

OFFERING CIRCULAR



KAUPTHING BANK

KAUPTHING BANK HF.

(Incorporated in Iceland as a public limited company)

€175,000,000

Non-cumulative Undated 6.25 per cent. Capital Notes

Issue Price 100 per cent.

Interest on the €175,000,000 Non-cumulative Undated 6.25 per cent. Capital Notes (the "**Notes**") of Kaupthing Bank hf. (the "**Issuer**") will, subject to Condition 4, be payable, quarterly in arrear on 27 March, 27 June, 27 September and 27 December in each year at a rate of 6.25 per cent. per annum.

In making an investment decision, potential investors should carefully consider the merits and risks of an investment in the Notes and carefully review the Terms and Conditions of the Notes. In particular:

- (i) the Notes are undated and deeply subordinated;
- (ii) principal in respect of the Notes may be converted into conditional capital contributions as described in Condition 3;
- (iii) conditional capital contributions may only be reconverted and reinstated as provided in Condition 3;
- (iv) the Issuer shall not pay accrued interest in certain circumstances as provided in Condition 4; and
- (v) the Notes may be redeemed at the option of the Issuer, in whole but not in part (a) on 27 June 2010 or any Interest Payment Date thereafter or (b) (subject as provided herein) in the event of certain tax or regulatory changes affecting the Issuer, in each case subject to certain conditions including the prior approval of the Financial Supervisory Authority of Iceland and provided that any conditional capital contributions have been reconverted and reinstated as provided in Condition 3, all as further described in Condition 6.

Application has been made for the listing of the Notes on Eurolist by Euronext Amsterdam and the Frankfurt Stock Exchange.

The Notes will initially be represented by a temporary global Note (the "**Temporary Global Note**"), without interest coupons ("**Coupons**"), to be deposited with Clearstream Banking AG, Frankfurt am Main ("**Clearstream, Frankfurt**") on or about 27 June 2005 (the "**Closing Date**"). The Notes will also be eligible for clearing and settlement through Euroclear Bank S.A./N.V., as operator of the Euroclear System ("**Euroclear**") and Clearstream Banking, société anonyme, Luxembourg ("**Clearstream, Luxembourg**") on the Closing Date. The Temporary Global Note will be exchangeable for interests in a permanent global Note (the "**Permanent Global Note**"), without Coupons, on and after 8 August 2005 upon certification of non-U.S. beneficial ownership. The Permanent Global Note will be exchangeable in whole but not in part for definitive Notes in bearer form in the denomination of €1,000 each, with Coupons attached, only in certain limited circumstances as described in Condition 1.

The Notes have been assigned a "A3" rating by Moody's Investors Service Limited ("**Moody's**"). A rating is not a recommendation to buy, sell or hold securities and may be subject to suspension, change or withdrawal at any time by the assigning rating agency.

Joint Lead Managers

Credit Suisse First Boston

Deutsche Bank

Co-Lead Managers

Barclays Capital

Daiwa Securities SMBC Europe

Dresdner Kleinwort Wasserstein

Co-Manager

Natexis Banques Populaires

The date of this Offering Circular is 23 June 2005.

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

This Offering Circular is to be read in conjunction with all documents which are deemed to be incorporated herein by reference (see “*Incorporation by Reference*” below). This Offering Circular shall be read and construed on the basis that such documents are incorporated in and form part of this Offering Circular.

No person has been authorised to give any information or to make any representations other than those contained in this Offering Circular in connection with the offering or sale of the Notes and, if given or made, such information or representations must not be relied upon as having been authorised by the Issuer or the Managers (as defined under “*Subscription and Sale*”). Neither the delivery of this Offering Circular nor any sale made hereunder shall under any circumstances create any implication or constitute a representation that there has been no change in the affairs of the Issuer since the date hereof. This Offering Circular does not constitute an offer of, or an invitation by or on behalf of the Issuer or the Managers to subscribe for or purchase, any of the Notes.

The distribution of this Offering Circular and the offering of the Notes in certain jurisdictions may be restricted by law. Neither the Issuer nor the Managers represents that this Offering Circular may be lawfully distributed or that the Notes may be lawfully offered, in compliance with any applicable registration or other requirements in any such jurisdiction, or pursuant to an exemption available thereunder, or assumes any responsibility for facilitating any such distribution or offering. In particular, no action has been taken by the Issuer or the Managers which would permit a public offering of the Notes or distribution of this Offering Circular in any jurisdiction where action for that purpose is required. Accordingly, the Notes may not be offered or sold, directly or indirectly, and neither this Offering Circular nor any advertisement or other offering material relating to the Notes may be distributed or published in any jurisdiction, except under circumstances that will result in compliance with any applicable laws and regulations.

The Notes have not been and will not be registered under the United States Securities Act of 1933, as amended (the “**Securities Act**”). The Notes may not be offered or sold within the United States or to, or for the account or benefit of, U.S. persons (as defined in regulation S under the Securities Act (“**Regulation S**”)) except in certain transactions exempt from or not subject to the registration requirements of the Securities Act. This Offering Circular has been prepared by the Issuer solely for use in connection with the offer and sale of the Notes outside the United States to non-U.S. persons pursuant to Regulation S. For a description of these and certain further restrictions on offers and sales of the Notes and distribution of this Offering Circular, see “*Subscription and Sale*”.

Unless otherwise specified or the context requires, references to “**ISK**” are to Icelandic krona, to “**£**” are to pounds sterling and to “**euro**” and “**€**” are to the currency introduced at the start of the third stage of European economic and monetary union pursuant to the Treaty establishing the European Community, as amended.

INCORPORATION BY REFERENCE

The audited financial statements of the Issuer in respect of the financial years ended 31 December 2004 and 2003 and of each of Kaupthing Bank hf. and Bunadarbanki Islands hf. in respect of the financial year ended 31 December 2002 shall be deemed to be incorporated in, and form part of, this Offering Circular.

Copies of the above financial statements may be obtained free of charge at the specified office of the Issuer and each of the Paying Agents.

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In connection with the issue and distribution of the Notes, Deutsche Bank AG, London Branch or any person acting for it may over-allot or effect transactions with a view to supporting the market price of the Notes at a level higher than that which might otherwise prevail for a limited period. However, there may be no obligation on Deutsche Bank AG, London Branch or any agent of its to do this. Such stabilising, if commenced, may be discontinued at any time and must be brought to an end after a limited period. Such stabilising shall be in compliance with all applicable laws, regulations and rules.

Stabilisation transactions conducted on Euronext Amsterdam N.V. must be conducted in accordance with all applicable rules and regulations, including those of Euronext Amsterdam N.V. and article 32 of the "Further regulation on the supervision of the securities trade 2002" (Nadere regeling gedragstoezicht 2002).

TERMS AND CONDITIONS OF THE NOTES

The following are the terms and conditions of the Notes which, subject to completion and amendment, will be incorporated by reference into the Global Notes (as defined below) and which will be endorsed on each Note in definitive form (if issued).

The €175,000,000 Non-cumulative Undated 6.25 per cent. Capital Notes (the “**Notes**”) of Kaupthing Bank hf. (the “**Issuer**”) are issued subject to and with the benefit of a Fiscal Agency Agreement dated 27 June 2005 (the “**Agency Agreement**”) made between the Issuer, Deutsche Bank Aktiengesellschaft (the “**Fiscal Agent**”) and Deutsche Bank AG, Amsterdam Branch (together with the Fiscal Agent, the “**Paying Agents**”). The statements in these Terms and Conditions include summaries of, and are subject to, the detailed provisions of and definitions in the Agency Agreement. Copies of the Agency Agreement are available for inspection during normal business hours by the holders of the Notes and the holders of the interest coupons appertaining to the Notes (the “**Couponholders**” and the “**Coupons**”, respectively) at the specified office of each of the Paying Agents. Any reference to “**Noteholders**” or “**holders**” in relation to any Notes shall mean the holders of the Notes and shall, in relation to any Notes represented by a Global Note, be construed as provided below. The Noteholders and the Couponholders are entitled to the benefit of, are bound by, and are deemed to have notice of, all the provisions of the Agency Agreement applicable to them. References in these Terms and Conditions to the Fiscal Agent and the Paying Agents shall include any successor appointed under the Agency Agreement.

1. Form, Denomination and Title

- (1) The Notes are initially represented by a temporary global note (the “**Temporary Global Note**”) without Coupons attached which has been deposited with Clearstream Banking AG, Frankfurt am Main (“**Clearstream, Frankfurt**”) on 27 June 2005. Upon deposit of the Temporary Global Note, Clearstream, Frankfurt credited each subscriber with a principal amount of Notes equal to the principal amount thereof for which such subscriber had subscribed and paid. Payments of principal and interest on the Temporary Global Note will be made only upon certification as to non-U.S. beneficial ownership as provided therein.

The Temporary Global Note is exchangeable in whole or in part as provided therein for a further global Note (the “**Permanent Global Note**” and, together with the Temporary Global Note, the “**Global Notes**” and each a “**Global Note**”) without Coupons attached on and after 8 August 2005, provided certification as to non-U.S. beneficial ownership has been received. Each Global Note is or will be in bearer form and transferable by delivery. The Permanent Global Note will be exchangeable in whole, but not in part, for definitive Notes with Coupons attached only upon an Exchange Event as described therein.

For these purposes, “**Exchange Event**” means that Clearstream, Frankfurt has been closed for business for a continuous period of 14 days or more (other than by reason of holiday, statutory or otherwise) or has announced an intention permanently to cease business or have in fact done so and, in any such case, no successor or alternative clearing system is available. The Issuer will promptly give notice to Noteholders in accordance with Condition 11 if an Exchange Event occurs. In the event of the occurrence of an Exchange Event, Clearstream, Frankfurt (acting on the instructions of any holder of an interest in the Permanent Global Note) may give notice to the Fiscal Agent requesting exchange. Any such exchange shall occur not later than 45 days after the date of receipt of the first relevant notice by the Fiscal Agent.

The Issuer undertakes that, in the event that any Notes are to be represented by Notes in definitive form, it will make any amendments necessary prior to the issue of such Notes in definitive form to the Notes and the Agency Agreement to permit the issue of Notes in definitive form with talons attached thereto. Any reference herein to “**Coupons**” or “**coupons**” shall, unless the context otherwise requires, be deemed to include a reference to talons.

- (2) The Notes are in bearer form, serially numbered (in the case of the definitive Notes), in the denomination of €1,000. Definitive Notes (if issued) will have Coupons attached.
- (3) Whenever there is any adjustment to the principal amount of any Note pursuant to these Terms and Conditions, upon presentation of such Note to the Fiscal Agent at its specified office, a record of such adjustment shall be endorsed by it on such Note provided that any failure to so present or record shall not in any way affect the decrease or increase pursuant to Condition 3.
- (4) Subject as set out below, title to the Notes and to the Coupons will pass by delivery.
- (5) The Issuer and any Paying Agent may (to the fullest extent permitted by applicable laws) deem and treat the holder of any Note and the holder of any Coupon as the absolute owner for all purposes (whether or not the Note or Coupon shall be overdue and notwithstanding any notice of ownership or writing on the Note or Coupon or any notice of previous loss or theft of the Note or Coupon) but, in the case of a Global Note, without prejudice to the provisions set out in Condition 1(6).
- (6) For so long as any of the Notes is represented by a Global Note held on behalf of Clearstream, Frankfurt each person who is for the time being shown in the records of Clearstream, Frankfurt as the holder of a particular principal amount of the Notes (in which regard any certificate or other document issued by Clearstream, Frankfurt as to the principal amount of the Notes standing to the account of any person shall be conclusive and binding for all purposes save in the case of manifest error) shall be treated by the Issuer and the Paying Agents as the holder of such principal amount of the Notes for all purposes (including for the purposes of any quorum requirements of, or the right to demand a poll at, meetings of the Noteholders) other than with respect to the payment of principal or interest on such principal amount of such Notes, for which purpose the bearer of the relevant Global Note shall be treated by the Issuer and the Paying Agents as the holder of such principal amount of such Notes in accordance with and subject to the terms of the relevant Global Note and the expressions “**Noteholder**” and “**holder of Notes**” and related expressions shall be construed accordingly.

Notes which are represented by a Global Note will be transferable only in accordance with the rules and procedures for the time being of Clearstream, Frankfurt.

References to Clearstream, Frankfurt shall, whenever the context so permits, be deemed to include a reference to any additional or alternative clearing system approved by the Issuer and the Fiscal Agent.

2. Status and Subordination

The Notes and the Coupons constitute and will constitute unsecured, subordinated debt obligations of the Issuer.

