 when it took over the domestic operation of the Bank based on the decision by the FME. However the Icelandic operations, now transferred to New Kaupthing, are long established and go back to 1930 when Bunadarbanki Islands (Agricultural Bank of Iceland) was established.

New Kaupthing is a leading commercial and investment bank in Iceland. New Kaupthing builds on the extensive experience of the staff of the Bank, its heritage and infrastructure. New Kaupthing has a strong franchise and operates in a historically profitable market. It offers financial services to individuals, companies and institutional investors. These services include retail banking, corporate banking, investment banking, capital markets services, asset management and comprehensive wealth management for private banking clients. The bank operates a nationwide retail franchise in Iceland and has 30 branches. The bank employed 997 people in 2009.

Further details on New Kaupthing can be found in *Appendix 2 New Kaupthing Introduction* which is not included herein but consists of a presentation which must be accessed in an on-line public data room. Creditors interested in getting access to this data room must confirm their status as creditors of the Bank and send their request by e-mail to [creditorcontact@kaupthing.com](mailto:creditorcontact@kaupthing.com).

### **4.2 *SPM and SPRON transactions***

Since the foundation of New Kaupthing two significant transactions have taken place, which have changed the scope of New Kaupthing.

#### **Overview of SPM transaction**

On 3rd April 2009, New Kaupthing entered into a definitive acquisition agreement with SPM, a regional savings bank in Iceland which was in financial distress. Merger talks had been in progress between the Bank and SPM since summer 2008 and subsequently talks with creditors of SPM since October 2008 when SPM followed by a standstill agreement. The transaction agreement allowed for the acquisition of SPM assets by New Kaupthing, following the restructuring of SPM's senior debt. Given New Kaupthing's high proportional ownership of the senior debt, the transaction was estimated by New Kaupthing's management and the Board of New Kaupthing to be the best solution to maximize recovery. The transaction requires SPM senior creditors to significantly write down their debt while subordinated claims will be 100% cancelled. Accordingly the loan book of SPM was significantly written down based on assessment performed by KPMG.

ISK 8.9 billion bond will be issued from New Kaupthing to SPM creditors. If SPM agrees to a merger with New Kaupthing, they will receive the above bond, as well as ISK 1.9 billion of equity in New Kaupthing. The duration of the bond is 9 year, with no installments for the first 2 years.

#### **Overview of SPRON transaction**

New Kaupthing was contacted on 20 March 2009 by the ICB and asked to take over the deposits of SPRON, a savings bank in Reykjavik. All the assets of SPRON were placed into a limited liability company and a bond that has a pledge over the assets of the limited liability company was issued to New Kaupthing as a payment for the deposits. The bond has a maturity of five years with a 12-month

extension at the end of the 5-year period. There is no formal guarantee provided by the Icelandic Government for the value of the bond, but the Ministry of Finance has provided New Kaupthing with a hold harmless guarantee covering any shortfall in the value of the assets serving as security for the bond. The transaction took place 22 March 2009 and total deposits transferred summed up to approximately ISK 85 billion. All branches of SPRON were closed. The transfer of SPRON increased the efficiency of the branch network as all its branches were closed, provided New Kaupthing with 25,000 new customers and increased New Kaupthing's market share in retail deposits to approximately 32%.

### 4.3 Summary of Opening balance sheet

Provisional opening balance sheet of New Kaupthing, 22 October 2008.

New Kaupthing	22-Oct-08 ISK Million
Cash and cash balances	1,729
Government backed securities	71,225
Loans to credit institutions	39,620
Loans to customers	327,469
Financial assets	11,673
Compensation instrument	38,358
Associates and subsidiaries	8,473
Other assets	19,670
<b>Total Assets</b>	<b>518,216</b>
Deposits from credit institutions	52,179
Deposits from customers	391,342
Other liabilities	2,695
Total Equity	72,000
<b>Total Equity and Liabilities</b>	<b>518,216</b>

Additional information on New Kaupthing (*Appendix 2 New Kaupthing Introduction*) which is not included herein consists of a presentation which must be assessed in an online data room. The presentation includes details of New Kaupthing's set-up and divisions, strategy, loan portfolio breakdown, funding, FX imbalance, loan restructuring and governance.

### 4.4 Summary of New Kaupthing's business plan

*New Kaupthing is currently finalizing its revised business plan based on latest information available. The respective information will be published as an amendment to this report as soon as available.*

#### **4.5 Further potential performance improvement levers under the Bank's ownership**

*The below sub-chapter is based on the latest business plan available to the Bank.*

New Kaupthing's management has formed a strategy which has been presented to the Resolution Committee and to the ICC. A similar strategy would be employed under the stewardship of the Resolution Committee. Under the Resolution Committee's direction New Kaupthing will continue to be a full service bank to retail and corporate customers in Iceland. The aim would be to strengthen the Bank's competitive position in traditional banking services and build on strengths in asset management, debt capital markets and investment banking.

If *Option 1* is chosen and the Bank retains New Kaupthing, the Resolution Committee believes that further improvement measures can be implemented improving New Kaupthing's profitability compared to the presented business plan under Government ownership:

- Focus will be put on the brisk restructuring of the corporate loan book with the target of achieving higher economic recoveries for New Kaupthing.
- Due to the current economic turmoil, lending would for the next couple of years most likely be conservative with an emphasis on strengthening the current credit processes.
- Due consideration will be given to a more efficient branch network.
- More efficiency is likely to be achieved by streamlining the Bank's IT infrastructure as it has been designed and set up to serve a large multinational bank.
- Focus will be put on overhauling and refitting internal processes and cost structures across all activities to adapt to the Bank's new size and scope.
- Private ownership could also impact the range of available strategic options for several departments such as asset management, investment banking and capital markets.

The Resolution Committee would continue to form the strategy by working with the management and key employees of New Kaupthing with the aim of leveraging the Bank's existing strengths, positional advantages taking into account the various economic factors currently affecting the business model.

## Appendices

### **Appendix 1. Description of the agreements**

For *Option 1* the following agreements were signed:

- Kaupthing Capitalization Agreement
- Tier II Capital Instrument
- Shareholders' Agreement
- Hold Harmless Letter

For *Option 2* the following agreements were signed:

- Equity Option Agreement
- Escrow and Contingent Value Right Agreement
- Set off Agreement

### **Option 1 Agreements**

#### **THE KAUPTHING CAPITALIZATION AGREEMENT**

##### **Purpose**

After the Government Capitalization the Icelandic Government currently holds 100% of the issued share capital in New Kaupthing (the "Government Capitalization Agreement") and has capitalized New Kaupthing with Government Bonds. It is the intention of the parties to the Kaupthing Capitalization Agreement ("KCA"), if certain capitalization conditions therein are fulfilled, that the Bank will through a 100% owned holding company capitalize and acquire 87% of the shares in New Kaupthing in consideration for certain subscription assets.

##### **Interim Period**

According to the KCA both parties, the Bank and the Government, are entitled to equal representation on the New Kaupthing board with five votes each from 3 September 2009, the date when documentation with regards to New Kaupthing was signed by the Resolution Committee and the Government until 31 October 2009 (the "Interim Period"). In the Interim Period it is provided that certain matters or transactions cannot be undertaken without the prior written consent of the Government and the Bank (not to be unreasonably withheld or delayed). Furthermore the Bank and its professional advisers and creditors are provided with access for the purposes of conducting due diligence on New Kaupthing.

