Icebank hf.

Financial Statements for the year 2006

ISK

Icebank hf.
Rauðarárstíg 27
105 Reykjavík
Iceland

kt. 681086-1379

Contents

Endorsements and Signatures of the Board of Directors and the CEO

The Financial Statements of Icebank for the year ended 31 December 2006 have been prepared in accordance with International Financial Reporting Standards (IFRS). These are the Bank's first Financial Statements where IFRS 1 has been applied.

Profit of the year, according to the Income Statement, amounted to ISK 5,662 million for the year 1 January to 31 December 2006. Capital, according to the Balance Sheet, amounted to ISK 12,007 million at the end of the year. The equity ratio of the Bank, calculated according to the Act on Financial Undertakings, was 17.0%. This ratio may not be lower than 8.0%. The Board of Directors does not propose payment of dividend for the year 2006. Allocation of profit and changes in equity are further explained in the notes to the Financial Statements.

During the year 2007 the average number of employees of the Bank was 67. Salaries amounted to ISK 472 million. the Bank also paid salary related expenses amounting to ISK 103 million.

The share capital at year-end 2006 amounted to ISK 691 million but during the year, the Bank's equity was increased by the nominal value of ISK 81 milion and market value of ISK 610 million. The Bank is authorized to issue a non-taxable stock dividend amounting to ISK 449 million, which means that share capital could be multiplied by a factor of 1.65. At year-end shareholders were 21, of which the following three owned more than 10%:

Sparisjódur vélstjóra	28.7%
Sparisjódur Reykjavíkur og nágrennis	24.5%
Sparisjódurinn í Keflavík	12.2%

The Board of Directors and the CEO of Icebank hf. hereby confirm the Financial Statements for the year 2006.

Reykjavík, 6 February 2007

Board of Directors:

Geirmundur Kristinsson
Chairman

Fridrik Fridriksson

Gudmundur Hauksson

Ragnar Z. Gudjónsson

Magnús Ægir Magnússon

CEO:

Finnur Sveinbjörnsson

Independent Auditor's Report

To the Board of Directors and Shareholders of Icebank hf.

Indroduction

We have audited the accompanying Financial Statements of Icebank hf. (the "Bank"), which comprise the Balance Sheet as at 31 December 2006, and the Income Statement, Statement of changes in Equity and Cash Flow Statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these Financial Statements in accordance with International Financial Reporting Standards as adopted by EU. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of Financial Statements that are free from material misstatements, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

Our responsibility is to express an opinion on these Financial Statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance whether the Financial Statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the Financial Statements. The procedures selected depend on our judgement, including the assessment of the risks of material misstatement of the Financial Statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the Financial Statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the Financial Statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Opinion

In our opinion, the Financial Statements give a true and fair view of the financial position of Icebank hf. as at 31 December 2006, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by EU.

Reykjavík, 6 February 2007.

Sigurdur Jónsson

Ólafur Már Ólafsson

KPMG hf.

Income Statement
for the year 2006

	Notes	2006	2005
Interest income		5,234,622	3,344,470
Interest expense		(3,980,813)	(2,521,184)
Net interest income	27	1,253,809	823,286
Fee and commission income		209,497	195,442
Fee and commission expense		(73,361)	(76,595)
Net fee and commission income	28	136,136	118,847
Dividend income	29	302,788	1,346
Net (loss) gain on trading assets and liabilities	30	(391,925)	1,272,072
Net gain on financial assets designated at fair value	31	6,230,058	1,402,671
Net foreign exchange difference		221,265	126,294
Share of profit of associates	49	(5,904)	(131)
Other operating revenue	32	74,184	28,330
Other net operating income		6,430,466	2,830,582
Net operating income		7,820,411	3,772,715
Salaries and related expenses	34	(575,234)	(373,300)
Administrative expenses		(408,325)	(288,269)
Depreciation	50	(12,366)	(46,758)
Impairment on loans and advances	45	15,096	(141,578)
		(980,829)	(849,905)
Profit before income tax		6,839,582	2,922,810
Income tax expense	36	(1,177,957)	(542,236)
Profit for the year		5,661,625	2,380,574
Earnings per share			
Basic and diluted earnings per share	37	8.5	3.9