In the event of the voluntary or involuntary liquidation or bankruptcy of the Issuer, the rights of:

- (a) the Noteholders and Couponholders to payments of the principal amount of the Notes and any other amounts including interest due in respect of the Notes; and
- (b) where the whole or any part of the principal amount of the Notes has been converted into conditional capital contributions as described below and such conditional capital contributions have not been reconverted and reinstated as provided below, the providers of such conditional capital contributions, in respect of such conditional capital contributions,

shall rank:

- (i) *pari passu* without any preference among the Noteholders, the Couponholders and such providers;
- (ii) at least *pari passu* with the rights of the holders of any other outstanding Capital Securities whether or not such Capital Securities have been converted in the manner described below and at least *pari passu* with the rights of the holders of any other obligations of the Issuer constituting or eligible (“eligible” to be construed, *mutatis mutandis*, as provided in the definition of Capital Event) as constituting Tier I Capital of the Issuer, in each case in relation to their rights as such holders and to payments in respect thereof;
- (iii) in priority to the rights of holders of all classes of ordinary share capital, preferred share capital and other share capital, of the Issuer and in priority to the rights of holders of any obligation of the Issuer expressed to rank junior to the Notes, in each case in relation to their rights as such holders and to payments in respect thereof; and
- (iv) junior in right of payment to the payment of any present or future claims of (a) depositors of the Issuer, (b) other unsubordinated creditors of the Issuer and (c) subordinated creditors of the Issuer in respect of Subordinated Indebtedness (other than Capital Securities).

No Noteholder or Couponholder or provider of any conditional capital contribution who shall in the event of the voluntary or involuntary liquidation or bankruptcy of the Issuer be indebted to the Issuer shall be entitled to exercise any right of set-off or counterclaim against moneys owed by the Issuer in respect of the Notes or conditional capital contributions held or provided by such Noteholder, Couponholder or provider, as the case may be.

The Issuer reserves the right to issue other Capital Securities in the future or other obligations constituting or eligible as constituting Tier I Capital of the Issuer, provided, however, that any such obligations may not in the event of voluntary or involuntary liquidation or bankruptcy of the Issuer rank in priority to the Notes.

3. Utilisation and Conversion

To the extent that it may be required, to avoid the Issuer no longer meeting the requirements with respect to minimum own funds (“**Minimum Own Funds**”) as set out in The Act on Financial Undertaking (161/2002), as amended, the Board of Directors of the Issuer, by resolution passed at a board meeting, may decide that the principal amount (or part thereof, as the case may be) of each Note will be utilised by writing down the part or whole of the principal amount to the extent and by the amount required to avoid falling below the required Minimum Own Funds and converting such aggregate amount (the “**Converted Amount**”) into a conditional capital contribution. The rights of the Noteholders and the Couponholders in respect of the Converted Amount will thereupon be converted into rights of providers of conditional capital contributions as set out herein.

Upon utilisation of the Converted Amount as above, the Issuer shall give notice to the Noteholders in accordance with Condition 11.

Utilisation of the Converted Amount for the purpose of avoiding the Issuer’s own funds falling below the required Minimum Own Funds shall be made (i) prior to the utilisation for the same purpose of the principal amount of outstanding perpetual/undated subordinated debt issued by the Issuer (other than other Capital Securities), (ii) following the utilisation for the same purpose of the principal amount of Capital Securities and any other securities ranking junior to the Notes and outstanding at the time of such utilisation and (iii) *pro rata* to the principal amount of Capital Securities ranking *pari passu* with the Notes and outstanding at the time of such utilisation.

Where, pursuant to this Condition 3, writing down and conversion applies to part only of the principal amount of the Notes, the part of the principal amount of each Note to be subject to such writing down and conversion shall bear the same proportion to the total amount of the principal amount in respect of such Note as the aggregate amount of the principal amount of all the Notes to be subject to such writing down and conversion bears to the aggregate outstanding principal amount of all the Notes respectively. Any reconversion and reinstatement as provided below will be made on the same basis.

Utilisation of the Converted Amount as aforesaid may only be made provided that the Fiscal Agent has received prior to such utilisation a certificate signed by two Directors of the Issuer (copies of such certificate will be available for inspection at the specified office of the Fiscal Agent) confirming that:

- (i) following such conversion to a Converted Amount (a) the rights of the providers thereof in respect of such amounts will rank as provided in Condition 2; and (b) such amount will be a conditional capital contribution and will be accounted for as such in the balance sheet of the Issuer; and
- (ii) prior to such conversion to a Converted Amount, the Issuer had consulted with the Financial Supervisory Authority of Iceland (*Fjármálaeftirlitid*) or any successor (the “FSA”) and the FSA expressed no objection thereto.

Utilisation as described above of the whole or part of the principal amount of the Notes shall not constitute an Event of Default under Condition 9.

Reconversion and Reinstatement

Reconversion and reinstatement (in whole or in part) as obligations in respect of the Notes of the Converted Amount may only be made out of Unallocated Distributable Profits of the Issuer and subject to a resolution of the Board of Directors of the Issuer.

Reconversion and reinstatement shall first be made in respect of perpetual/undated subordinated debt (other than Capital Securities) issued by the Issuer that may have been converted into conditional capital contributions.

Reconversion and reinstatement as obligations in respect of the Notes of the Converted Amount shall be made *pro rata* with any amounts converted in respect of other Capital Securities of the Issuer ranking *pari passu* with the Notes. For the avoidance of doubt, amounts converted in respect of Capital Securities and any other securities expressed to rank junior to the Notes shall be reconverted and reinstated as debt only after the Converted Amount (and any other amounts converted in respect of other Capital Securities of the Issuer expressed to rank *pari passu* with the Notes) has been reconverted and reinstated as aforesaid.

If the Issuer’s own funds exceed the required Minimum Own Funds allowing for reconversion and reinstatement (in whole or in part) as debt of amounts converted in respect of subordinated indebtedness in the form of Capital Securities and/or perpetual/undated subordinated securities and/or any other securities or reconversion and reinstatement (in whole or in part) as obligations in respect of the Notes of any Converted Amount, the Board of Directors of the Issuer shall subsequently decide that such reconversion and reinstatement shall be made with due observance taken to the prescribed ranking between the relevant instruments to the extent such replenishment does not result in the Issuer’s own funds falling below the required Minimum Own Funds.

If and to the extent that any Converted Amount has been reconverted and reinstated as an obligation in respect of such Note in the balance sheet of the Issuer, such amount shall be reconverted and reinstated as principal and shall be added to the principal amount of such Note not converted to a Converted Amount for all purposes thereafter (and references to “principal” and “principal amount” shall be construed accordingly) and interest shall start to accrue on such

amount and become payable in accordance with the terms of the Notes as from the date of such reconversion and reinstatement.

Upon reconversion and reinstatement as obligations in respect of the Notes of the Converted Amount as described above, the Issuer shall give notice to Noteholders in accordance with Condition 11.

The principal amount of the Notes may be utilised and converted as described above on one or more occasions.

4. Interest

Rate of Interest

- (1) (i) The Notes bear interest from, and including, 27 June 2005 at the rate of interest of 6.25 per cent. per annum.

Interest on the Notes is payable, subject as provided below, quarterly in arrear on 27 March, 27 June, 27 September and 27 December in each year (each an “**Interest Payment Date**”) commencing on 27 September 2005.

- (ii) Whenever it is necessary to compute an amount of interest in respect of the Notes for a period other than an Interest Period, such interest shall be calculated by applying the rate of interest (a) while the Notes are represented by a Global Note, to the aggregate principal amount of the Notes (taking into account any adjustment to such amount during such period), multiplying such sum by the Day Count Fraction and rounding the resultant figure to the nearest cent, half a cent being rounded upwards or otherwise in accordance with applicable market convention, and (b) upon delivery of definitive Notes, to the principal amount of such Note (taking into account any adjustment to such amount during such period), multiplying such sum by the Day Count Fraction and rounding the resultant figure to the nearest cent, half a cent being rounded upwards or otherwise in accordance with applicable market convention.

Interest accruing after the due date for redemption in certain circumstances

- (2) Each Note will cease to bear interest from the due date for final redemption unless, upon due presentation, payment of principal is improperly withheld or refused, in which case it will continue to bear interest at such rate until whichever is the earlier of (a) the day on which all sums due in respect of such Note up to that day are received by or on behalf of the relevant Noteholder and (b) the day which is seven days after the Fiscal Agent has notified the Noteholders that it has received all sums due in respect of the Notes up to such seventh day.

Sufficiency of Available Distributable Funds

- (3) (a) (i) Payments of interest on any Interest Payment Date may not exceed, taking into account all payments previously made in the fiscal year in which the Interest Payment Date falls in respect of the Notes, Junior Securities and Other Tier I Securities, the Available Distributable Funds.
- (ii) To the extent that, on any Interest Payment Date, Available Distributable Funds are insufficient to pay or provide for payment in full of all accrued but unpaid interest under the Notes, other Capital Securities ranking *pari passu* with the Notes and Other Tier I Securities (in each case falling due on that Interest Payment Date), the Issuer will make partial payment of all accrued but unpaid interest under the Notes, such other Capital Securities and Other Tier I Securities *pro rata* to the extent of such Available Distributable Funds.

- (iii) If, and to the extent that Available Distributable Funds are insufficient or non-existent and the Issuer makes partial payment of, or does not pay, accrued but unpaid interest, the right of the Noteholders to receive accrued but unpaid interest in respect of the relevant Interest Period will be deferred until the Deferral End Date.
- (iv) At the Deferral End Date, the Issuer will make full or partial payment of all deferred but unpaid interest under these Notes and such other Capital Securities and Other Tier 1 Securities *pro rata* to the extent the Issuer has accrued any Unallocated Distributable Profits, as determined by the Board of Directors of the Issuer after consultation with the Issuer's auditors, in such fiscal year.
- (v) To the extent that the principal amount of the Notes has been converted in part into Converted Amounts and has not reconverted and reinstated prior to such Deferral End Date, payment will be made under (iv) above on a Deferral End Date only out of Unallocated Distributable Profits remaining after reconversion and reinstatement in full of such Converted Amounts and converted amounts in respect of any Capital Security ranking *pari passu* with the Notes.

If, and to the extent that, any deferred payments remain unpaid after the applicable Deferral End Date, the right of the Noteholders to receive such deferred payments will be lost. The Issuer will have no obligation to make such payments of unpaid deferred interest or to pay interest thereon, whether or not payments of interest in respect of subsequent Interest Periods are made, and such unpaid deferred interest will not be deemed to have "accrued" or been earned for any purpose.

Notwithstanding anything to the contrary herein, the Issuer will not make any payments of interest if the Issuer, following payment of such interest, would no longer meet the requirements with respect to Minimum Own Funds.

- (b) The Issuer covenants that, so long as any Note is outstanding, if the most recent scheduled payments on the Notes have not been made in full or utilisation of a Converted Amount has been made, as aforesaid:
 - (i) subject to sub-clause (a) above, it shall not declare (nor shall its Board of Directors propose the declaration of), pay or distribute interest, a dividend or any other amount on, or in respect of, any Other Tier I Securities or any Junior Securities or make any payment on a Tier I Guarantee (except, in the case of Capital Securities ranking *pari passu* with the Notes, any payments made on a *pro rata* basis as contemplated above);
 - (ii) subject to sub-clause (a) above, it shall not redeem, purchase or otherwise acquire any Other Tier I Securities or Junior Securities or purchase or otherwise acquire any security benefiting from a Tier I Guarantee (save where those shares or securities being redeemed, purchased or acquired are replaced contemporaneously by an issue of shares or securities of the same aggregate principal amount and the same ranking in a voluntary or involuntary liquidation or bankruptcy of the Issuer to those shares or securities being redeemed, purchased or acquired); and
 - (iii) it will procure that no payment is made, or any redemption, purchase or acquisition is effected, by any Subsidiary on any security (however named or designated) benefiting from a Tier I Guarantee,

in each case until the Dividend Stopper End Date or, as the case may be, until an amount equal to any Converted Amount has been reconverted and reinstated in full

as an obligation in respect of the Notes in the balance sheet of the Issuer, or such amount has been redeemed (such redemption having been approved by the FSA).

If the Issuer deems that it does not have sufficient Available Distributable Funds to pay accrued interest on the Notes on the next Interest Payment Date, the Issuer shall, if reasonably practicable and if so permitted by the applicable regulations of any stock exchange upon which the Issuer's equity or debt is then listed, give not more than 14 nor less than five days' prior notice to the Noteholders in accordance with Condition 11.

The Issuer shall also give not more than 14 nor less than five days' prior notice to the Noteholders in accordance with Condition 11 in case of a deferred payment of interest out of Unallocated Distributable Profits.

On any occasion when the Issuer determines it has insufficient Available Distributable Funds to pay accrued interest on the next Interest Payment Date or Unallocated Distributable Profits to make a full or partial payment of accrued interest on any deferred Interest Payment Date prior to the Deferral End Date, it will procure that its auditors certify this to be the case and a copy of such certificate will be available for inspection at the specified office of each Paying Agent.

5. Payments

(1) *Method of payment*

Subject as provided below, payments will be made by credit or transfer to an account in euro maintained by or on behalf of the payee.

Payments will be subject in all cases to any fiscal or other laws and regulations applicable thereto in the place of payment, but without prejudice to the provisions of Condition 7.

A holder shall be entitled to present a Global Note, a definitive Note or a Coupon for payment only on a Presentation Date and shall not be entitled to any further interest or other payment if a Presentation Date is after the due date.