##### **Conditions**

The subscription obligations of the Bank are i.a. conditional upon the satisfaction (or waiver, as the case may be) of certain matters (the "Capitalization Conditions") which are mainly: (i) satisfactory completion of a due diligence review and a creditors' due diligence review (as set out in a schedule to the KCA), as reasonably determined by the Bank, (ii) creditors' feedback satisfactory to the Bank, and (iii) the subsequent discretionary decision by the Resolution Committee whether or not to undertake the Kaupthing Capitalization (*Option 1*).

##### **The Bank's Capitalization**

If the Capitalization Conditions are fulfilled the Kaupthing Capitalization shall take place whereby New Kaupthing's share capital shall be increased and the Bank shall subscribe for shares in New Kaupthing sufficient to meet its obligation as provided for in the KCA. By way of consideration the Bank shall transfer certain subscription assets to New Kaupthing. This will take place at a shareholders' meeting.

At the same meeting the shareholders of New Kaupthing shall decide on the decrease in the share capital of New Kaupthing, in consideration of the transfer to the Government of a principal amount of the Government Bond as determined under the KCA.

The amount required for the Government to subscribe for the Tier II Capital Instrument (calculated on the basis of the Tier II Capital Ratio Percentage) shall be retained by New Kaupthing as consideration for the issue to the Government of the Tier II Capital Instrument. Upon the completion of the Kaupthing Capitalization (*Option 1*) the Escrow and Contingent Value Rights Agreement and Equity Option Arrangement (which are described below) shall terminate and be cancelled (as the case may be) and the Shareholders' Agreement shall become effective, each in accordance with their respective terms. The parties to the KCA shall furthermore begin the process of agreeing or determining the Net Income of New Kaupthing as defined therein. Within 5 Business Days of the Net Income having been so agreed or determined New Kaupthing shall transfer to the Government a principal amount of the Government Bond equal to the returned capital less any amounts already released.

If the Kaupthing Capitalization has not been undertaken on or before 31 October 2009 the Resolution Committee can decide to proceed with the Kaupthing Capitalization before 31 October 2009, failing such a decision the parties shall treat the KCA as terminated for breach of condition. The Bank may furthermore, at any time until 31 October 2009, declare that it will not undertake the Kaupthing Capitalization by giving notice in writing to that effect to the Government, and thereby terminating the KCA and the Shareholders' Agreement which shall cease to have any effect and the Escrow and Contingent Value Rights Agreement and the Equity Option Arrangement shall become effective, each in accordance with their respective terms.

#### **Position following the Kaupthing Capitalization**

The capitalization and capital ownership structure of New Kaupthing following the Kaupthing Capitalization shall be as follows: The Government shall have contributed, in total since October 2008, 35% of the New Kaupthing Capitalization and the Bank shall have contributed, in total, 65% of the New Kaupthing Capitalization.

'New Kaupthing Capitalization' means the aggregate capitalization needed in order to raise the capital ratio of New Kaupthing to 16% ("Capital Ratio Percentage") based on the risk-weighted asset value and consequent regulatory capital requirements of New Kaupthing prevailing as at the Business Day prior to the date of the Kaupthing Capitalization. Thereof 4% ("Tier II Capital Ratio Percentage") shall be in the form of the Tier II Capital Instrument (unless otherwise required by the FME) based on the risk-weighted asset value and consequent regulatory capital requirements of New Kaupthing prevailing as at the date of the Kaupthing Capitalization.

The Government's holding in New Kaupthing shall consist of the entire Tier II Capital Instrument (subscribed for at par) with the remainder of the Government's 35% capital contribution being by way of subscription for share capital. The Bank's holding in New Kaupthing shall consist entirely of share capital and shall in total equate to a percentage of 100% minus the percentage of the fully diluted share capital represented by the shares held by the Government.

#### **Kaupthing Guarantee**

The Bank guarantees to the Government and New Kaupthing the full, prompt and complete performance by the Bank of all its obligations under the KCA and shall step in as principal obligor in case of non-performance by the Bank:

## **Net Income**

Up until end of 30 September 2009 the Government will be entitled to the profits of New Kaupthing. In case an aggregate loss is recorded for the time period from 22 October 2008 to 30 September 2009 the Government will compensate New Kaupthing accordingly.

## **Transfer of Assets**

For a period of six months commencing on the signing date, transferred assets, which were given a zero value in the opening balance sheet of New Kaupthing and which are set out in a schedule to the KCA (the "Zero Value Assets"), shall be transferred back to the Bank if the Bank so requests, the Zero Value Assets to be transferred back at zero value without compensation being payable to New Kaupthing. It should be noted that the transferred assets are not contingent upon the completion of the KCA.

## **Liquidity Facility**

On 3 September 2009 the Ministry of Finance provided New Kaupthing with a letter confirming that in the event the KCA is completed as contemplated in the KCA the Government will provide liquidity facility for the benefit of New Kaupthing. The Government confirmed that it would lend ISK 75 billion of Government bonds against security in the SPRON bond, but that amount can be reduced by an amount corresponding to the notional amount the SPRON bond is reduced. The Government bond would fulfil the requirements set by the ICB to be used as collateral for the purpose of liquidity provision on standard terms.

Charges incurred by New Kaupthing will be as follows if the facility is utilised:

When SPRON bond is used as collateral:

- No upfront fee
- Utilisation fee
  - Draw down of ISK 0 billion to ISK 25 billion: 0bps (the same will apply to further draw down if it can be demonstrated that it is the result of withdrawal of deposits from SPRON depositors)
- Draw down of ISK 25 billion up to ISK 75 billion at agreed fees. (It is contingent upon the completion of the KCA).

If other assets are used as collateral:

- 0.5 per cent. Upfront
- 300bps utilisation fee

The Government declared in the letter that it would continue its negotiations with the Central Bank and endeavour on best effort basis to seek to agree that the ICB should accept the SPRON bond directly as collateral for the purpose of liquidity provision.

Further the Government declared that it was prepared to enter into negotiations with New Kaupthing on further liquidity provision should the outflow of other deposits than the SPRON deposits create liquidity problems for New Kaupthing.

## **Governing Law**

The KCA is governed by and construed in accordance with Icelandic law and the Icelandic courts have exclusive jurisdiction in connection with the KCA.

## TIER II CAPITAL INSTRUMENT

### **Purpose**

Upon the KCA's entry into force New Kaupthing has agreed to issue, and the Government has agreed to subscribe for, euro denominated unsecured subordinated notes (the "Notes") in an amount equal to approximately ISK 25 billion (the conversion rate to euro to be calculated on the issue date). When the Notes are issued, the capital ratio of New Kaupthing will be increased by 4% to bring the Tier II ratio from 12% to 16% as further stipulated in the KCA. The Notes shall be in registered form and shall be issued in such denominations as New Kaupthing shall determine. The Notes will be subordinated to the other liabilities of New Kaupthing.

### **Term and interest**

The term of the Notes is 10 years from the issue date (the date of the KCA's entry into force). Interest shall be paid on the Notes by New Kaupthing on a quarterly basis in arrears on 31 March, 30 June, 30 September and 31 December each year, with the first such payment due on 31 December 2009. New Kaupthing may though defer interest payments for the first two years. Interest accrues at 400 basis points above EURIBOR per annum for the first five years with a step up in the margin to 500 basis points above EURIBOR thereafter.

### **Early redemption**

New Kaupthing may redeem any Note, or part thereof, on an interest payment date after the date falling five years after the issue date (or earlier, if permitted by the FME), together with accrued (but unpaid) interest thereon to the date of payment (provided that such redemption is made pro rata to all noteholders in proportion to the outstanding amounts of the Notes held by each of them).