Notes numbered 1-78 are an integral part of these financial statements

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Balance sheet
as at 31 December 2006

	Notes	2006	2005
Assets			
Cash and balances with the Central Bank	38	7,292,521	10,386,957
Loans and advances	39-45	61,520,424	45,555,484
Trading assets	46	8,869,689	5,123,550
Financial assets designated at fair value	48	8,786,951	4,201,155
Investments in associates	49	18,045	24,619
Property and equipment	50	342,836	329,994
Other assets	51	94,793	45,015
Total Assets		86,925,259	65,666,774
Liabilities			
Deposit from credit institutions and the Central Bank	52	12,705,456	13,675,151
Other deposits	53	4,130,836	4,165,338
Borrowings	54-55	53,257,960	39,827,865
Subordinated loans	56	2,430,339	1,126,393
Trading liabilities	57	6,965	17,345
Current tax liability		87,560	0
Deferred tax liability	58-59	2,006,222	915,825
Other liabilities	60	293,279	203,784
Total Liabilities		74,918,617	59,931,701
Equity			
Share capital		691,270	609,944
Reserves		879,924	351,306
Retained earnings		10,435,448	4,773,823
Total Equity	61-62	12,006,642	5,735,073
Total Liabilities and Equity		86,925,259	65,666,774

Notes numbered 1-78 are an integral part of these financial statements

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Statement of Changes in Equity
for the year 2006

	Share capital	Reserves	Retained earnings	**Total**
Changes in equity in 2005				
Equity 31 December 2004	604,464	248,078	2,383,589	3,236,131
Changes due to adoption of IFRS	0	0	89,033	89,033
Equity 1 January 2005, IFRS	604,464	248,078	2,472,622	3,325,164
Profit for the year	0	0	2,380,574	2,380,574
Reserve provisions	0	79,373	(79,373)	0
Paid-in capital	5,480	23,855	0	29,335
Equity 31 December 2005, IFRS	609,944	351,306	4,773,823	5,735,073
Changes in equity in 2006				
Equity 31 December 2005	609,944	351,306	4,727,268	5,688,518
Changes due to adoption of IFRS	0	0	46,555	46,555
Equity 1 January 2006, IFRS	609,944	351,306	4,773,823	5,735,073
Profit for the year	0	0	5,661,625	5,661,625
Paid-in capital	81,326	528,618	0	609,944
Equity 31 December 2006, IFRS	691,270	879,924	10,435,448	12,006,642

Notes numbered 1-78 are an integral part of these financial statements

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Statement of Cash Flows
for the year 2006

	Notes	2006	2005
Operating activities:			
Net profit before income tax		5,661,625	2,380,574
Adjustments for:			
Impairment on loans and advances	45	(15,096)	141,578
Depreciation of property and equipment		12,366	46,758
Share of profit of associates	49	5,904	131
Indexation and exchange rate difference		(328,080)	(120,995)
Net gain on sale of an associate		(30,458)	0
Income taxes expense	36	1,177,957	542,236
		6,484,218	2,990,282
Loans and advances, changes		(15,618,690)	(16,298,953)
Trading assets, changes		(3,746,139)	1,001,335
Financial assets designated at fair value, changes		(4,585,796)	2,014,483
Other assets, changes		(49,778)	(44,747)
Other liabilities, changes		89,495	58
Net cash (used in) provided by operating activities		(17,426,690)	(10,337,542)
Investing activities:			
Investements in associates, changes		(44,774)	(105,177)
Proceeds from sale of share in associates		27,946	62,935
Purchase of property and equipment	50	(25,208)	0
Proceeds from sale of property and equipment		0	20,200
Cash used in investing activities		(42,036)	(22,042)
Financing activities:			
Deposits, change		(969,695)	1,696,340
Borrowings, change		13,430,095	12,685,176
Proceeds from the issue of equity		1,303,946	1,126,393
Dividends paid		609,944	29,335
Cash from financing activities		14,374,290	15,537,244
Increase in cash and cash equivalents		(3,094,436)	5,177,660
Cash and cash equivalents at beginning of the year		10,386,957	5,209,297
Cash and cash equivalents at year-end	38	7,292,521	10,386,957