(2) *Presentation of definitive Notes and Coupons*

Payments of principal in respect of definitive Notes will (subject as provided below) be made in the manner provided in paragraph (1) above only against presentation and surrender (or, in the case of part payment of any sum due, endorsement) of definitive Notes, and payments of interest (if any) in respect of definitive Notes will (subject as provided below) be made as aforesaid only against presentation and surrender (or, in the case of part payment of any sum due, endorsement) of Coupons, in each case at the specified office or any Paying Agent outside the United States (which expression, as used herein, means the United States of America (including the States and the District of Columbia, its territories, its possessions and other areas subject to its jurisdiction)).

Upon the date on which any Note in definitive form becomes due and repayable, unmatured Coupons shall become void and no payment or, as the case may be, exchange for further Coupons shall be made in respect thereof.

If the due date for redemption of any definitive Note is not an Interest Payment Date, interest (if any) accrued and payable in respect of such Note from, and including, the preceding Interest Payment Date shall be payable only against surrender of the relevant definitive Note.

(3) *Payments in respect of Global Notes*

Payments of principal and interest (if any) in respect of the Temporary Global Note will be made only upon certification as to non-U.S. beneficial ownership as provided therein. On and after 8 August 2005, no payment will be made on the Temporary Global Note unless exchange for an interest in the Permanent Global Note is improperly withheld or refused.

Payments of principal and interest (if any) in respect of Notes represented by a Global Note will (subject as provided below) be made in the manner specified in paragraph (1) above and otherwise in the manner specified in the relevant Global Note against presentation or surrender, as the case may be, of such Global Note at the specified office of any Paying Agent outside the United States. A record of each payment made against presentation or surrender of any Global Note, distinguishing between any payment of principal and any payment of interest, will be made on such Global Note by the Paying Agent to which it was presented and such record shall be *prima facie* evidence that the payment in question has been made.

The holder of a Global Note shall be the only person entitled to receive payments in respect of Notes represented by such Global Note and the Issuer will be discharged by payment to, or to the order of, the holder of such Global Note in respect of each amount so paid. Each of the persons shown in the records of Clearstream, Frankfurt as the beneficial holder of a particular principal amount of Notes represented by such Global Note must look solely to Clearstream, Frankfurt for his share of each payment so made by the Issuer to, or to the order of, the holder of such Global Note.

(4) The names of the initial Paying Agents and their initial specified offices are set out at the end of these Terms and Conditions. The Issuer reserves the right at any time to vary or terminate the appointment of any Paying Agent and to appoint additional or other Paying Agents provided that:

- (a) there will at all times be a Fiscal Agent;
- (b) there will at all times be at least one Paying Agent (which may be the Fiscal Agent) having its specified office in a European city which so long as the Notes are listed on Eurolist by Euronext Amsterdam shall be a city in the Netherlands and so long as the Notes are listed on the Frankfurt Stock Exchange, shall be Frankfurt;
- (c) the Issuer undertakes that it will ensure that it maintains a paying agent in a Member State of the European Union that is not obliged to withhold or deduct tax pursuant to European Council Directive 2003/48/EC or any other Directive implementing the conclusions of the ECOFIN Council meeting of 26-27 November 2000 or any law implementing or complying with, or introduced in order to conform to, such Directive; and
- (d) there will at all times be a Paying Agent in a jurisdiction within continental Europe.

Notice of any termination or appointment and of any changes in specified offices given to the Noteholders promptly by the Issuer in accordance with Condition 11.

6. **Redemption and Purchase**

- (1) Subject to paragraph (6) below, on 27 June 2010 or on any Interest Payment Date thereafter the Issuer may, subject to prior approval of the FSA and having given not less than ten TARGET Settlement Day's notice to the Noteholders in accordance with Condition 11 (which notice shall be irrevocable), redeem all (but not some only) of the Notes at an amount equal to the principal amount of the Notes, together with interest (if any) on the principal amount accrued to, but excluding, the due date for redemption (provided that the Issuer is obliged to make payment of interest in accordance with Condition 4(3)).

- (2) Subject to paragraph (6) below, if:
- (a) as a result of any change in, or amendment to, the laws or regulations of Iceland or any political subdivision of, or any authority in, or of, Iceland having power to tax, or any change in the application or official interpretation of such laws or regulations, which change or amendment becomes effective after 23 June 2005, on the occasion of the next payment due in respect of the Notes the Issuer would be required to pay additional amounts as provided or referred to in Condition 7; and
 - (b) the requirement cannot be avoided by the Issuer taking reasonable measures available to it,

the Issuer may, at any time subject to the prior approval of the FSA and after having given not less than 30 nor more than 60 days' notice to the Noteholders in accordance with Condition 11 (which notice shall be irrevocable), redeem all (but not some only) of the Notes at an amount equal to the principal amount of the Notes, together with interest (if any) on the principal amount accrued to, but excluding, the due date for redemption (provided that the Issuer is obliged to make payment of interest in accordance with Condition 4(3)), provided that no notice of redemption shall be given earlier than 90 days before the earliest date on which the Issuer would be required to pay the additional amounts were a payment in respect of the Notes then due.

Prior to the publication of any notice of redemption pursuant to this paragraph, the Issuer shall deliver to the Fiscal Agent a certificate signed by two Directors of the Issuer stating that the requirement referred to in (a) above will apply on the occasion of the next payment due in respect of the Notes and cannot be avoided by the Issuer taking reasonable measures available to it and an opinion of an independent Icelandic law firm of recognised standing to the effect that the Issuer has or will become obliged to pay such additional amounts as a result of the change or amendment.

- (3) Subject as provided in paragraph (6) below, upon the occurrence of a Special Event, the Issuer may, subject to the prior approval of the FSA (and provided that such approval can validly be given in accordance with the rules, regulations and policies of the FSA), at its option, having given not less than 30 days nor more than 60 days' notice to the Noteholders in accordance with Condition 11 (which notice shall be irrevocable), redeem all (but not some only) of the Notes at any time prior to 27 June 2010 at an amount equal to the principal amount of the Notes, together with interest (if any) on the principal amount accrued to, but excluding, the due date for redemption (provided that the Issuer is obliged to make payment of interest in accordance with Condition 4(3)).
- (4) The Issuer or any of its Subsidiaries may, subject to the prior approval of the FSA (and provided that such approval can validly be given in accordance with the rules, regulations and policies of the FSA) at any time purchase Notes (provided that, in the case of definitive Notes, all unmatured Coupons appertaining to the Notes are purchased with the Notes) in any manner and at any price. Notes purchased by the Issuer or any of its Subsidiaries shall be cancelled.
- (5) All Notes which are redeemed will forthwith be cancelled, together, in the case of definitive Notes, with all relative unmatured Coupons and accordingly may not be reissued or resold.
- (6) Save as provided in Condition 9, where any principal amount has been converted into Converted Amounts as described in Condition 3, the Issuer shall not redeem the Notes until all Converted Amounts have been reconverted and reinstated in full as an obligation in respect of the Notes.

Furthermore any redemption pursuant to this Condition 6 prior to, but excluding, 27 June 2015, shall also be subject to the satisfaction of the Redemption Condition.

7. Taxation

All payments of principal and interest in respect of the Notes by the Issuer will be made without withholding or deduction for or on account of any present or future taxes or duties of whatever nature imposed or levied by or on behalf of any Tax Jurisdiction unless such withholding or deduction is required by law. In such event, the Issuer will pay such additional amounts as shall be necessary in order that the net amounts received by the Noteholders and Couponholders after such withholding or deduction shall equal the respective amounts of principal and interest which would otherwise have been receivable in respect of the Notes or Coupons in the absence of such withholding or deduction; except that no such additional amounts shall be payable with respect to any Note or Coupon presented for payment:

- (i) by or on behalf of a holder who is liable for such taxes or duties in respect of such Note or Coupon by reason of his having some connection with a Tax Jurisdiction other than the mere holding of such Note or Coupon;
- (ii) more than 30 days after the Relevant Date except to the extent that the holder thereof would have been entitled to an additional amount on presenting the same for payment on such thirtieth day assuming that day to have been a Presentation Date;
- (iii) where such withholding or deduction is imposed on a payment to an individual and is required to be made pursuant to European Council Directive 2003/48/EC or any other Directive implementing the conclusions of the ECOFIN Council meeting of 26-27 November 2000 on the taxation of savings income or any law implementing or complying with, or introduced in order to conform to, such Directive; or
- (iv) by or on behalf of a holder who would have been able to avoid such withholding or deduction by presenting such Note to another Paying Agent in a Member State of the European Union.

8. Prescription

Claims against the Issuer in respect of principal and interest on the Notes while the Notes are represented by a Global Note will become void unless the Global Note is presented for payment within a period of 10 years (in the case of principal) and five years (in the case of interest) after the Relevant Date therefor.

Claims against the Issuer in respect of definitive Notes and Coupons will become void unless presented for payment within a period of 10 years (in the case of principal) and five years (in the case of interest) after the Relevant Date therefor.

9. Events of Default

- (1) The following events or circumstances (each an “**Event of Default**”) shall be an event of default in relation to the Notes:
 - (i) the Issuer shall default in the payment of principal for a period of 3 days in respect of any Note which has become due and payable in accordance with these Terms and Conditions; or
 - (ii) the Issuer shall, to the extent that it is obliged to pay interest under Condition 4(3), default for a period of 7 days in the payment of interest due on any Note in accordance with these Terms and Conditions; or
 - (iii) a court or agency or supervisory authority in Iceland (having jurisdiction in respect of the same) shall have instituted a proceeding or entered a decree or order for the appointment of a receiver or liquidator in any insolvency, rehabilitation, readjustment of debt, marshalling of assets and liabilities or similar arrangements involving the Issuer or all or substantially all of its property and such proceedings, decree or order

shall not have been vacated or shall have remained in force undischarged or unstayed for a period of 14 days; or

- (iv) the Issuer shall file a petition to take advantage of any insolvency statute or shall voluntarily suspend payment of its obligations.
- (2) If any Event of Default shall have occurred and shall be continuing, any Noteholder may give notice to the Issuer that the Note is, and it shall accordingly, subject to this Condition 9, forthwith become, immediately due and repayable whether or not the whole or any part of any Converted Amount has been reconverted and reinstated as an obligation in respect of the Notes at an amount equal to the principal amount (construed as provided above) of the Notes, together with interest (if any) on the principal amount accrued to, but excluding, the due date for redemption (provided that the Issuer is obliged to make such payment of interest in accordance with Condition 4(3)).
- (3) If a Note has been declared due and payable under this Condition 9, the Noteholder may claim payment in respect of the Notes only in the bankruptcy or liquidation of the Issuer and may therefore institute such steps, including the obtaining of a judgment against the Issuer for any amount due in respect of the Notes, as it thinks desirable with a view to having the Issuer declared bankrupt or put into liquidation.
- (4) A Noteholder may institute such proceedings against the Issuer as it may think fit to enforce any obligation, condition, undertaking or provision binding on the Issuer under the Notes (other than, without prejudice to sub-paragraphs (2) and (3) above, any obligation for the payment of any principal or interest in respect of the Notes) provided that the Issuer shall not by virtue of the institution of any such proceedings be obliged to pay any sum or sums sooner than the same would otherwise have been payable by it.

A provider of any Converted Amount may institute such proceedings against the Issuer as it may think fit to enforce any obligation, condition, undertaking or provision binding on the Issuer under Condition 2 or 3 provided that the Issuer shall not by virtue of the institution of such proceedings be obliged to pay any sum or sums sooner than the same would otherwise have been payable by it.

- (5) No remedy against the Issuer, other than as provided in sub-paragraphs (2), (3) and (4) above, or proving or claiming in the liquidation or bankruptcy of the Issuer in Iceland or elsewhere, shall be available to the Noteholders, whether for the recovery of amounts owing in respect of the Notes or in respect of any breach by the Issuer of any of its obligations or undertakings with respect to the Notes.

10. Replacement of Notes and Coupons

If any Note or Coupon is lost, stolen, mutilated, defaced or destroyed, it may be replaced at the specified office of any Paying Agent subject to all applicable laws and market practice upon payment by the claimant of the expenses incurred in connection with the replacement and on such terms as to evidence and indemnity as the Issuer may require. Mutilated or defaced Notes or Coupons must be surrendered before replacements will be issued.

11. Notices

- (1) All notices regarding the Notes will be deemed to be validly given if published in a daily newspaper having general circulation in the Netherlands and in a daily newspaper designated by the Frankfurt Stock Exchange (*Börsenpflichtblatt*) having general circulation in Germany. It is expected that such publication will be made in *Het Financieele Dagblad* and the *Börsen-Zeitung*. For so long as the rules of Euronext Amsterdam N.V. so require, notices will also be published in the Euronext Daily Official List (*Officiële Prijscourant*). Any such notice will be deemed to have been given on the date of the first publication or, where

required to be published in more than one newspaper, on the date of the first publication in all required newspapers. Couponholders will be deemed for all purposes to have notice of the contents of any notice given to the Noteholders in accordance with this Condition 11.