### **Conversion**

New Kaupthing may elect at any time (if permitted by the FME) to convert part or the entire outstanding principal amount of the Notes into a Tier I Instrument. As part of the election the holder can choose between receiving common shares or non-voting preferred equity yielding interest of ISK risk free rate + 400 bps with certain step up provisions.

### **Subordination**

The rights of a noteholder are subordinated in all respects to the rights of senior creditors. In the event of a winding-up of New Kaupthing, any claims of a noteholder shall be junior to the claims of all senior creditors, and accordingly no amount shall be payable to a noteholder until the claims of all senior creditors admitted in the winding-up have been satisfied. Payment of any amount under or in connection with the Notes whether in respect of principal, interest or otherwise, shall be in all respects conditional upon no order having been made or effective resolution having been passed for a winding-up of New Kaupthing and no default having occurred and continuing in relation to the senior liabilities and the payment not causing New Kaupthing to be in breach of its capital requirements.

### **Event of default and enforcement**

If a default is continuing for a period of ten Business Days or more in the payment of any of the principal amount of the Notes or any of the interest due in respect of the Notes (except deferred interest as permitted in the Notes), the noteholders (acting by Specified Majority) may institute proceedings to wind up New Kaupthing in accordance with Icelandic law, subject to subordination provisions.

### **Governing law**

The Tier II Capital Instrument and the Notes are governed by, and shall be construed in accordance with, Icelandic law and the Icelandic courts have exclusive jurisdiction in connection with the Instrument and the Notes.

## **SHAREHOLDERS' AGREEMENT**

Upon the completion of the KCA, a Shareholders' Agreement between the Bank, the Bank, New Kaupthing and the Ministry of Finance will enter into force. The Shareholders' Agreement will remain in force until such time when the total shareholding of the Government becomes less than 5% of the total share capital of New Kaupthing. The principal terms of the Shareholders' Agreement are otherwise as follows:

### **Organization of the Board**

Kaupthing shall have the right to nominate four Directors to the Board of New Kaupthing, one of whom shall be nominated the Chairman of the Board. The Government shall have the right to nominate one Director to the Board of New Kaupthing who shall upon the request of the Government have a seat in New Kaupthing's Remuneration Committee.

### **The Government's right of veto**

The Government shall have the right to veto decisions on any of the following matters:

- To cease the operation of New Kaupthing as a commercial bank
- To dispose of all or substantially all of the assets of New Kaupthing
- To liquidate or wind up New Kaupthing
- To change the Articles of New Kaupthing in such a way that materially prejudices the Government, unless the change also affects, in materially the same way, other shareholders
- To pay any dividend for the first three years
- Transactions between New Kaupthing and the Bank

### **Pre-emption rights**

If the Government wishes to transfer any of its shares to a third party it shall first offer to the Bank the right to buy these shares at the same price and under the same conditions that are being offered to the third party.

### **Drag Along rights**

If Kaupthing wishes to sell more than 50% of the shares then in issue in New Kaupthing and finds a purchaser which is not an Affiliated Company of Kaupthing and agrees terms for the sale to the purchaser of such shares then, the Government shall be bound to accept any offer from the purchaser on the same terms as agreed by Kaupthing.

### **Tag Along rights**

No transfer of any shares (or any interest in any shares) in a single transaction or a series of related transactions may be made by Kaupthing if it would result in Kaupthing ceasing to hold more than 50% of the shares in issue unless the proposed acquirer of such shares has first made an offer to the Government to purchase proportionally the same number of its shares at the same price per share and on the same terms and conditions as to be paid and given to and by Kaupthing.

### **The Bank's options**

The Bank shall have a call option on all the Government's shares which may be exercised at any time during the term of the Shareholders' Agreement. If this call option is exercised the Bank shall be obliged to procure a corresponding purchase of the Tier II Capital Instrument. The Bank shall further have an additional call option to enable it to increase its shareholding in the total share capital of New Kaupthing to 90%. The exercise of the additional call option will not trigger the obligation to procure the corresponding purchase of the Tier II Capital Instrument.

**New shareholders**

No shares shall be issued or transferred to a person who is not a party to the Shareholders' Agreement unless prior to such issue or transfer that person has executed an Adherence Agreement in respect of the Shareholders' Agreement.

**Governing law and jurisdiction**

The Shareholders' Agreement is governed by Icelandic law and the Icelandic courts have exclusive jurisdiction over any disputes arising there under.

**HOLD HARMLESS LETTER**

The Ministry of Finance provided New Kaupthing with a letter that confirms that the Government will hold New Kaupthing harmless with respect to the SPRON transaction and thereby guarantee payment on the SPRON bond.

## **Option 2 Agreements**

### **EQUITY OPTION INSTRUMENT**

#### **Purchase Rights**

If the Kaupthing Capitalization is not undertaken, as provided for in the KCA, the Government shall release the Equity Option Instrument from escrow and issue an option on the lesser of (i) 90 per cent of the issued equity share capital of New Kaupthing or (ii) the percentage of the issued equity share capital of New Kaupthing owned by the Government, as calculated on the date of the exercise of the Equity Option, and the Equity Option and the Purchase Rights shall become effective.

#### **Exercise Period**

The Purchase Rights according to the Equity Option can be exercised during a period of one calendar month falling immediately after the publication of New Kaupthing's annual report for each of the financial years ending 31 December 2010, 31 December 2011, 31 December 2012, 31 December 2013 and 31 December 2014. Furthermore, the rights become exercisable during a certain period with respect to an Exit. An Exit constitutes (a) listing of the ordinary shares of New Kaupthing or any of its subsidiaries on any regulated market, (b) a change of control of New Kaupthing. If the Purchase Rights have not been exercised in accordance with the relevant provisions of the Equity Option they shall lapse (and the Equity Option shall be cancelled) but only upon the relevant Exit being achieved.

#### **Purchase Price**

The Purchase Price is calculated as an amount in ISK per Equity Option Share as calculated by reference to the following formula (subject to Adjustment):

(ISK 5.6935) multiplied by  $(1 + [\text{Risk-Free Rate} + 5\%])^x$

(where "x" equals the number of years (to 3 decimal places) since 22 October 2008 and the date of the relevant Notice of Exercise pursuant to which this Purchase Price is being calculated (the "Determination Period") and "Risk-Free Rate" means the average annual interest rate receivable by New Kaupthing on the Government Bond over the Determination Period, calculated from the total amount of interest receivable by New Kaupthing on the Government Bond as against its aggregate principal amount).

#### **Board representation**

While the Equity Option is in place, the Bank shall have board representation in New Kaupthing with one board member with full rights. That board member shall have the right to take a seat in those committees of New Kaupthing considered relevant in relation to the Equity Option.

For certain issues the representative for the Equity Option holder shall have veto rights including material changes to constitutional documents, winding-up, material changes in the nature of the business operations including acquisitions, disposals or closing down of businesses, any material transaction with a shareholder or any of its associated companies other than on an arm's length basis, and in the normal course of business, the borrowing of material amounts, the giving of any material guarantee and/ or indemnity, making of any material loan or advance to any person and payment of any dividend or other distribution on account of shares in its capital other than in the ordinary course of business.

#### **Adjustments**

Appropriate adjustments are in place with respect to stock splits, stock dividends, capital increase etc. in New Kaupthing ("Adjustment Event"). An adjustment to the Equity Option and the Purchase Price shall be "appropriate" if, as a consequence of the adjustment, the Optionholders would enjoy to the maximum

extent possible in all the circumstances the same economic effect on the exercise of the Equity Option as if the relevant Adjustment Event had not occurred or arisen.