Notes numbered 1-78 are an integral part of these financial statements

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Notes to the Financial Statements

General information

1. **Reporting entity**

Icebank hf. is a company domiciled in Iceland. The address of the Bank is Rauðarárstígur 27 in Reykjavík. Icebank is a commercial bank, focusing on wholesale transactions with domestic and foreign financial institutions, especially with Icelandic savings banks and businesses.

The Financial Statements were approved by the Board of Directors and the CEO of Icebank hf. on 6 February 2007.

2. **Basis of preparation**

a) *Statement of compliance*

The Financial Statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union. These are the Bank's first IFRS financial statements and IFRS 1 *First-time Adoption of International Financial Reporting Standards* has been applied.

The preparation of the Financial Statements for the year 2006 in accordance with IFRS resulted in changes to the accounting policies as compared with the Financial Statements for the year 2005, which were prepared under Icelandic Generally Accepted Accounting Principles. Information about how the transition to IFRS has affected the financial position and performance of the Bank is provided in note 78. These notes include reconciliations of equity and profit for the comparative period reported under Icelandic Generally Accepted Accounting Principles and under IFRS.

b) *Basis of measurement*

The Financial Statements are prepared on the historical cost basis except that trading assets and liabilities and financial instruments designated at fair value are measured at fair value.

c) *Functional and presentation currency*

These financial statements are prepared and presented in Icelandic króna (ISK), which is the Bank's functional currency. Except as indicated, financial information presented has been rounded to the nearest ISK thousand.

d) *Use of estimates and judgements*

The preparation of the Financial Statements in conformity with IFRS requires management to make judgements, estimates and assumptions, which affect the application of accounting policies and the reported amounts of assets and liabilities as well as income and expenses. The estimates and underlying assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying amounts of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

Information about areas of estimation uncertainty and judgements made by management in applying accounting policies that have the most significant effect on the amounts recognised in the financial statements is provided in note 26.

Summary of significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these Financial Statements. They have also been used for the preparation of the opening IFRS balance sheet at 1 January 2005 for the purpose of adopting IFRS.

3. Interest income and expense

Interest income and expense are recognised in the the income statement on an accrual basis using the effective interest method. Interest income and expense includes the amortisation of any discount or premium or other differences between the initial carrying amount of a financial instrument and its maturity amount, calculated using the effective interest method.

The effective interest rate is the rate that exactly discounts estimated future cash flows through the expected life of the financial instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Bank estimates the cash flows considering all contractual terms of the financial instrument, but it does not consider future credit losses.

Once a financial asset or a group of similar financial assets has been written down as a result of impairment loss, interest income is recognised at the rate of interest used for the purpose of calculating the impairment loss. Interest income on financial assets which have been written down as a result of impairment is calculated based on their net carrying amount.

4. Fee and commission income and expense

The Bank provides various services to its clients and earns income there from, such as income from transactions on behalf of third parties, commission from customers for equity and bond transactions and other services. Fees and commission income are recognised in the income statement as the services are provided. Fees that are performance-linked are recognised when the performance criteria are fulfilled.

Fees and commission expense relate mainly to transaction and service fees, which are expensed as the services are received.

5. Other net operating income

Other net operating income comprises net gains (losses) from trading assets and liabilities and financial assets designated at fair value, including fair value changes, dividends and foreign exchange differences. Dividend income is recognised in the income statement on the date that the dividend is declared.