Until such time as any definitive Notes are issued, there may, subject to the rules of any stock exchange on which the Notes may be listed and so long as any Global Notes representing the Notes are held in their entirety on behalf of Clearstream, Frankfurt, be substituted for such publication in such newspaper(s) the delivery of the relevant notice to Clearstream, Frankfurt for communication by them to the Noteholders. Any such notice shall be deemed to have been given to the Noteholders on the day on which the said notice was given to Clearstream, Frankfurt.

- (2) Notices to be given by any Noteholder shall be in writing and given by lodging the same, together (in the case of any Note in definitive form) with the relative Note or Notes, with the Fiscal Agent. Whilst any of the Notes are represented by a Global Note, such notice may be given by any Noteholder to the Fiscal Agent through Clearstream, Frankfurt, as the case may be, in such manner as the Fiscal Agent and Clearstream, Frankfurt may approve for this purpose.

12. Meetings of Noteholders and Modification

- (1) The Agency Agreement contains provisions which are binding on the Issuer for convening meetings of the Noteholders to consider any matter affecting their interests, including the modification of these Terms and Conditions or the provisions of the Agency Agreement although any modification cannot be made without the prior approval of the FSA.
- (2) The quorum at any meeting for passing an Extraordinary Resolution will be one or more persons present holding or representing a clear majority in principal amount of the Notes for the time being outstanding or at any adjourned meeting one or more persons present whatever the principal amount of the Notes held or represented by him or them, except that at any meeting, the business of which includes the modification of certain of these Terms and Conditions the necessary quorum for passing an Extraordinary Resolution will be one or more persons present holding or representing not less than two-thirds, or at any adjourned meeting not less than one-third, of the principal amount of the Notes for the time being outstanding.
- (3) The Fiscal Agent may agree, without the consent of the Noteholders or Couponholders, to any modification of any of the provisions of the Agency Agreement which is not materially prejudicial to the interests of the Noteholders or to any modification which is of a formal, minor or technical nature or to correct a manifest error.
- (4) Any modification shall be binding on the Noteholders and the Couponholders and, unless the Fiscal Agent agrees otherwise, any modification shall be notified by the Issuer to the Noteholders as soon as practicable thereafter in accordance with Condition 11.

13. Further Issues

The Issuer may from time to time, without the consent of the Noteholders, create and issue further securities having the same terms and conditions as the Notes in all respects (or in all respects except for the first payment of interest on them) so as to form a single series with the Notes.

14. Third Party Rights

Except as provided herein in relation to providers of any Converted Amount, no person shall have any right to enforce any term or condition of the Notes under the Contracts (Rights of Third Parties) Act 1999.

15. Governing Law and Submission to Jurisdiction

- (1) The Agency Agreement, the Notes and the Coupons are governed by, and will be construed in accordance with, English law except that the provisions of Conditions 2, 3, 4(3) and 6 shall be governed by the laws of Iceland.
- (2) The Issuer irrevocably agrees for the benefit of the Noteholders that the courts of England shall have jurisdiction to hear and determine any suit, action or proceedings, and to settle any disputes, which may arise out of or in connection with the Notes (respectively, “**Proceedings**” and “**Disputes**”) and, for such purposes, irrevocably submits to the jurisdiction of such courts.

The Issuer hereby irrevocably waives any objection which it may have now or hereafter to the laying of the venue of any such Proceedings in any such court and any claim that any such Proceedings have been brought in an inconvenient forum and hereby further irrevocably agrees that a judgment in any such Proceedings brought in the English courts shall be conclusive and binding upon it and may be enforced in the courts of any other jurisdiction.

Nothing contained in this Condition shall limit any right to take Proceedings against the Issuer in any other court of competent jurisdiction, nor shall the taking of Proceedings in one or more jurisdictions preclude the taking of Proceedings in any other jurisdiction, whether concurrently or not.

- (3) *Appointment of Process Agent*

The Issuer appoints Kaupthing Limited of 89 New Bond Street, 5th Floor, London W1S 1DA, England as its agent for service of process, and undertakes that, in the event of it ceasing so to act or ceasing to be registered in England, it will appoint another person as its agent for service of process in England in respect of any Proceedings. Nothing herein shall affect the right to serve proceedings in any other manner permitted by law.

16. Regulatory matters

For so long as the Notes are listed on Eurolist by Euronext Amsterdam, the Issuer will comply with the provisions set forth in Article 2.1.20 of Schedule B of the Listing and Issuing Rules (*Fondsenreglement*) of Euronext Amsterdam N.V. as amended.

Any reference herein to the approval of the FSA being required prior to any action of the Issuer shall only be required to the extent such approval is required for such action under the then prevailing rules, regulations and policies of the FSA.

17. Definitions

For the purposes of these Terms and Conditions:

“**Available Distributable Funds**” means, in respect of each fiscal year of the Issuer, the aggregate amount, as calculated as of the end of the immediately preceding fiscal year in the individual financial statements of the Issuer, of accumulated retained earnings and any other reserves and surpluses capable under Icelandic law of being available for distribution as cash dividends to holders of Bank Share Capital, but before deduction of the amount of any dividend or other distribution declared on Bank Share Capital in respect of such prior fiscal year.

“**Bank Share Capital**” means the ordinary share capital of the Issuer, together with all other securities of the Issuer, ranking *pari passu* with the ordinary shares of the Issuer as to participation in a liquidation surplus.

A “**Capital Event**” means the determination by the Issuer (such determination to be evidenced by a certificate signed by two Directors of the Issuer and to be binding on the Noteholders without further investigation (copies of such certificate to be available for inspection at the specified office of the Fiscal Agent)), having received confirmation or similar proof thereof from the FSA, that the Notes are no longer eligible for inclusion in Tier I Capital (*Eiginfjárháttur A*) of the Issuer and for these purposes the Notes shall be deemed to be so “eligible” notwithstanding that any limits in respect of obligations which can be included in determining such eligibility would be exceeded by including in such determination all or any part of the Notes and accordingly for these purposes any such limits shall be disregarded.

“**Capital Securities**” means any subordinated and undated debt instruments of the Issuer which are recognised as “*Eiginfjárháttur A*” from time to time by the FSA and including, where the context so requires, the Notes.

“**Day Count Fraction**” means the number of days in the period divided by 360 (the number of days to be calculated on the basis of a year of 360 days with 12 30-day months (unless (a) the last day of the period is the 31st day of a month but the first day of the period is a day other than the 30th or 31st day of a month, in which case the month that includes that last day shall not be considered to be shortened to a 30-day month, or (b) the last day of the period is the last day of the month of February, in which case the month of February shall not be considered to be lengthened to a 30-day month)).

“**Deferral End Date**” means the earlier of (i) the date on which the Issuer accrues enough Unallocated Distributable Profits during the fiscal year of the Issuer in which such interest payments were otherwise due, as determined by the Board of Directors of the Issuer after consultation with the Issuer’s auditors, to pay the aggregate amount of deferred payments due under the Notes and under any other Capital Securities ranking *pari passu* with the Notes and Other Tier I Securities, and makes such payments or (ii) 31 December of the fiscal year of the Issuer in which such payments were otherwise due.

“**Dividend Stopper End Date**” means the later of (a) if all such scheduled payments are paid on the Deferral End Date applicable to such payment, such Deferral End Date or (b) the date which is twelve calendar months after the earlier of the date (i) on which a full interest payment is not paid on the Notes and (ii) on which a full scheduled dividend, interest payment or distribution on any Capital Security ranking *pari passu* with the Notes has not been paid.

“**Interest Period**” means the period from, and including, 27 June 2005 to, but excluding, the first Interest Payment Date and each successive period from, and including, an Interest Payment Date, to, but excluding, the next Interest Payment Date.

“**Junior Securities**” means (i) ordinary share capital of the Issuer, (ii) each class of preference share capital of the Issuer and any other instrument of the Issuer ranking *pari passu* herewith or junior hereto, and (iii) preference share capital or any other instrument of any Subsidiary of the Issuer subject to any guarantee or support agreement of the Issuer ranking junior to the obligations of the Issuer under these Notes.

“**Other Tier I Securities**” means any securities which are Tier I Capital of the Issuer and which rank on a voluntary or involuntary liquidation or bankruptcy of the Issuer *pari passu* with the Notes.

“**Presentation Date**” means (subject to Condition 8):

- (a) in respect of definitive Notes, a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in Frankfurt and in the relevant place of presentation and which is a TARGET Settlement Day; and
- (b) in respect of Notes represented by a Global Note, a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including

dealing in foreign exchange and foreign currency deposits) in Frankfurt and which is a TARGET Settlement Day.

The “**Redemption Condition**” shall have been satisfied if the Issuer has proceeds available from an issue of Replacement Capital that has been issued for the purpose of funding the redemption in an amount at least equal to the redemption price payable on the relevant date fixed for redemption.

“**Relevant Date**” means the date on which such payment first becomes due, except that, if the full amount of the moneys payable has not been duly received by the Fiscal Agent on or prior to such due date, it means the date on which, the full amount of such moneys having been so received, notice to that effect is duly given to the Noteholders in accordance with Condition 11.

“**Replacement Capital**” means share capital or other securities issued by the Issuer or a Subsidiary which, as of the date of issue thereof, would be included in the Tier I Capital of the Issuer.

A “**Special Event**” means the occurrence of any of a Tax Event or a Capital Event.

“**Subordinated Indebtedness**” means any obligation, whether dated or undated, of the Issuer which by its terms is, or is expressed to be, subordinated in the event of voluntary or involuntary liquidation or bankruptcy of the Issuer to the claims of depositors and all other unsubordinated creditors of the Issuer but not further or otherwise.

Subsidiary means, in relation to the Issuer, any company (i) in which the Issuer holds a majority of the voting rights or (ii) of which the Issuer is a member and has the right to appoint or remove a majority of the board of directors or (iii) of which the Issuer is a member and controls a majority of the voting rights, and includes any company which is a Subsidiary of a Subsidiary of the Issuer.

“**TARGET**” means the Trans European Real-Time Gross Settlement Express Transfer (TARGET) System.

“**TARGET Settlement Day**” means a day on which TARGET is operating.

A “**Tax Event**” means the receipt by the Issuer of an opinion of counsel in Iceland (experienced in such matters) to the effect that, as a result of (i) any amendment to, clarification of, or change (including any announced prospective change) in, the laws or treaties (or any regulations thereunder) of Iceland or any political subdivision or taxing authority thereof or therein affecting taxation, (ii) any governmental action or (iii) any amendment to, clarification of, or change in the official position or the interpretation of such governmental action or any interpretation or pronouncement that provides for a position with respect to such governmental action that differs from the theretofore generally accepted position, in each case, by any legislative body, court, governmental authority or regulatory body, irrespective of the manner in which such amendment, clarification or change is made known, which amendment, clarification or change is effective or such pronouncement or decision is announced on or after the date of issuance of the Notes, there is more than an insubstantial risk that the Issuer is, or will be, subject to more than a *de minimis* amount of other taxes, duties or other governmental charges or civil liabilities with respect to the Notes or any amount payable in respect of the Notes.

“**Tax Jurisdiction**” means Iceland or any political subdivision or any authority thereof or therein having power to tax or any other jurisdiction or any political subdivision or any authority thereof or therein having power to tax to which the Issuer becomes subject in respect of payments made by it of principal and/or interest on the Notes.

“**Tier I Capital**” means capital which is treated as issued tier I capital (“*Eiginfjárháttur Á*”) by the FSA either on a solo or on a consolidated basis.

“Tier I Guarantee” means any guarantee, indemnity or other contractual support arrangement entered into by the Issuer in respect of securities (regardless of name or designation) issued by a Subsidiary which constitutes Tier I Capital of the Issuer.

“Unallocated Distributable Profits” means, in respect of each fiscal year of the Issuer, the aggregate amount, as calculated during the course of such fiscal year in the individual financial statements of the Issuer, of accumulated retained earnings and any other reserves, surpluses, including current operating profits, capable under Icelandic law of being available for distribution as cash dividends to holders of Bank Share Capital in the following fiscal year.

USE OF PROCEEDS

The net proceeds amount from the issue of the Notes is €171,500,000, which will be applied by the Issuer for the purpose of improving the Issuer's capital structure.

CAPITALISATION

Capitalisation of the Issuer

The following table sets forth the capitalisation of the Issuer as at 31 December 2004 and 31 December 2003 including 2004 according to IFRS :

	<i>IFRS</i> <i>Kaupthing</i> <i>Bank</i> <i>01.01.2005</i>	<i>Local GAAP</i> <i>Kaupthing</i> <i>Bank</i> <i>31.12.2004</i>	<i>Local GAAP</i> <i>Kaupthing</i> <i>Bank</i> <i>31.12.2003</i>
	<i>(ISK millions)</i>		
Equity			
Share capital	6.521	6.521	4,384
Share premium	110.402	110.402	23,304
Accrued stock options	157	157	316
Retained earnings	32.290	32.363	17,925
Total equity	149.370	149.443	45,929
Borrowing			
Issued Bonds	850.159	850,159	150,424
Loans	118.354	34,060	60,221
Deposits	202.193	202,038	182,497
Subordinated Loans	57.623	57,627	10,704
Total capitalisation	<u>1.377.699</u>	<u>1,293,327</u>	<u>449,775</u>

Notes:

- (1) Save as disclosed in note (2) below, there has been no material change in the capitalisation of the Issuer since 31 December 2004.
- (2) Following authorisation being given by a shareholders' meeting, on 13 October 2004, the board of directors of the Issuer increased the Issuer's share capital by ISK 1,100,000,000 shares. As at 13 October 2004, the authorised and issued share capital of the Issuer was ISK 6,606,856,400 in nominal amount, fully paid up and comprising 660,685,640 ordinary shares

KAUPTHING BANK HF.