### **Information rights**

New Kaupthing's half-yearly accounts will be provided to the Optionholders within thirty Business Days following 30 June and 31 December each year. New Kaupthing's quarterly accounts (if produced) will be provided to the Optionholders as soon as reasonably practicable after they become available. In addition information regarding restructuring or debt forgiveness of a material nature will be provided and the board representative can comment on a decision but not veto it.

### **Transfer rights**

The Equity Option is freely transferable by Optionholders.

### **Meetings of Optionholders**

At an Optionholders meetings, Optionholders holding options representing the right to purchase at least 75% of the Option shares will have the ability to agree to certain matters binding on all Optionholders including, sanctioning any compromise or arrangement proposed to be made between the Icelandic Government and the Optionholders, agreeing modifications to the Options, agreeing to the exchange or substitution of the Options into shares, stock, bonds, debentures, debenture stock or other obligations or securities of New Kaupthing, or any other company and appointing a director of New Kaupthing to act on behalf of the Optionholders.

### **Governing law**

The Equity Option is governed by English law and is subject to the exclusive jurisdiction of the courts of England.

## **ESCROW AND CONTINGENT VALUE RIGHTS AGREEMENT**

If the Kaupthing Capitalization is not undertaken, as provided for in the KCA, the Escrow and Contingent Value Rights Agreement ("ECVRA") will take effect. The ECVRA sets out how assets from the Bank are put in escrow to cover for the assessed initial shortfall in value arising from the transfer of assets and liabilities from the Bank to New Kaupthing. This shortfall was assessed at ISK 38 billion on which an agreed interest rate is payable. 50% of the shortfall is agreed as ISK debt with an interest charge of 15bps above the average rate paid by New Kaupthing on the Bank's deposits with New Kaupthing; the other 50% is agreed as euro debt with interest charge of 1 month EURIBOR +175 bps. It should be noted that the shortfall can never exceed ISK 38 billion, save for the interest payable and currency fluctuations according to the ECVRA. In addition, the Bank receives a contingent value right on a portfolio of the largest loans of New Kaupthing representing approximately 67% of the transfer value of the total loans to customers and 50% of the gross values of the transferred assets. The upside beyond the anticipated return on the assets will be shared between New Kaupthing and the Bank as follows: the Bank will receive 80% of the upside until full recovery of the shortfall of ISK 38 billion and 50% of the next ISK 10 billion in recovery. The upside will be credited against the initial shortfall of ISK 38 billion from the transfer of the net assets to New Kaupthing. The agreement will run until 30 June 2012. The Bank will also pay an agreed interest on the initial shortfall to the New Bank until the shortfall is recovered or assets in the equivalent amount have been transferred to New Kaupthing.

### **Submission of Proposed Escrow Assets**

The Bank is to submit a schedule to New Kaupthing setting out which assets it proposes will constitute the escrow assets. These assets are to have a value at least equal to the initial shortfall. Following the

receipt of the schedule New Kaupthing shall have 20 business days to review the list of assets and assess their aggregated value. If New Kaupthing is of the opinion that the aggregated value of the assets is lower than the initial shortfall it has the possibility to object to the Bank by sending the Bank a written notice within 20 business days from receiving the schedule. If New Kaupthing objects the Bank and New Kaupthing shall endeavour to reach an agreement within 20 business days from the Bank's receipt of the notice. If the Escrow Resolution Period expires, and New Kaupthing and Kaupthing have failed to reach agreement on the matters in dispute, either New Kaupthing or Kaupthing may refer the matter to an independent accountant firm (to be mutually agreed between the parties) on the basis that it is to determine the value of Proposed Escrow Assets, and to recommend, if necessary, an adjustment to the value of the assets of the Bank.

### **Operation of the Escrow Assets**

The Bank has the obligation to notify New Kaupthing on 1 April each year (the "Escrow Valuation Date") of the aggregated value of the escrow assets as at 31 December of the previous year. Furthermore, the Bank shall notify New Kaupthing of any material default of a debtor and material changes to the terms of any of the escrow assets. The Bank is entitled to transfer assets from the escrow asset pool 10 days following each Escrow Valuation Date and prior to any proposed restructuring or sale of an escrow asset. If this leads to the value of the escrow assets being lower than the initial shortfall the Bank is obligated to provide substitution assets to cover the difference. If New Kaupthing objects to the transfer and subsequent substitution, similar procedures as described above are initiated, through which the parties will endeavour to reach agreement. If no agreement is reached, however, the issue can be referred to an independent accountant firm for resolution.

If the value of the escrow assets turns out to be lower than the initial shortfall at any Escrow Valuation Date the Bank shall propose additional assets to be put into the escrow assets. The same process as described previously will be used if New Kaupthing objects to the proposed assets on the basis that their value is too low for this purpose. For the avoidance of doubt it should be noted that the shortfall can never exceed ISK 38 billion, save for the interest payable and currency fluctuations according to ECVRA.

Any income generated by the escrow assets shall be paid into an interest account held for the benefit of New Kaupthing. It should be noted that the Bank can withdraw the excess amounts from the account at any time.

### **The Bank's Rights of Enforcement**

If the Bank fails to provide escrow assets equal in value to the shortfall or in other ways fails to comply with a material obligation under the ECVRA and does not rectify this within 5 business days of New Kaupthing serving it with a notice to this effect, New Kaupthing has the right to enforce its rights over the escrow assets, including by taking possession of and selling the assets. If New Kaupthing exercises its right of enforcement the ECVRA will be considered to have been terminated by New Kaupthing and a final valuation according to the agreement will be conducted. This may result in either the Bank being obligated to pay New Kaupthing an additional sum to that recovered through the enforcement actions if the value of those assets is deemed to be less than the shortfall or New Kaupthing being obligated to repay the Bank if it is found that the assets taken through the enforcement are of greater value than the shortfall. New Kaupthing's claim under the shortfall will be a priority claim against the Bank.

### **Ring-Fenced Assets**

As described above the ECVRA contains a schedule in which ring-fenced assets of New Kaupthing are listed and their estimated aggregated value is set out. On 1 April of each calendar year New Kaupthing shall submit to Kaupthing a further valuation of the ring-fenced assets as at 31 December of the

previous year (the "Interim Valuation"). The Bank shall have 20 business days after receiving the valuation to raise any disputes. If that occurs the Bank and New Kaupthing shall endeavour to agree on a valuation of the ring-fenced assets but if that proves to be impossible either party can refer this to an independent accountant firm for resolution.

### **Interim Valuation**

If and to the extent the aggregate value of the ring-fenced assets in the Interim Valuation is greater than the aggregate value of the Ring-fenced Assets as set out shown in the initial valuation then an amount equal to 80 per cent of the difference may be released from the escrow assets by Kaupthing. Following such release, the released assets shall cease to constitute escrow assets. If this occurs on more than one occasion the ECVRA provides due consideration to be given to what assets have already been released from the escrow assets. It should be noted that the euro denominated part of the debt will be reduced prior to the ISK part.

### **Monitoring of Ring-Fenced Assets**

The Bank has the right under the ECVRA to appoint an observer to monitor the ring-fenced assets. The observer shall be entitled to attend all meetings of credit committees and board meetings of New Kaupthing during which the ring-fenced assets are discussed or decisions are made regarding the ring-fenced assets. He shall furthermore be informed in relation to all decisions in connection with the ring-fenced assets to the extent such decisions are not discussed in the meetings referred to and be entitled to receive information relating to the ring-fenced assets relevant for the purposes of the meeting at which it is to be discussed, in advance of such meetings and no later than the other attendees of such meetings receive the relevant information. Lastly the observer shall be entitled to propose to New Kaupthing any course of action with respect to any ring-fenced asset intended to maximize the value thereof. It should be noted that the observer will not have veto rights in relation to decisions taken by New Kaupthing.