Introduction

The Issuer, is a Nordic bank offering comprehensive retail, corporate and investment banking services to individuals, companies and institutional investors. It is the largest bank in Iceland and a leading player in all key areas of the Icelandic financial market. It has the highest market capitalisation on the Iceland Stock Exchange. The activities of the Issuer and its subsidiaries (together, the “**Group**”) in Iceland are divided into retail banking, corporate banking and investment banking but internationally its focus is on corporate and investment banking. The Issuer is one of the ten largest banks in the Nordic countries.

The Issuer was created in its present form by the merger of two of Iceland’s foremost banks, Kaupthing Bank and Bunadarbanki Islands hf., both of which enjoyed a strong market position in Iceland. Bunadarbanki Islands dates back to 1929, when the Icelandic parliament, the Althing, passed a law on the founding of Bunadarbanki Islands. At the beginning of 1998, Bunadarbanki Islands hf. became a limited liability company, and the government began to sell its holdings in the bank. The Bank was privatised in stages and this process was completed at the beginning of 2003. Bunadarbanki Islands hf. was listed on the Main List of the Iceland Stock Exchange hf. on 17 December 1998.

Kaupthing hf. was established by eight Icelanders in 1982, at the same time as the free capital market was launched in Iceland. Kaupthing hf. later became an investment bank and changed its name to Kaupthing Bank in 2002. In September 2000, Kaupthing Bank hf. was listed on the Iceland Stock Exchange main list and on the Stockholm Stock Exchange (Stockholmsbörsen) O-list, in December 2002.

In May 2003, Kaupthing Bank hf. and Bunadarbanki Islands hf. merged under the name Kaupthing Bank hf. Kaupthing Bank hf. took over the assets and liabilities of Bunadarbanki Islands, hf. and shareholders in Bunadarbanki Islands hf. received 48.23 per cent. of the total share capital in Kaupthing Bank hf. in exchange for their shares.

In recent years, the Issuer has strengthened its position abroad by acquiring financial companies and establishing subsidiaries. The most important developments so far have been the acquisition of the Swedish bank, JP Nordiska AB (now Kaupthing Bank Sverige AB), and the recent acquisition of the Danish bank FIH Erhvervsbank A/S (“**FIH**”). JP Nordiska AB was acquired in 2002 which significantly strengthened the Issuer’s position in the Nordic countries, an area which the Bank defines as its home market. FIH Erhvervsbank A/S is a Danish corporate lending bank which has a nine per cent. market share in lending to corporates in Denmark. FIH was acquired in September 2004 and its acquisition doubled the balance sheet of Kaupthing Bank. In April 2005, the boards of Kaupthing Bank and the UK bank Singer & Friedlander announced that they had reached an agreement on the terms of a recommended cash offer for the entire issued and to be issued share capital of Singer & Friedlander (see further “*Recent Developments*” below).

The Issuer has six core business areas: Retail Banking; Corporate Banking; Asset Management and Private Banking; Investment Banking; Capital Markets and Treasury. It also has ancillary divisions such as Risk Management, IT, Finance, and Sales and Marketing.

At the end of 2004, the Issuer had operations in ten countries, including all of the Nordic countries and two of the world’s main business centres, London and New York. Its main subsidiaries are Kaupthing Bank Sverige in Sweden, Kaupthing Bank Luxembourg, Kaupthing Bank Sofi Oyj and Norvestia in Finland, FIH in Denmark, Kaupthing Føroyar in the Faroe Islands, Kaupthing New York, Kaupthing Asset Management in Switzerland, Kaupthing Ltd in the United Kingdom, Kaupthing Norge in Norway, Arion Custody Service and KB-LIF in Iceland. At the end of March 2005, the number of the Group’s full-time equivalent staff was 1,606.

The Issuer and its subsidiaries are members of seven stock exchanges in Europe and the United States. Trading in their shares accounted for a combined total of 4.28 per cent. of the equities turnover in the Nordic stock exchanges in 2004. As at 31 December 2004, the Group's assets under management totalled ISK 508 billion, and its assets in custody amounted to ISK 910 billion.

Recent developments

Following the Issuer's acquisition of FIH in September 2004, the Issuer's subsidiary in Denmark, Kaupthing Bank A/S, was restructured and transferred to the Faroese savings bank, Føroya Sparikassi P/F, which already held 25 per cent. of Kaupthing Bank A/S. Before transfer of the remaining 75 per cent. of the shares, Kaupthing Bank A/S (now Eik Bank) transferred certain of its activities to FIH.

FIH acquired the investment banking division from Kaupthing Bank A/S. The lending operation of Kaupthing Bank A/S remained in the bank, and thus became a part of Føroya Sparikassi P/F's Danish activities. At the same time Kaupthing Bank purchased 49 per cent. of the share capital in Kaupthing Føroyar Virdisbraevameklarafelag P/F from Føroya Sparikassi P/F, which means that all share capital in Kaupthing Føroyar is owned by the Issuer.

On 26 November 2004, the Issuer announced that its subsidiary, Kaupthing Bank Luxembourg S.A., had acquired all of the shares in PFA Pension Luxembourg. The seller was the leading Danish pension company PFA Pension. PFA Pension Luxembourg S.A. is, amongst other things, a supplier of unit linked policies to both corporate and private individuals.

The purpose of the acquisition was to increase Kaupthing Bank Luxembourg S.A.'s client base in Private Banking as well as to expand the business by offering insurance products to its existing clients. PFA Pension Luxembourg S.A. has an equity capital of DKK 45 million and a portfolio of unit -linked products amounting to DKK 375 million.

In December 2004, the Finnish financial supervisory authorities granted Kaupthing Bank's Finnish subsidiary, Kaupthing Sofi Oyj, a banking licence. The company has changed its name to Kaupthing Bank Oyj.

In February 2005, Kaupthing Bank hf. sold its subsidiary Lysing hf. to Iceland Insurance Company (Vatryggingafelag Islands hf. / VIS) for ISK 6.1 billion. Kaupthing Bank's profit from the transaction is estimated to be ISK 3 billion. Lysing is one of the two largest leasing companies in Iceland and employs 40 people. The founders of Lysing in 1986 included Kaupthing Bank (then Bunadarbanki Islands) and VIS. Before the transaction Lysing was 100 per cent. owned by Kaupthing Bank.

In April 2005, Kaupthing Bank hf., through a wholly owned subsidiary Kaupthing Holdings UK, announced an offer to acquire British bank Singer & Friedlander Group plc (Singer & Friedlander) and the board of directors of Singer & Friedlander has recommended that its shareholders accept the offer. If the acquisition takes place, Kaupthing Bank will significantly strengthen its position in the UK, which will become one of the largest markets for the bank alongside Denmark and Iceland. The bid is worth 316 pence per share, which corresponds to approximately £547 million (ISK 64.6 billion) for the entire issued share capital. Kaupthing Bank will pay for the shares in cash. Shareholders on the register on 29 April 2005 will also retain the right to the 2004 final dividend of 4.25 pence per Singer & Friedlander share. Kaupthing Bank already owns 19.5 per cent. of share capital in Singer & Friedlander.

On 15 June 2005, Kaupthing Holdings UK announced that as of 14 June 2005 it had received valid acceptances of the offer in respect of a total of 104,782,244 Singer & Friedlander shares, representing approximately 60.5 per cent. of the total issued share capital of Singer & Friedlander and representing 75.1 per cent. of the Singer & Friedlander shares to which the offer related. The offer is therefore unconditional as to acceptances. Taken together with the 33,659,283 Singer & Friedlander shares already owned by Kaupthing Bank, Kaupthing Holdings UK and Kaupthing

Bank have acquired or agreed to acquire 138,441,527 Singer & Friedlander shares, representing 79.9 per cent. of the issued share capital of Singer & Friedlander.

Legal Status and Legislative Background

The Issuer is a public limited company incorporated in Iceland in 1982 for an unlimited duration and operating under Icelandic law. It is registered with the registrar of companies in Iceland and its registration number is 560882-0419. The registered office of the Issuer is at Borgartun 19, 105 Reykjavik, Iceland, tel. +354 444 6000. The operations of the Issuer are, among other things, subject to the provisions of Act no. 2/1995 on Public Limited Companies, as amended, and Act no. 161/2002 on Financial Undertakings, as amended. The Issuer is subject to the supervision of the Icelandic Financial Supervisory Authority.

Under the Issuer's constitutional documents, its legal name is Kaupthing Bank hf. (Kaupþing banki hf. in Icelandic, previously Kaupþing Búnadarbanki hf.). Prior to 28 April 2004, the Issuer issued Notes under the Programme using the legal name Kaupthing Bunadarbanki hf. On and after 28 April 2004, the Issuer has used the legal name Kaupthing Bank hf. for all purposes under the Programme, since it became the policy of the Issuer to use the legal name Kaupthing Bank hf. abroad instead of the English spelling of the previous Icelandic legal name, Kaupthing Bunadarbanki hf.

SOURCES OF FUNDS

The Issuer's principal sources of funding are customer deposits and borrowing in the capital markets. Other sources of funding include capital markets and financial institutions.

The table below provides a breakdown of the Group's sources of funds as at 31 December 2004 and 31 December 2003 in accordance with local GAAP and as at 1 January 2005 in accordance with IFRS :

	<i>IFRS</i>	<i>Local GAAP</i>	<i>Local GAAP</i>
	<i>1/1/2005</i>	<i>31/12/2004</i>	<i>31/12/2003</i>
	<i>(ISK millions)</i>		
Equity	149,370	149,443	45,929
Minority interest in subsidiaries' equity	9,539	9,306	10,603
Subordinated loans	57,623	57,627	10,704
Deposits	234,681	202,038	182,497
Core funding	451,213	418,414	249,733
Borrowings	968,513	884,219	210,645
Credit institutions		147,455	79,267
Financial liabilities	68,010		
Other liabilities	58,984	74,767	17,278
Provision for Deferred Income-Tax Liability	7,733	9,165	1,646
Finance in the market	1,103,240	1,115,606	308,836
Total funds	1,554,453	1,534,020	558,569

The composition of the Group's funding has changed significantly in recent years as the Issuer's business has moved from primarily serving individuals, small businesses and clients in the agricultural sector to serving larger corporations in the domestic and Nordic markets. As a result, intermediation of borrowing has grown rapidly.

Equity

The table below sets out the 10 largest shareholders of the Issuer as of 31 December 2004:

	<i>Shares</i>	<i>%</i>
Meidur ehf.	112,180,448	17.0%
Egla ehf.	63,733,352	9.7%
Lifeyrissjodir Bankastraeti 7	26,595,340	4.0%
Lifeyrissjodur verslunarmanna	25,367,000	3.8%
Vatryggingafelag Islands hf.	25,109,701	3.8%
Eignarhaldsfelagid Sveipur ehf.	24,777,585	3.8%
Landsbanki Islands hf.	13,760,136	2.1%
Islandsbanki hf.	13,201,420	2.0%
Lifeyrissjodurinn Framsyn	9,478,541	1.4%
Lifeyrissjodur sjomanna	9,358,093	1.4%

Capital Adequacy

According to the provisions of Art. 84 and 85 of the Law no. 161/2002 on Financial Undertakings, a bank's subordinated loans and equity capital, after subtraction of the book value of shares held in other financial institutions, may not at any time fall below 8.0 per cent. of its risk-adjusted asset base, as defined by law. The risk-adjusted asset base of a bank is comprised of total assets as well as guarantees issued and calculated risk factors after the deduction of various figures in the balance sheet, according to the rules of the Financial Supervisory Authority. At 31 December 2004, the Issuer complies with all statutory ratios in accordance with the provisions of Art. 28 and 83 of the Act on Financial Undertakings. Together with subordinated loans, total capital and reserves amounted to ISK 168,776 million as at 31 December 2004 of which ISK 81,234 million consisted of Tier 1 capital. It is the Issuer's policy to seek to maintain a 11 per cent. capital ratio for the Group with a minimum Tier 1 ratio of 8 per cent.

Equity at the end of the period amounts to ISK 149,443 million. The capital adequacy ratio, calculated in accordance to Article 84 of the Act on Financial Undertakings, was 14.2 per cent. According to the law the ratio may not go below 8.0 per cent. The ratio is calculated as follows:

	<i>31/12/2004</i>	
	<i>Book</i>	<i>Weighted</i>
	<i>value</i>	<i>value</i>
	<i>(ISK millions)</i>	
Risk base:		
Assets recorded in the Annual Accounts	1,534,020	1,166,377
Assets deducted from capital		(50,335)
Guarantees and other items not included in the Balance Sheet ..		73,129
		<u>1,189,171</u>
Capital:		
Tier I capital:		
Equity		158,749
Goodwill		(34,208)
Assets subtracted from capital		(1,232)
Subordinated loans		13,947
Tier II capital:		
Subordinated loans		43,108
Investment in credit institutions		(11,598)
Total equity base		<u>168,766</u>
Capital ratio		14.2%
Thereof Tier I ratio		11.5%

Deposits

As at 31 December 2004, the Issuer had approximately 260,000 deposit accounts, including current accounts, savings accounts and currency accounts. As at the same date, the Issuer's total deposits amounted to 21 per cent. of the total deposits in all of Iceland's commercial banks and savings banks. The deposits from customers are well diversified, with a majority of the customers having relatively low deposits. Deposit accounts bear interest at a floating rate.

The table below sets out a breakdown of the Issuer's deposits as at 31 December 2004 and 31 December 2003 including 2004 in accordance with local GAAP and as at 1 January 2005 in accordance with IFRS:

	<i>IFRS</i>	<i>Local GAAP</i>	<i>Local GAAP</i>
	<i>1/1/2005</i>	<i>31/12/2004</i>	<i>31/12/2003</i>
	<i>(ISK millions)</i>		
Deposits on demand	80,084	79,929	103,432
Time deposits	122,109	122,109	79,065
Total	202,193	202,038	182,497
Savings deposits by maturity			
Up to 3 months	82,980	82,980	36,274
Over 3 months and up to 1 year	8,773	8,773	20,999
Over 1 year and up to 5 years	23,922	23,922	16,797
Over 5 years	6,434	6,434	4,995
Total	122,109	122,109	79,065

Other Funding

The majority of the Issuer's funding derives from international capital markets i.e. bond markets and syndicated loans, commercial paper and money markets.

The following table sets out a breakdown of the Issuer's borrowings from bonds and notes issued, as well as borrowings from other credit institutions, as at 31 December 2004 and 31 December 2003 in accordance with local GAAP and as at 1 January 2005 in accordance with IFRS. The Group's borrowings in foreign currency, international syndicated loans and private placements generally have maturities from 2 to 5 years.

	<i>IFRS</i>	<i>Local GAAP</i>	<i>Local GAAP</i>
	<i>1/1/2005</i>	<i>31/12/2004</i>	<i>31/12/2003</i>
	<i>(ISK millions)</i>		
Bonds issued	850,159	850,159	150,424
Loans	118,354	34,060	60,221
Total	968,513	884,219	210,645

Uses of Funds

The table below sets out a breakdown of the Issuer's uses of funds as at 31 December 2004 and 31 December 2003 in accordance with local GAAP and as at 1 January 2005 in accordance with IFRS :

	<i>IFRS</i> <i>1/1/2005</i>	<i>Local</i> <i>GAAP</i> <i>31/12/2004</i>	<i>Local</i> <i>GAAP</i> <i>31/12/2003</i>
	<i>(ISK millions)</i>		
Cash and amounts from credit institutions	6,290	113,543	50,545
Loans to customers	1,186,170	991,093	327,019
Mortgages foreclosed		2,402	1,962
Lease contracts		94,851	22,014
Bonds and other fixed-income securities		169,666	80,832
Shares and other variable-income securities		78,686	50,327
Financial assets	274,207		
Shares in associated and affiliated companies	3,649	8,266	2,926
Other assets	84,137	75,513	22,944
Total assets	1,554,453	1,534,020	558,569

The predominant lending activity of the Issuer is making loans to an extensive range of corporate customers and private individuals.

The Issuer provides services to all sectors and has sought to establish a diversified portfolio of marketable securities and loans in order to minimise its lending risks. The Issuer believes that its portfolio of loans and marketable securities is well distributed between economic sectors.

The table below sets out the breakdown of the Issuer's total loans and marketable securities by customer categories as at 31 December 2004:

	<i>31/12</i> <i>2004</i>
Industry	28.1%
Services	27.5%
Real estate	15.0%
Individuals	13.5%
Trade	9.0%
Holding companies	6.3%
Transportation	0.6%
	100.0%

The table below sets out a breakdown by remaining maturity of the Group's loans to customers and leasing agreements as at 31 December in each of the years indicated:

	<u>2004</u>	<u>2003</u>
	<i>(ISK millions)</i>	
On demand	39,611	21,177
Up to 3 months	141,288	122,160
Over 3 months and up to 1 year	124,813	58,196
Over 1 year and up to 5 years	402,552	117,105
Over 5 years	377,680	30,395
	<u>1,085,944</u>	<u>349,033</u>

The Issuer's exposure to market risk in bonds, derivatives included, amounts to ISK 72,456 million. The bond portfolio is predominantly comprised of AAA bonds. Kaupthing Bank hf. has entered into derivatives amounting to ISK 12,925 million against its position in shares.

Risk Management

The Issuer faces various types of risks related to its business as a financial institution, which arise from its day to day operations. The most significant of these risks are listed below. Management devotes a significant portion of its time to the management of risk. Effective risk management involves the identification of the significant risks, the quantification of the Issuer's exposure to these risks and taking appropriate action to limit these risks including constantly monitoring them. Among other risk management techniques, the Issuer has established a range of limits, has sought to ensure that these limits are complied with and has sought to quantify its exposures to different risks. It is management's responsibility to identify where established limits have been exceeded and to take the appropriate action. The Issuer has documented these responsibilities and limits.

Approval and Revision of Risk Policy

The Issuer's Risk Policy has been adopted and approved by its Board of Directors. It is reviewed and revised at least annually. Amendments or minor changes can be made more frequently but each change needs the approval of the Issuer's chief executive officer (CEO) before it is effective and then needs to be approved by the Board of the Issuer as soon as practicable thereafter.

Types of Risks

Credit Risk

Credit risk is managed on a Group-wide level by the Group Credit Committee and the Group Credit Manager (or Head of Credit Risk). The role of the Credit Manager is to manage the process and make sure all the requirements set out by the Credit Committee such as requirements on documentation and collateral are satisfied. The value of collateral is adjusted for volatility (called a "haircut"); such adjustments are different for each asset class depending on its estimated liquidation quality. The Credit Manager monitors collateral quality on a daily basis and reacts to any deficiencies identified. The collateral system integrates loan, foreign exchange and derivative information with custody data and the values of pledged securities in the clients' portfolios and calculates the collateral value daily. The Group Credit Manager ensures that an exposure to a single customer within the group does not exceed certain limits set by the Group Credit Committee.

Credit and collateral risk is managed on a local level in the Issuer's subsidiaries according to the same rules and in accordance with any further requirements of local regulation. The local credit committees and credit managers receive their credit limits from the Group Credit Committee and all larger credits require approval from the Group Credit Committee.

Security market risk

Trading departments are only permitted to trade certain listed stocks on certain exchanges within prescribed limits and in some cases on an intra-day basis only.

Currency risk

Currency risk is the risk associated with fluctuations in assets and liabilities denominated in different currencies due to movements in exchange rates. Currency risk is controlled by the Issuer's Treasury, is subject to limits and is estimated using the risk models described above.

Interest rate risk

Interest rate risk arises due to the maturity or interest rate reset periods of assets and liabilities not coinciding. Fluctuations in market interest rates cause fluctuations in interest income. Short to medium term interest risk is controlled by the Issuer's Treasury using limits on mismatch in expected in- and-outgoing payments as well as limits on interest rate sensitivity of overall interest bearing assets and liabilities. The Issuer's Trading Department is responsible for positions in long term bonds and interest rate risk is further controlled using position limits and estimated using various risk models as described above.

Liquidity risk

The Issuer is subject to the risk of being unable to repay its depositors on demand, or as and when due, through holding insufficient cash or near-cash assets. This risk is measured by constant monitoring of liquidity ratios. The Issuer's Treasury is responsible for maintaining liquidity by maintaining a sufficiently high ratio of liquid assets and available funding to near term liabilities and possible payment outflows. The liquidity measures are calculated at the end of each trading day and monitored by the Head of Risk and reported to the CEO.

Operational risk

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, human and system error, or from external events that affect the Issuer's operations. These operational risks are monitored through a system of internal control set up at different levels in the Group (including daily controls, supervisory controls and management controls).

Risk Monitoring

At least twice a year the risk management department submits to the Board of Directors an overview of at least the 10 largest credits of the Issuer. The overview includes long- and short-term obligations, stock holdings, collateral and major financial information. At least twice a year a list of the largest credits in doubt is also presented to the Board of Directors.

Market Risk Limits

Position limits and any changes to them are proposed by the Issuer's Head of Trading and accepted by the Issuer's Head of Risk Management (Head of Risk) and reviewed by the CEO. Each position limit size is based on, among other things, underlying liquidity, the Issuer's risk appetite as well as legal limitations on individual positions stipulated by relevant authorities. The Head of Risk maintains a document detailing current limits and a journal of changes to them. Final approval of all position limits is required from the CEO. All trades outside of position limits are prohibited and the penalty will be decided by Head of Risk and paid by the relevant Trading Department from its profit and loss account. The penalty amount is, in general, based on the profit or loss generated by the unauthorised trades and is twice that amount or 1 per cent. per day of the limit overrun, whichever is larger. Disputes on breaches of position limits or amounts can be referred to the CEO.

All violations of this risk policy need to be documented in the journal maintained by Head of Risk and made available to the CEO.

Monitoring

The Issuer monitors the different risks incurred carefully. The different types of risks (excluding credit risk) are specified below. The overall responsibility of complying with the established limits lies with the Board of Directors. Management is, however, responsible for the day-to-day routines aimed at controlling the different risk parameters. The positions are continuously monitored against the limits where possible and otherwise daily.

Risk Reporting

Intra-Day Reports

All trades and intra-day profit or loss is reported continuously to the Head of Risk through a position monitoring system. The Head of Risk appoints a person and a backup person whose responsibility it is to monitor the intra-day positions and alert the Head of Risk to any deviations or exceptions observed.

Daily Reports

The Issuer's Risk Management sends a daily report on profit and loss and turnover to the Head of Risk, Head of Trading and the CEO.

Monthly Reports

The Risk Management department sends a monthly risk assessment report to the Head of Trading, the CEO and the Board of Directors detailing volatility based and scenario based measures such as Value-at-Risk, Earnings-at-Risk and stress tests based on current position limits.

Quarterly Reports

The Head of Trading sends a quarterly report to the Head of Risk and the CEO on activities, profit and loss and general observations on the market and his view on future prospects for the trading operations.

Risk Models

Risk models employed are position based (risk limits), volatility based (i.e. based on the volatility of market variables and their related co-variance) and scenario based (i.e. based on a prescribed scenario which is likely to cause severe drawdown in profits).

Risk measures are generated by proprietary systems that utilise counter party and market data and trade databases generated and used by the Issuer's trade systems. Additionally the risk management systems are augmented by a number of third party solutions.

PROVISIONS AND NON-PERFORMING LOANS

The Issuer evaluates non-performing loans according to the rules of the Financial Supervisory Authority, which are based on EU Directive no. 554/1994 regarding rules on the annual accounts of commercial banks. Non-performing loans amounted to ISK 7,013 million as at 31 December 2004 and ISK 6,584 million at 31 December 2003. There are no non-performing loans as of 2005. The table below sets out a breakdown of the Group's non-performing loans as at 31 December in each of the years indicated:

	<i>31 December 2004</i>	<i>31 December 2003</i>
	<i>(ISK millions)</i>	
Loans with specific provision for losses	16,561	7,149
Specific provision for losses	(12,5421)	(5,465)
Other non-performing loans	2,973	4,900
Total non-performing loans	7,013	6,584

Provisions for losses on the loan portfolio have been made each year by the Issuer to meet the estimated risk attached to these assets. These provisions do not represent a final write-off. Certain risk factors are evaluated in addition to a regular contribution for this purpose. The Issuer uses specific provisions as well as general provisions to meet the general risk of lending operations.

The table below sets out changes in the Issuer's provisions as at 31 December 2004 and 31 December 2003 including 2004 according to IFRS:

Changes in the provision for losses are specified as follows:

<i>Group</i>	<i>GAAP</i>		<i>GAAP</i>	
	<i>Provisions for losses</i>		<i>31 December 2004</i>	<i>31 December 2003</i>
	<i>Specific</i>	<i>General</i>	<i>Total</i>	<i>Total</i>
	<i>(ISK millions)</i>			
Balance at the beginning of the year	5,465	2,836	8,301	5,764
Provision for losses during the year/Impairment	2,989	831	3,819	3,894
Exchange rate difference on the translation of foreign subsidiaries	(378)	(64)	(443)	25
Actual losses during the period	(5,566)	(36)	(5,601)	(1,402)
Paid in, previously written off	21	0	21	20
Taken over at acquisitions	9,990	404	10,395	0
Balance at year-end	12,521	3,971	16,492	8,301
Provision for losses on the loan portfolio as a percentage of loans and issued guarantees ..	1.10%	0.30%	1.40%	2.40%

BOARD OF DIRECTORS OF THE ISSUER

The Issuer's Board of Directors consists of nine members and nine alternates.