For 10 business days following any material decision having been made in relation to the Ring-fenced Assets, Kaupthing shall however have the right to escalate any disputes or objections in relation to the ring-fenced assets by referring the dispute or objection to arbitration. Kaupthing shall have the right to receive compensation, decided by the arbitrator at his unfettered discretion, for a financial loss suffered by it resulting from decisions taken by New Kaupthing in respect of the ring-fenced assets which are determined to be inconsistent with maximizing the value of the ring-fenced assets prior to the final valuation date or otherwise to be unfair or prejudicial to the interests of Kaupthing.

### **Final Valuation**

A final valuation of the ring-fenced assets shall be undertaken within 20 business day of 30 June 2012 and New Kaupthing shall within that period submit a copy of the final valuation to the Bank for review. The Bank shall have 20 business days after delivery of the final valuation to review the final Valuation and if the Bank disputes the valuation it must, within the 20 days Period, serve New Kaupthing a notice to that effect. If this occurs the parties will have 10 business days to agree on a final valuation. If an agreement is not reached within that period either party may refer the dispute to an independent accountant firm for resolution.

### **Payment**

When the final valuation has been agreed either the Bank or New Kaupthing will pay the outstanding amount with accrued interest in cash or by transferring assets of equal value. As described above, if and to the extent that the aggregate value of the ring-fenced assets shown in the final valuation is greater than the aggregate value of the ring-fenced assets as shown in the initial valuation, then an amount equal to 80 per cent of such difference shall be deducted from the shortfall. If the shortfall is eliminated

due to an increase in the aggregate value of the ring-fenced assets (such increase then being 125% of the shortfall) Kaupthing will receive a payment from New Kaupthing amounting to 50% of any such increase up to maximum of ISK 10 billion above the amount needed to eliminate the shortfall.

### **Interest**

Interest will be calculated on the average annual shortfall for the period from 21 October 2008 until the Completion Date. The principal amount, so determined, will bear interest amounting to EURIBOR plus 175 bps on the euro debt and the average interest rate paid by New Kaupthing on the Bank's Deposits with New Kaupthing, plus 15 bps on the ISK debt.

### **Currency**

If Kaupthing is to pay New Kaupthing according to the final valuation it can settle the euro part of the debt in a currency at its discretion, denominated into euro and the ISK part in ISK. If Kaupthing proposes to pay all or part of the debt in a currency that cannot be used for such conversion at the time of payment, as a result of a market disruption or force majeure events, New Kaupthing can refuse to accept such payment until such disruption or force majeure event has receded. At such date the remaining debt will be paid with interest (EURIBOR+175bsp). If New Kaupthing is to pay Kaupthing according to the final valuation it can settle in ISK.

## **SET OF AGREEMENT**

### **Agreement relating to certain aspects of the financial settlement between the Bank and New Kaupthing**

The Agreement relating to certain aspects of the financial settlement between the Bank and New Kaupthing sets out how the parties to the agreement will handle issues relating to set-off that may occur in respect of assets and liabilities that were separated by the FME transfer decision, treatment of collateral that is shared between the Bank and New Kaupthing and guarantees transferred to New Kaupthing.

### **Set-off**

If a transferred asset, cf. the transfer decision is repaid to New Kaupthing by a customer in part or in full by way of set-off, through the utilisation of a counter-claim against the Bank that was not transferred cf. the transfer decision, the Bank undertakes to pay to New Kaupthing an amount equal to the set-off amount. Such an amount shall however never exceed the relevant transfer value given to the assets according to the opening balance sheet of New Kaupthing.

### **Guarantees**

If New Kaupthing suffers a loss under a transferred guarantee, cf. the FME decision, after having made reasonable efforts to collect the relevant subrogated claim from the guaranteed party, including but not limited to foreclosing on any collateral, the Bank shall compensate New Kaupthing for such loss and pay an amount to New Kaupthing equal to the loss suffered. The total amount payable shall however never exceeds ISK 3 billion.

### **Treatment of collateral**

In situations where there exists a general collateral (securing all obligations of a particular customer) that is enforced by New Kaupthing and the Bank does not have a share of security interest in the general collateral New Kaupthing will have a first priority claim against the collateral. What may be left of the collateral after the payment to New Kaupthing will be transferred to the Bank.

In situations where General Collateral exists that is shared between the Bank and New Kaupthing (Shared Collateral) each party shall be entitled to a pro rata share in the security interest of the general collateral. The pro rata split referred to above shall be made on the basis of the nominal value of claims held by New Kaupthing bank and the Bank respectively. The agreement sets out a process to deal with issues that may arise in relation to this, including the obligation to use best efforts to agree on the treatment of shared collateral and that the parties will in this respect take into account the shared interests in respect of collateral that is related to the ring-fenced assets according to the ECVRA. The parties further commit solving disputes through the mechanics of an arbitration procedure.

**Governing law**

The KCF is governed by and construed in accordance with Icelandic law and the Icelandic courts have exclusive jurisdiction in connection with the KCA except as limited by an arbitration resolution process as provided for in the agreement.

## ***Appendix 2. New Kaupthing Introduction***

Additional information on New Kaupthing which is not included herein consists of a presentation which must be accessed in an on-line public data room. Creditors interested in getting access to this data room must confirm their status as creditors of Kaupthing Bank hf. and send their request by e-mail to [creditorcontact@kaupthing.com](mailto:creditorcontact@kaupthing.com).



### **Appendix 3. Background on the Icelandic Economy**

*This appendix was written by employees of New Kaupthing Bank Research.*

#### **Background**

The growth of the Icelandic economy had been strong though volatile throughout the 20th century taking the country on top ten on the OECD list of richest nations in the world in terms of output per capita. The modern prosperity can be attributed to its ability to utilize its comparative advantages by exploiting natural resources, both marine and land-based as well as human capital. Iceland's strong growth can also be traced to its high labour force participation, especially by women, the young and the elderly and likewise to long working hours. In 1989 the Icelandic fishing sector suffered a severe setback as the stock of cod collapsed but growth was brought back on track in the early 1990's with wide ranging free market reforms and privatizations of state owned companies. Iceland also became a member of the European Economic Area 1993 and hereby an active participant of the European Economic integration. In 1994 the capital account was opened and very quickly foreign funds began to flow into the country leading first to a decade of healthy growth but eventually to a domestic asset boom from 2004 onwards.

The Icelandic banks were privatized in 2002-2003 and began shortly after to expand outside the country supported both by high ratings and easy access to foreign whole sale funding markets. In 2003 the ratio of Icelandic owned banking assets was about 2 times GDP at year end 2007 the ratio had reached 10. Iceland is the smallest independent currency area of the world and the ICB was in no capacity to serve a lender of last resort for the oversized banking system leaving them exposed in the international financial crisis that began in mid 2007. In the first week of October 2008, the wake of the default of Lehman in the US, the three large Icelandic banks collapsed in just a week.

#### **GDP**

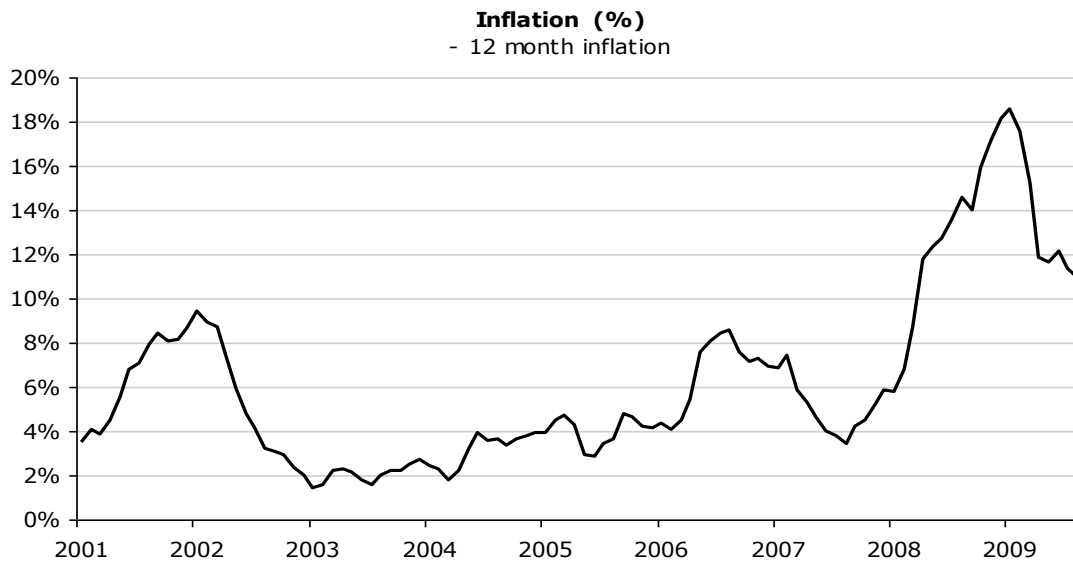
In November 2008 the Icelandic government sought the assistance of the IMF. In the contract made with the Fund the policy rate should be brought to about 18% to shore up the ISK that had lost about half of its value against other major currencies in the banking collapse. The IMF also introduced capital controls and managed to stabilize the currency in 2009.

Iceland's GDP is expected to drop by 7-8% in 2009 and to decline about 2% in 2010. Growth is forecasted to resume in the H2 of 2010 and in medium term the Icelandic economy will return to its previous growth path of about 4% annual real growth. The scale of the adjustment is better measured in the development of private consumption which is expected to reach more than decade old levels (down around 1/3). However, the drop in GDP is expected to be significantly smaller because of the positive impact from net exports. Therefore, GDP is likely to contract by just over 10% before growing again in 2011, according to growth forecasts by the IMF and the ICB.



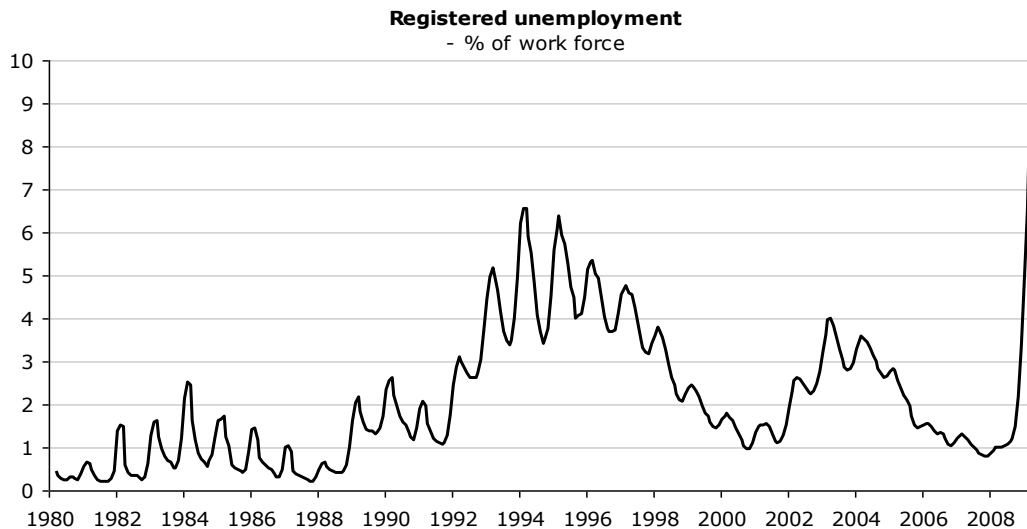
### Inflation rate

The year-on-year inflation rate in September 2009 was 10.9%, compared to the ICB's target rate of 2.5%. Inflation peaked at 18.6% in January 2009 but inflationary pressures have been easing somewhat since then due to weak domestic demand and a rising unemployment rate. The deflation process is expected to continue given stable exchange rates and stability of nominal wages. See graph of 12 months inflation below.



### Unemployment rate

The unemployment rate has been rising quickly since 2008 and approximately 9% of the Icelandic workforce was unemployed in August 2009. In comparison, the unemployment rate has averaged around 3.5% since 1990. According to ICB's forecast the unemployment rate will start to fall gradually at the end of 2009. This is an opposite of the preceding years whereas the country received large inflows of foreign workers. Forecasts assume that unemployment will start dropping again in 2011 after peaking at around 11% in 2010. The unemployment will partly be solved by young people going back to school.



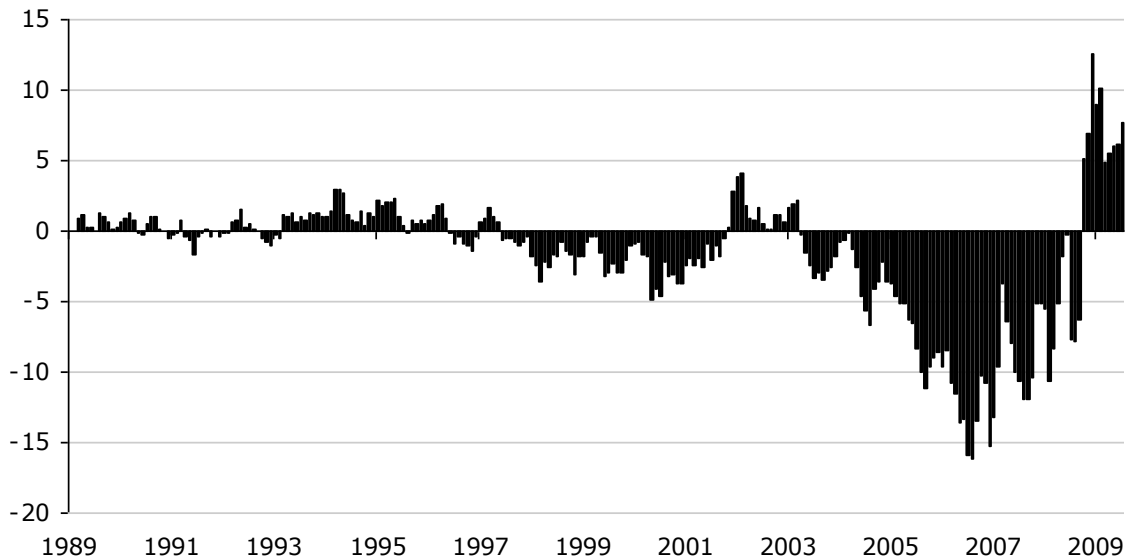
### Trade balance

The trade balance in Iceland has been negative to two digit numbers in recent years. For example, it was about -10.8% of GDP in 2007 and in the same year the current account balance amounted to -16.4% of GDP. A weak ISK and a huge drop in private consumption have improved the trade balance recently, as imports have been decreasing. Furthermore, exporters, who mainly consist of fishing and aluminum companies, get more ISK for their products. The trade balance was only negative by approximately -2.9% of GDP in 2008 and is expected to rise to approximately +10% in 2009. This result is substantial turnaround since the balance of payments has worsened dramatically since October 2008 and a large sum of foreign currency is needed to pay off foreign debt. Despite weak ISK, reduced world demand and lower export prices have resulted in a less spectacular trade surplus than otherwise expected. See development of trade balance on the graph below.