Board

Sigurdur Einarsson – Born 1960 • Executive Chairman of Kaupthing Bank • Cand. Polit from the University of Copenhagen • Joined Kaupthing Bank in 1994.

Hjorleifur Thor Jakobsson – Born 1957 • Vice Chairman of the Board • Elected 2003 • CEO of Olíufélagid ehf.

Business address: Oliufelagið ehf., Suðurlandsbraut 18, 108 Reykjavík, Iceland

Asgeir Thoroddsen – Born 1942 • Elected 2003 • Attorney to the Supreme Court of Iceland.

Business address: Intrum a Islandi, Laugavegi 97, 101 Reykjavík, Iceland

Bjarnfredur H. Olafsson – Born 1967 • Elected 2003 • Attorney to the District Court of Iceland.

Business address: Taxis logmenn sf, Laugavegi 182, 105 Reykjavík, Iceland

Brynja Halldorsdottir – Born 1957 • Elected 2004 • CFO of Norvik ehf.

Business address: BYKO hf, Skemmuvegi 2a, 200 Kopavogur, Iceland

Finnur Ingolfsson – Born 1954 • CEO of Vatryggingafelag Islands hf • Elected 2003.

Business address: Vatryggingafelag Islands hf, Armula 3, 108 Reykjavík, Iceland

Gunnar Pall Palsson – Born 1961 • Elected 2001 • CEO of Commercial Workers' Union of Reykjavík (VR).

Business address: Verslunarmannafelag Reykjavíkur, Kringlunni 7, 103 Reykjavík, Iceland

Niels de Coninck-Smith – Born 1956 • Elected 2005 • Chief Executive Officer of Ferrosan

Business address: Ferrosan A/S, Sydmarken 5, 2860 Soeborg, Denmark

Tommy Persson – Born 1948 • Elected 2002 • CEO of Länsförsäkringar AB • Other directorships: Chairman of the Swedish Insurance Federation and the Swedish Insurance Employers' Association. • Chairman of EurAPCO AG. • Board member of Eureka BV.

Business address: Länsförsäkringar AB, Tegeluddsvägen 11-13, Stockholm, SE-173 82, Sweden

Senior Management

Chief Executive Officer

The Issuer has one Chief Executive Officer who is appointed by the Board of Directors.

Hreidar Mar Sigurdsson – CEO

Born 1970 • Business Studies graduate from University of Iceland • Joined Kaupthing Bank in 1994.

Managing Directors of the Profit Centres

Armann Thorvaldsson – Managing Director of Corporate Finance.

Born 1968, a History graduate with an MBA from Boston University. He has been with Kaupthing Bank since 1994.

Business address: Kaupthing Ltd., 89 New Bond Street, 5th floor, London W1S 1DA, UK

Bjarki H. Diego – Managing Director of Corporate Banking.

Born 1968, Graduated in Law from the University of Iceland in 1993, LL.M from University of London in 1999 • He has been with Kaupthing Bank since 2000.

Fridrik Halldorsson – Managing Director of Retail Banking.

Born 1959, BA in Business Administration, Senior Manager Treasury Bunadarbanki 1993-1999. Deputy Managing Director of Retail Banking since 2002-2003.

Ingolfur Helgason – Managing Director of Capital Markets.

Born 1967, a Business Studies graduate from the University of Iceland. He has been with Kaupthing Bank since 1993.

Kristin Petursdottir – Managing Director of Treasury.

Born 1965, a Business Studies graduate with an MS in International Business from the Norwegian School of Management in Bergen. She has been with Kaupthing Bank since 1997.

Kristjan Arason – Managing Director of Private Banking.

Born 1961, a Business Studies graduate from University of Iceland. He has been with Kaupthing Bank since 2001.

Thorarinn Sveinsson – Managing Director of Asset Management.

Born 1967, an MSc in Engineering from Massachusetts Institute of Technology (MIT). He has been with Kaupthing Bank since 1999.

Managing Directors of Finance and Risk Management

Gudny Arna Sveinsdottir – Managing Director of Finance and Accounting.

Born 1966, a Business Studies graduate with an MS from the University of Uppsala in Sweden. She has been with Kaupthing Bank since 2001.

Dr. Steingrimur P. Karason – Managing Director of Risk Management.

Born 1968, an Engineering graduate with an ScD in Mechanical Engineering from MIT Boston. He has been with Kaupthing Bank since 1997.

Internal Auditor

Gudjon Johannesson – Internal Auditor

Born 1969. Graduated in Business Administration from the University of Iceland in 1995. Joined Banadarbanki Islands hf. in 1999.

No director has any actual or potential conflict of interest between his or her duties to the Issuer and his or her private interests or other duties.

Unless otherwise stated. The business addresses of each of the directors set out above is Borgartun 19, 105 Reykjavik, Iceland.

State Authorised Public Accountants

The state authorised public accountants of Kaupthing Bank are KPMG Endurskodun hf. and on their behalf, Sigurdur Jonsson.

Sigurdur Jonsson

Born 1956. State Authorised Public Accountant. Accountant of Kaupthing Bank from 1991.

Business address: KPMG Endurskodun hf., Borgartuni 27, 105 Reykjavik, Iceland.

AUDITORS' REPORT ON THE ANNUAL ACCOUNTS 2004

To the Board of Directors of Kaupthing Bank hf.

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

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

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

Reykjavik, 25 January 2005

Sigurdur Jonsson

KPMG Endurskodun hf.

FIVE YEAR SUMMARY – THE GROUP (PREVIOUS GAAP)

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

FIVE YEAR SUMMARY – THE GROUP (ACCORDING TO IFRS)

	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>	<u>2000</u>
	<i>(ISK millions)</i>				
Profit and Loss					
Net interest income	18,259	10,124	6,998	5,811	4,089
Other operating income	31,687	21,656	14,414	8,039	5,112
Net operating income	49,946	31,780	21,412	13,850	9,201
Other operating expenses	-23,624	-18,493	-12,455	-10,565	-7,030
Impairment	-3,825	-3,894	-2,794	-1,691	-815
Taxes	-4,237	-1,486	-764	321	-343
Net earnings	18,258	7,907	5,399	1,915	1,013
Net shareholders' earnings	17,707	7,520	5,363	1,915	1,013
Minority interest	552	387	36	-	-
Balance Sheet					
Assets					
Cash balance with central banks	6,290	-	-	-	-
Loans and advances	1,154,416	-	-	-	-
Mortgage loans at fair value	31,754	-	-	-	-
Trading assets	205,186	-	-	-	-
Finance assets at fair value through P/L	63,694	-	-	-	-
Financial assets available-for-sale	1,507	-	-	-	-
Derivatives used for hedging	3,820	-	-	-	-
Investment in associates	3,649	-	-	-	-
Intangible assets	35,098	-	-	-	-
Investment property	19,155	-	-	-	-
Property and equipment	6,092	-	-	-	-
Current and deferred tax assets	1,092	-	-	-	-
Non-current assets and disposal groups classified as held for sale	3,631	-	-	-	-
Reinsurers' share	107	-	-	-	-
Other assets	18,962	-	-	-	-
Total assets	1,554,453	558,569	432,412	317,563	207,620
Liabilities and equity					
Deposits	202,193	182,497	164,570	83,473	67,369
Other liabilities	1,135,728	308,837	222,339	203,349	121,390
Minority interest	9,539	10,603	1,114	223	58
Subordinated loans	57,623	10,704	11,010	8,364	6,187
Shareholders' equity	149,370	45,928	33,379	22,154	12,616
Total liabilities and equity	1,554,453	558,569	432,412	317,563	207,620
KEY RATIOS					
Cost/income ratio	47.3%	58.2%	58.2%	76.3%	76.4%
Return on shareholders' equity	25.5%	23.0%	18.7%	-	-
Impairment	0.4%	1.1%	1.0%	0.8%	0.6%
Total credit reserves	1.4%	2.4%	2.1%	2.0%	1.7%
Earnings per share, (ISK)	35.6	18.5	14.8	6.1	4.2
Earnings per share diluted, (ISK)	35.1	18.4	14.7	6.1	4.2
Average no. of shares outstanding, (million)	497	406	362	314	239
Avg. no. of shares outstanding diluted, (million)	505	411	364	315	239
No. of shares at end of period, (million)	652	438	409	356	239
No. of shares at end of period diluted, (million)	660	443	411	358	239

Profit and Loss account for 2004, change from previous GAAP to IFRS

		<i>Change in valuation</i>		<i>Change in presentation</i>		
		<i>(ISK millions)</i>				
According to previous GAAP						According to IFRS
Net interest income	18,900	0	(641)	18,259		Net interest income
		0	467	467		Insurance premium
Fees, commissions and other service charges	15,645	0	(2,337)	13,308		Fee and commission net income
Fees, commissions and other service charges, paid	(2,348)	0	2,348	0		Dividends from shares and other holdings
	4,216	0	(244)	3,972		Dividend income
Trading gains	11,290	0	(10,798)	492		Net gain on financial assets / liabilities not at fair value
		0	11,219	11,219		Net gain on trading portfolio
		0	1,536	1,536		Net gain on assets designated at fair value through profit and loss
		670	(1,562)	(892)		Foreign exchange difference
		0	346	346		Gain on disposals of assets other than held for sale
Other operating income	866	0	278	1,144		Other operating net income
Salaries and salary related expenses	(12,652)	0	(199)	(12,851)		Salaries and related expenses
Other administrative expenses	(9,108)	0	(289)	(9,397)		Administration expenses
Depreciation and amortisation	(2,642)	1,289	(24)	(1,377)		Depreciation and amortisation
		0	(150)	(150)		Policyholder benefits and claims
Provision for losses	(3,819)	0	(6)	(3,825)		Impairment on loans and advances
		0	240	240		Share of profit of associates
		0	5	5		Profit from non current assets
Income tax	(4,040)	(12)	(185)	(4,237)		Income tax
	16,308	1,947	4	18,259		Net earnings
Minority interest	(548)	0	(4)	(552)		Minority interest
Net earnings according to previous GAAP	15,760	1,947	0	17,707		Net earnings attributable to shareholders of Kaupthing Bank

Balance Sheet, change from previous GAAP to IFRS

<i>Previous GAAP 31 December 2004</i>			<i>Change in valuation</i>	<i>Change in presentation</i>	<i>IFRS 1 January 2005</i>
			<i>(ISK millions)</i>		
Cash and amounts due from credit institutions	113,543	0	(107,253)	6,290	Cash and cash balances with central bank
Loans, lease contracts	1,088,346	11,704	54,366	1,154,416	Loans and advanced
–		630	31,124	31,754	Mortgage loans measured at fair value
Bonds, shares and other securities	248,352	30	(43,196)	205,186	Trading assets
–		1,446	62,248	63,694	Financial assets designated at fair value through profit and loss
–		(28)	1,535	1,507	Financial assets available-for-sale
–		3,246	574	3,820	Derivatives used for hedging
Shares in associated companies	8,266	(461)	(4,156)	3,649	Investment in associates
Goodwill	34,208	(11)	901	35,098	Intangible assets
–		377	18,778	19,155	Investment property
Fixed assets	6,467	12	(387)	6,092	Property and equipment
Deferred tax assets	1,039	0	53	1,092	Current and deferred tax assets
–		(61)	3,692	3,631	Non-current assets and disposal groups classified as held for sale
–		0	107	107	Reinsurers' share in insurance fund
Other assets	33,799	109	(14,945)	18,963	Other assets
Total Assets	1,534,020	16,992	3,441	1,554,453	Total Assets
Amounts owed to credit institutions	147,455	0	(114,967)	32,488	Deposits from credit institutions and Central bank
Savings deposits	202,038	0	155	202,193	Other deposits
Borrowings	884,219	2,862	81,432	968,513	Borrowings
Subordinated loans	57,627	0	(4)	57,623	Subordinated loans
–		696	34,180	34,876	Mortgage funding measured at fair value
–		0	1,345	1,345	Insurance liabilities
–		1,654	12,262	13,916	Trading liabilities
–		11,124	8,094	19,218	Derivatives used for hedging
Provision for deferred income-tax liability	9,165	392	(1,824)	7,733	Current and deferred tax liabilities
–		0	1,402	1,402	Liabilities included in disposal groups classified as held for sale
Other liabilities	74,767	337	(18,867)	56,237	Other liabilities
Equity	149,443	(73)	0	149,370	Shareholders' equity
Minority interests in subsidiaries' equity	9,306	0	233	9,539	Minority interest
Total Liabilities and Equity	1,534,020	16,992	3,441	1,554,453	Total Liabilities and Equity

TAXATION

Icelandic Taxation

The comments below are of a general nature based on the Issuer's understanding of current law and practice in Iceland. They relate only to the position of persons who are the absolute beneficial owners of the Notes and/or Coupons. They may not apply to certain classes of person such as dealers. Prospective holders of the Notes who are in any doubt as to their personal tax position or who may be subject to tax in any other jurisdiction, should consult their professional advisers.