As previously stated the ISK has lost extensive value against major currencies that has led to a debt crisis and output contraction. However, in the medium term the low real exchange rate provide the basis for an export led recovery which is already visible with significant surplus on the trade and service balance which is expected to be around 10% of GDP in the years 2010-2012. The export sector is around 40% of Iceland's GDP and will take approximately 4 quarters for the export boom to deliver positive GDP growth rates in the latter half of 2010.



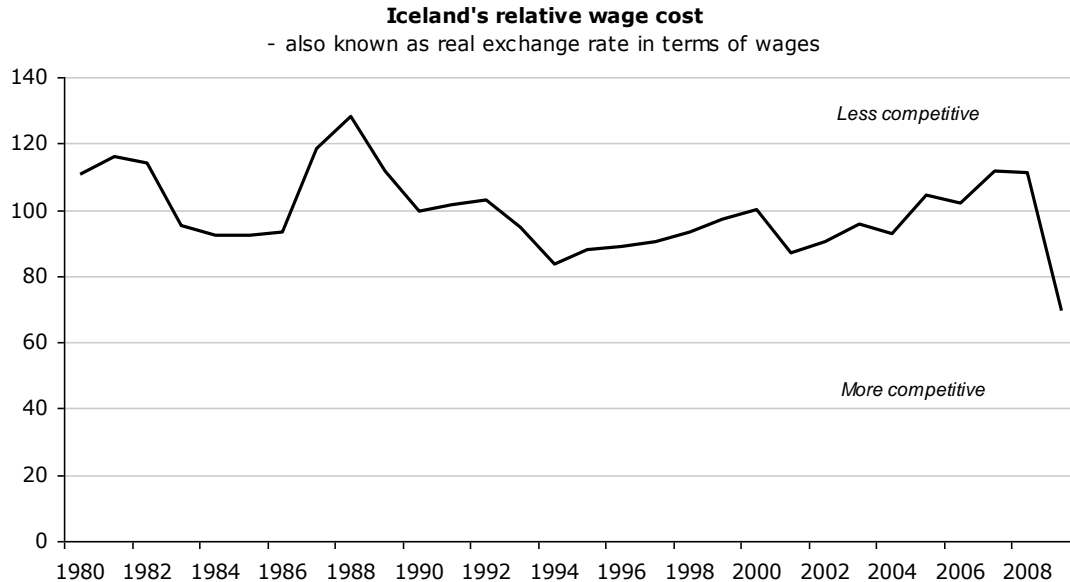
### Trade balance - bn. ISK



### Export industries

All of Iceland's major export industries benefit greatly from the depreciation of the ISK exchange rate.

- Energy – Ample resources to produce more energy. The main challenge at the moment is the difficulty of funding new projects.
- Travel industry – Despite contraction in the travel industry worldwide, Iceland is now receiving the same number of visitors as the year before. The Icelandic travel industry has grown around 10% annually in the last 60 years or so. At the moment around 500 thousand travellers visit the country each year and there is still room for expansion in the sector.
- Fisheries – The depreciation of the ISK has boosted revenues for the nations' nr. 1 export sector. Looking ahead, however, the growth potential of this sector is very limited.
- Other industries – Other industries have more potential after the depreciation of the ISK. The main reason is that the Icelandic population is very well educated and wages have dropped significantly in comparison with other countries because of the depreciation of the ISK – therefore Icelandic wages in EUR terms have dropped significantly (the graph below shows Icelandic wage costs relative to weighted wage costs amongst Iceland's main trading partners, measured in the same currency). In fact, there are already signs that new jobs are being created in the service and manufacturing sector.



## Financial Position

Estimates of Iceland's foreign debt vary greatly. The ICB has estimated that the total debt, before taking in assets, amounts to more than 220% of GDP. The total foreign debt is estimated to sum up to approximately ISK 820 billion. This figure includes the debt of the ICB National Treasury and the Municipalities. The ICB has made a preliminary estimation that the deposit institution's liabilities now amount to about ISK 300 billion. The total liabilities of public corporations, which are mainly energy companies, are estimated to be approximately ISK 500 billion. Finally, the foreign debt of private parties is approximately ISK 870 billion and government liabilities could be expected to rise by ISK 700 billion with the Icesave deal, though it could possibly be considerably lower when related assets are taken into account. The total debt could therefore amount to about ISK 3,200 billion.

With regards to the abolishment of capital controls, one of the ICB's main concerns for the ISK is related to assets owned by foreign entities (such as government bonds, T-bills and deposits). The ICB's assumption is that considerable amount is "impatient capital".

Outstanding Eurobonds have decreased rapidly, from over ISK 300 billion in September 2008 to ISK 60 billion in June. Furthermore, due to capital controls, maturing Eurobonds have no impact on the ISK. Also, there are concerns what the locals will do when the capital controls are abolished, saving accounts are packed with ISK 1500 billion, which equals 100% of GDP.

However, the country's foreign assets are considerable. If the two biggest contributors are taken into account, the ICB foreign accounts amount to about ISK 430 billion and the assets of the Icelandic pension system has assets amounting to approximately ISK 500 billion.



### **The agreement between the Government and IMF**

IMF has been monitoring the development of the Icelandic economy and put up strict conditions for improvements in the monetary policy, fiscal policy and restructuring process for the new banks. The plan aims to support the exchange rate through high interest rates combined with strict capital controls that are intended to be abolished in the future depending on the economy success. On 19 November 2008, the Executive Board of IMF confirmed that it would extend the request for the USD 2.1 billion loan to Iceland. In addition to this support, loans of up to USD 3 billion have been secured from Denmark, Finland, Norway, Sweden, Russia, and Poland. Furthermore, The Faroe Islands had announced before that they intended to lend Iceland USD 50 million. However, some of those loans were conditional on the Icelandic Government resolving its debate about Icesave, Landsbanki's internet banking product. The British and the Dutch governments are requiring compensation for their citizens, who held high interest deposits in Icesave.

The need for completion of the New Banks' capitalization is considered essential for the Icelandic economy to be able to support and provide enough capital for domestic companies. Also, IMF is putting pressure on the government to complete the banks' restructuring in Iceland for further continuation of its loan program.

## **Appendix 4. FME framework on the disposal of assets and liabilities of the Bank to New Kaupthing**

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. Furthermore, 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. The decision was based on available information and data and any changes to the decision are authorized should premises change or otherwise be deemed more suitable. The FME appointed a recognized appraiser, i.e. Deloitte and Oliver Wyman, to evaluate the true worth of assets and liabilities allocated to New Kaupthing. According to the decision New Kaupthing was to issue a bond to the Bank as payment of the remuneration. The value of the bond shall be verified by an internationally recognized appraisal company to be appointed by the FME.

The disposal of assets and liabilities of the Bank to New Kaupthing was a complicated task, which was more extensive than presumed. Therefore, a couple of amendments to this decision, which are shown below, were made by the FME. It had not proved possible to complete the valuation in the timeframe allowed for in the prior decision on 21 October 2008 which stated that complete valuation should be completed 90 days from the original decision. Furthermore, the appointment of an independent appraiser took more time than expected.