1. There are no taxes or other governmental charges payable under the laws of Iceland or any authority of, or in, Iceland in respect of the principal or interest on the Notes by a holder who is not a resident of Iceland, or in respect of any amount payable under the Subscription Agreement or the Fiscal Agency Agreement.
2. There are no estate or inheritance taxes, succession duties, gift taxes or capital gains taxes imposed by Iceland or any authority of, or in, Iceland in respect of the Notes if, at the time of the death of the holder or the transfer of the Notes, such holder or transferor is not a resident of Iceland.
3. The Issuer is not required by the current laws of Iceland to make any deductions or withholding from any payment of principal or interest due or to become due under the Notes or from any amount payable under the Subscription Agreement or the Fiscal Agency Agreement, if the recipient is not a resident of Iceland.

Netherlands Taxation

General

The following summary describes the principal Netherlands tax consequences of the acquisition, holding, redemption and disposal of the Notes. This summary does not purport to be a comprehensive description of all Netherlands tax considerations that may be relevant to a decision to acquire, to hold, and to dispose of the Notes. Each prospective holder of Notes should consult a professional adviser with respect to the tax consequences of an investment in the Notes. The discussion of certain Netherlands taxes set forth below is included for general information purposes only.

Except as otherwise indicated, this summary only addresses the Netherlands tax legislation, as in effect and in force at the date hereof, as interpreted in published case law, without prejudice to any amendments introduced at a later date and implemented with or without retroactive effect.

This summary does not address the Netherlands tax consequences of a holder of Notes who holds a substantial interest (*aanmerkelijk belang*) in the Issuer, within the meaning of Section 4.3 of the Income Tax 2001. Generally speaking, a holder of Notes holds a substantial interest in the Issuer if such holder, alone or together with his or her partner (statutorily defined term) or certain other related persons, directly or indirectly, holds (i) an interest of 5 per cent. or more of the total issued capital of the Issuer or of 5 per cent. or more of the issued capital of a certain class of shares of the Issuer, (ii) rights to acquire, directly or indirectly, such interest or (iii) certain profit sharing rights in the Issuer.

For the purpose of the principal Netherlands tax consequences described herein, it is assumed that the Issuer is neither a resident nor deemed to be a resident of the Netherlands for Netherlands tax purposes.

Dutch income tax and corporate income tax

Dutch resident individuals

As a general rule, individuals who are resident or deemed to be resident in the Netherlands for Dutch tax purposes (“**Dutch resident individual**”) will be taxed annually on a deemed income of 4 per cent. of their net investment assets at an income tax rate of 30 per cent. The net investment assets for the year are the average of the investment assets less the attributable liabilities at the beginning and at the end of the relevant year. The value of the Notes is included in the calculation of the net investment assets. A tax-free allowance for the first €19,522 (€39,044 for partners (statutorily defined term)) of the net investment assets may be available. Actual benefits derived from the Notes and any capital gains realised upon the disposal of Notes are not as such subject to Dutch income tax.

However, if the Notes are attributable to an enterprise from which a Dutch resident individual derives a share of the profit, whether as an entrepreneur or as a person who has a co-entitlement to the net worth of such enterprise without being a shareholder, any benefit derived or deemed to be derived from the Notes, including any capital gains realised upon the disposal thereof, are generally subject to income tax at a progressive rate with a maximum of 52 per cent. Benefits derived from the Notes where a Dutch resident individual carries out activities that exceed regular portfolio asset management are subject to the same progressive rate.

Dutch income tax and corporate income tax – Dutch resident entities

Any benefit derived or deemed to be derived from the Notes held by entities, resident in the Netherlands for Dutch tax purposes (“**Dutch resident entities**”), including any capital gains realised upon the disposal thereof, is generally subject to corporate income tax at a rate of 31.5 per cent.

A Dutch qualifying pension fund is not subject to corporate income tax with respect to any benefits derived from the Notes, unless these benefits can be considered to have been derived from certain activities that will be designated by a decree that has yet to be published. A qualifying Dutch resident investment fund (*fiscale beleggingsinstelling*) is subject to corporate income tax at a special rate of 0 per cent.

Gift and Inheritance Taxes for Netherlands resident holders of Notes

Generally, gift and inheritance taxes will be due in the Netherlands in respect of the acquisition the Capital Securities by way of a gift by, or on the death of, a holder of Notes who is a resident or deemed to be a resident of the Netherlands for the purposes of Netherlands gift and inheritance tax at the time of the gift or his or her death.

An individual with Netherlands nationality is deemed to be a resident of the Netherlands for the purposes of gift and inheritance tax, if he or she has been resident in the Netherlands during the ten years preceding the gift or his death. An individual of any other nationality is deemed to be a resident of the Netherlands for the purposes of the Netherlands gift and inheritance tax only if he or she has been residing in the Netherlands at any time during the 12 months preceding the time of the gift. The same 12-month rule may apply to any entity that has transferred its seat of residence out of the Netherlands.

Other taxes

No Dutch capital tax, transfer tax or stamp duty or any other similar documentary tax or duty will be payable in the Netherlands in respect of or in connection with the subscription, issue, placement, allotment or delivery of the Notes.

EU Savings Directive

On 3 June 2003, the European Council of Economics and Finance Ministers adopted a Directive on the taxation of savings income under which Member States will be required, from 1 July 2005, to provide to the tax authorities of another Member State details of payments of interest (or similar income) paid by a person within its jurisdiction to an individual resident in that other Member State, except that, for a transitional period, Belgium, Luxembourg and Austria will instead be required (unless during that period they elect otherwise) to operate a withholding system in relation to such payments (the ending of such transitional period being dependent upon the conclusion of certain other agreements relating to information exchange with certain other countries).

SUBSCRIPTION AND SALE

Under a Subscription Agreement (the “**Subscription Agreement**”) dated 23 June 2005, Credit Suisse First Boston (Europe) Limited and Deutsche Bank AG, London Branch (the “**Managers**”) have agreed to subscribe for the Notes at 100 per cent. of their principal amount less a combined selling, management and underwriting commission of 2.00 per cent. of such principal amount. The Managers are entitled to terminate the Subscription Agreement in certain circumstances prior to payment being made to the Issuer.

The United States of America

The Notes have not been and will not be registered under the Securities Act and may not be offered, sold or delivered within the United States or to, or for the account or benefit of, U.S. persons, except in certain transactions exempt from the registration requirements of the Securities Act. Terms used in this paragraph have the meanings given to them by Regulation S under the Securities Act.

The Notes are in bearer form and subject to U.S. tax law requirements and may not be offered, sold or delivered within the United States or its possessions or to a United States person, except in certain transactions permitted by U.S. tax regulations. Terms used in this paragraph have the meaning given to them by the United States Internal Revenue Code and regulations thereunder.

Each Manager has represented and agreed that, except as permitted by the Subscription Agreement, it has not offered and sold, and will not offer, sell or deliver the Notes (i) as part of their distribution at any time and (ii) otherwise until 40 days after the later of the commencement of the offering and the Closing Date within the United States or to, or for the account or benefit of, U.S. persons, and that it will have sent to each dealer to which it sells Notes during the distribution compliance period a confirmation or other notice setting forth the restrictions on offers and sales of the Notes within the United States or to, or for the account or benefit of, U.S. persons.

In addition, until 40 days after the commencement of the offering of the Notes, an offer or sale of the Notes within the United States by any dealer (whether or not participating in the offering of such Securities) may violate the registration requirements of the Securities Act.

The United Kingdom

Each Manager has represented and agreed that, except as permitted by the Subscription Agreement:

- (i) it has not offered or sold and, prior to the expiry of the period of six months from the Closing Date, will not offer or sell any Notes to persons in the United Kingdom except to persons whose ordinary activities involve them in acquiring, holding, managing or disposing of investments (as principal or agent) for the purposes of their businesses or otherwise in circumstances which have not resulted and will not result in an offer to the public in the United Kingdom within the meaning of the Public Offers of Securities Regulations 1995 (as amended);
- (ii) it has only communicated or caused to be communicated and will only communicate or cause to be communicated an invitation or inducement to engage in investment activity (within the meaning of Section 21 of the FSMA) received by it in connection with the issue of the Notes in circumstances in which Section 21(1) of the FSMA does not apply to the Issuer; and
- (iii) it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to the Notes in, from or otherwise involving the United Kingdom.

Republic of Italy

The offering of the Notes has not been cleared by CONSOB (the Italian Securities Exchange Commission) or the Bank of Italy pursuant to Italian securities legislation and, accordingly, no Notes may be offered, sold or delivered, nor may copies of this Offering Circular or of any other document relating to the Notes be distributed in the Republic of Italy, except:

- i. to professional investors ("*operatori qualificati*"), as defined in Article 31, second paragraph, of CONSOB Regulation No. 11522 of 1 July 1998, as amended; or
- ii. in circumstances which are exempted from the rules on solicitation of investments pursuant to Article 100 of Legislative Decree No. 58 of 24 February 1998 (the "**Financial Services Act**") and Article 33, first paragraph, of CONSOB Regulation No. 11971 of 14 May 1999, as amended.

Any offer, sale or delivery of the Notes or distribution of copies of this Offering Circular or any other document relating to the Notes in the Republic of Italy under (i) or (ii) above must be:

- a. made by an investment firm, bank or financial intermediary permitted to conduct such activities in the Republic of Italy in accordance with the Financial Services Act and Legislative Decree No. 385 of 1 September 1993 (the "**Banking Act**"), as amended; and
- b. in compliance with Article 129 of the Banking Act and the implementing guidelines of the Bank of Italy pursuant to which the issue or the offer of securities in the Republic of Italy may need to be preceded and followed by an appropriate notice to be filed with the Bank of Italy depending, *inter alia*, on the aggregate value of the securities issued or offered in the Republic of Italy and their characteristics; and
- c. in accordance with any other applicable laws and regulations.

Germany

Each Manager has confirmed that it is aware of the fact that no German sales prospectus (*Verkaufsprospekt*) within the meaning of the Securities Sales Prospectus Act (*Wertpapier-Verkaufsprospektgesetz*, the "**Act**") of the Federal Republic of Germany has been or will be published with respect to the Notes and that it will comply with the Act and all other applicable legal and regulatory requirements. In particular, each of the Managers has represented that it has not engaged and has agreed that it will not engage in a public offering (*öffentliches Angebot*) within the meaning of the Act with respect to any Notes otherwise than in accordance with the Act. Any resale of the Notes in the Federal Republic of Germany may only be made in accordance with the provisions of the Act and any other laws applicable in the Federal Republic of Germany governing the sale and offering of securities.

Iceland

Each Manager has agreed that it will not offer the Notes to the public in Iceland, except in compliance with the Icelandic Act on Securities Transaction (No. 33/2003) and any applicable laws or regulations of Iceland.

General

Each Manager has agreed with the Issuer that it will obtain any consent, approval or permission which is, to the best of its knowledge and belief, required for the offer, purchase or sale by it of Notes under the laws and regulations in force in any jurisdiction to which it is subject or in which it makes such offers, purchases or sales and that it will, to the best of its knowledge and belief, comply with all such laws and regulations.

GENERAL INFORMATION

1. The issue of the Notes was authorised by a resolution of the Board of Directors of the Issuer dated 24 November 2004.
2. So long as any Note remains outstanding, copies of the following documents will, when published, be available free of charge from the registered office of the Issuer and from the specified offices of the Paying Agents for the time being:
 - (i) the articles of association (with an English translation thereof) of the Issuer;
 - (ii) the audited financial statements of the Issuer in respect of the financial years ended 31 December 2004 and 2003 and of each of Kaupthing Bank hf. and Bunadarbanki Islands hf. in respect of the financial year ended 31 December 2002;
 - (iii) the most recently published audited annual financial statements of the Issuer and the most recently published unaudited interim financial statements (if any) of the Issuer (with an English translation thereof);
 - (iv) the Subscription Agreement and the Agency Agreement; and
 - (v) any certificate referred to in Condition 3(a).
3. Save as disclosed in this Offering Circular, there has been no significant change in the financial or trading position of the Issuer or the Issuer and its subsidiaries, taken as a whole and there has been no material adverse change in the financial position or prospects of the Issuer or the Issuer and its subsidiaries, taken as a whole, since 31 December 2004.
4. Neither the Issuer nor any of its subsidiaries is or has been involved in any legal or arbitration proceedings (including any proceedings which are pending or threatened of which the Issuer is aware) which may have or have had in the 12 months preceding the date of this document a significant effect on the financial position of the Issuer or the Group.
5. The Notes have been accepted for clearance through Euroclear and Clearstream, Luxembourg with a Common Code of 022258079. The ISIN is DE000A0E6B87. The WKN is A0E6B8.
6. All consents and authorisations required by Icelandic law have been given for the issue of the Notes and for the Issuer to perform its obligations thereunder, under the Subscription Agreement and under the Fiscal Agency Agreement.
7. The auditors of the Issuer are KPMG Endurskodun hf., who have audited the Issuer's accounts, without qualification, in accordance with generally accepted auditing standards in Iceland for the financial years ended on 31 December 2003 and 2004.

THE ISSUER

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