The FME published the following amendments. A full version of these amendments can be accessed at the FME's website, [www.fme.is](http://www.fme.is).

**On 9 January 2009, 1<sup>st</sup> amendment:** According to the statement the conclusion of the report of the appraisers should be available according to a further decision of the FME. A decision on the final deadline shall be taken no later than 15 February 2009.

**On 14 February 2009, 2<sup>nd</sup> amendment:** It entailed that further time was needed for the asset valuation because the appointment of the independent appraiser took considerable time, so the valuation itself commenced later than planned. All provisions of prior decisions in this case were unchanged.

**On 6 March 2009, 3<sup>rd</sup> amendment:** The amendment stated that the payment of the remuneration is not restricted to a bond issued by New Kaupthing as previously mentioned, but the amendment allowed for issuance of a financial instrument instead. Furthermore, the decision implied that it is important that the Government has time to take a position on the instrument after consultations with the Resolution Committees and representatives of creditors. For these reasons it is considered necessary to extend the deadline to complete the preparation of the financial information which should be available no later than 18 May 2009.

**On 15 May 2009, 4<sup>th</sup> amendment:** The FME considered it necessary to extend the deadline even further, as the final timetable between the concerned parties regarding the completion of the terms of the financial instrument is not yet available. A decision on the final deadline shall be made no later than 15 June 2009.

**On 15 June 2009, 5<sup>th</sup> amendment:** As discussions were still ongoing to reach a final settlement, it was clear that more time was needed to finalize conclusive terms for the financial instrument between the parties, due to the scope and nature of the settlement. It is important that the concerned parties have an opportunity to study the available data and information, including reports on the valuation of disposed assets. The financial instrument on the settlement should be available no later than 17 July 2009.

**On 18 July 2009, 6<sup>th</sup> amendment:** It stated that an agreement has been reached on terms of the settlement and on a timetable for the financing of New Kaupthing. According to the decision, the financial instrument on the settlement shall be issued no later than 14 August 2009.

**On 14 August 2009, 7<sup>th</sup> amendment:** In this amendment, a further extension was granted to 28 August 2009 to finalize the financial instrument on the settlement with regards to New Kaupthing.

**On 28 August 2009, 8<sup>th</sup> amendment:** In this amendment, an even further extension was granted to 2 September 2009 to finalize the financial instrument on the settlement with regards to New Kaupthing.

## ***Appendix 5. Meeting overview during negotiation***

The ICC is composed of representatives of the Bank's largest creditors and includes a broad cross section of financial institutions. The members of the ICC were chosen in co-operation with the Committee's former advisor Deloitte. The selection was primarily based on the value and the nature of the creditors' claims as well as geography. The ICC does not have formal powers or duties under Icelandic law and is consultative in nature. The ICC, which was established to have a set up for creditors to provide direct feedback to the Resolution Committee, was kept closely informed regarding the progress of the due diligence and negotiations with the Government via several meetings, numerous conference calls and update emails where the committee were given opportunity to give their feedback on the process. Furthermore, the ICC was allowed to review and comment on all the draft agreements. Members of the ICC received and submitted helpful comments throughout the process.

**On 4 June 2009** an ICC meeting held by the Resolution Committee. At the meeting, a sub-ICC was appointed by the ICC, which constitute of three ICC members. The role of the sub-ICC was to act as direct creditor participants in the negotiations and to provide feedback on discussed structures. However, the members of the sub-ICC did not have a formal representative role for all creditors.

At the same day New Kaupthing's management presented to the negotiation committee and Morgan Stanley its preliminary business plan and opening balance sheet. The Government 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. The FME concluded the separation of the Bank and New Kaupthing on 11 June 2009.

The sub-ICC members sat at the negotiation table and participated actively in the formal negotiation process. Although the sub-ICC is not a formal representative body of the creditors, its direct involvement and contribution in the negotiation with the Government was important and very helpful for the Resolution Committee as it, among other things, enabled the Resolution Committee to receive first hand feedback from creditors throughout the process. Furthermore, the sub-ICC provided creditors with the opportunity to have their views directly heard during the negotiation.

**On 25 June 2009** a presentation was given to the ICC by New Kaupthing's management on the business plan, which included Q&A. Furthermore, a sub-ICC meeting was held and the sub-ICC was provided with the negotiation strategy and structural options.

**On 26 June 2009** the first negotiation meeting was held with the Government and Hawkpoint, its financial advisor.

**On 1 July 2009** a valuation discussion meeting with Hawkpoint and New Kaupthing's management was held. The topics were primarily on valuation assumptions, mainly the large corporate loan valuation. Furthermore, some business plan discussions and strategy discussions took place. 2nd negotiation meeting with the Government and Hawkpoint held.

**On 8 July 2009:** ICC meeting, where its members were given a full presentation on the business plan and assessment of structural options.

**On 9 July 2009** sub-ICC meeting, preparation meeting for the 3rd negotiation meeting where its members had the opportunity to ask questions and exchange views with members of the Resolution

Committee. Subsequently, the 3rd negotiation meeting with the Government and Hawkpoint was held, the sub-ICC participated.

**14 July 2009:** Sub-ICC meeting, a preparation meeting for the 4<sup>th</sup> negotiation meeting. Subsequently, the 4th negotiation meeting with the Government and Hawkpoint was held, sub-ICC present and were given the opportunity to ask any questions or comments.

**15 July 2009:** Sub-ICC meeting, preparation meeting for the 5<sup>th</sup> negotiation meeting.

**16 July 2009:** 5th negotiation meeting with the Government and Hawkpoint.

**23 July 2009:** Due Diligences meeting between creditors' appointed advisors and New Kaupthing

**28 July 2009:** Due Diligence meeting between creditors' appointed advisors and New Kaupthing. Main topics were balance sheet discussion and large corporate.

**29 July 2009:** Valuation discussion meeting with Hawkpoint and New Kaupthing's management. Part of the sub-ICC was present. Due Diligence meeting between creditors' appointed advisors and New Kaupthing and external auditors, Ernst & Young.

**30 July 2009:** 6th negotiation meeting with the Government and Hawkpoint – a part of the sub-ICC was present. Discussions were mainly on the shortfall (valuation gap). Initial talk about interest on Government bonds and profitability of New Kaupthing.

**31 July 2009:** 7th short negotiation meeting with the Government and Hawkpoint. Discussion mainly on agreement on shortfall (agreed), CVR right, value split (no agreement reached); initial discussion of Tier I conversion of the Tier 2 instrument. Liquidity line by the Government and hold harmless on SPRON and other transactions under Government ownership remained open.

**12 August 2009:** 8th Negotiation meeting between the Bank, Government and Hawkpoint. focus on operating loss treatment; liquidity line; hold harmless; governance.

**24 August 2009:** 9th Negotiation meeting between the Bank, Morgan Stanley, Government and Hawkpoint – Sub-ICC had the opportunity to participate; focus on outstanding points in the agreements, e.g. liquidity line; interests on the escrow.

**2/3 September 2009:**

*11<sup>th</sup> Negotiation meeting between the Bank, Morgan Stanley, Government and Hawkpoint – Sub-ICC had the opportunity to participate; focus on outstanding points in the agreements, e.g. liquidity line; interests on the escrow.*

Throughout the negotiation process the ICC members were updated on all material developments and provided with the opportunity to comment on all the agreements during the whole process. Further advisors to certain creditors had discussions with New Kaupthing's management as well as Morgan Stanley following the signing of the binding agreements.