6. Foreign currency

Transactions in foreign currencies are translated at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated to Icelandic krónas at the foreign exchange rate ruling at the reporting date. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are translated to Icelandic krónas at foreign exchange rates ruling at the dates the fair value was determined. Foreign exchange differences resulting from translation to Icelandic krónas is recognised in the income statement.

7. Impairment

The carrying amount of the Bank's assets, other than trading assets and financial assets designated at fair value, is reviewed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated. An impairment is recognised in the income statement whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount.

a) *Impairment on loans and advances*
The bank recognises impairment losses when there is objective evidence that loans and advances are impaired, whether individually or on a portfolio basis.

Two methods are used to calculate impairment losses, one based on an assessment of individual loans and advances and the other based on a collective assessment. Losses expected as a result of future events, no matter how likely, are not recognised.

7. a. contd.:

Objective evidence of impairment includes information about the following events and conditions:

(i) significant financial difficulty of the borrower;
(ii) a breach of contract, such as a default on installments or on interest or principal payments;
(iii) the Bank granting to the borrower, for economic or legal reasons relating to the borrower's financial difficulty, a refinancing concession, that the lender would not otherwise consider;
(iv) it becomes probable that the borrower will enter bankruptcy or undergo other financial reorganisation;
(v) the disappearance of an active market for that financial asset because of financial difficulties; or
(vi) observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of loans, even if the decrease cannot yet be identified with the individual financial assets in the group, including:
  – adverse changes in the payment status of borrowers in the group; or
  – general national or local economic conditions connected with the assets in the group.

Individually assessed loans and advances

Impairment losses on individually assessed loans and advances are determined by an evaluation of the exposures on a case-by-case basis. The Bank assesses at each balance sheet date whether there is any objective evidence that individual loans are impaired. This procedure is applied to all loans and advances that are considered individually significant. In making the assessment, the following factors are considered:

- the Bank's aggregate exposure to the customer;
- the amount and timing of expected receipts and recoveries;
- the likely dividend available on liquidation or bankruptcy;
- the complexity of determining the aggregate amount and ranking of all creditor claims and the extent to which legal and insurance uncertainties are evident;
- the realisable value of security (or other credit mitigants) and likelihood of successful repossession; and
- the likely deduction of any costs involved in recovery of amounts outstanding.

Impairment loss is calculated by comparing the carrying amount of individual loans and advances with the present value of their expected future cash flows, discounted at their original effective interest rate. In the case of loans at variable interest rates, the discount rate used is their current effective interest rate. The carrying amount of impaired loans and advances is reduced through the use of an allowance account.

Collectively assessed loans and advances

Where loans and advances have been individually assessed and no evidence of loss has been identified, these loans are grouped together on the basis of similar credit risk characteristics for the purpose of calculating a collective impairment loss. This loss covers loans that are impaired at the balance sheet date but which will not be individually identified as such until some time in the future.

The collective impairment loss is determined after taking into account:

- future cash flows in a group of loans evaluated for impairment are estimated on the basis of the contractual cash flows of the assets;
- historical loss experience in portfolios of similar risk characteristics (for example, by industry sector, loan grade or product);
- the estimated period between a loss occurring and that loss being identified and evidenced by the establishment of an allowance against the loss on an individual loan;
- management's experienced judgement as to whether the current economic and credit conditions are such that the actual level of inherent losses is likely to be greater or less than that suggested by historical experience.

Estimates of changes in future cash flows for groups of assets are consistent with changes in observable data from period to period, for example changes in property prices, payment status, or other factors indicative of changes in the probability of losses on the group and their magnitude. The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Bank to minimise any differences between loss estimates and actual losses.

Loan write-offs

Loans are written off, partially or in full, when there is no realistic prospect of recovery.

Reversals of impairment

If, in a subsequent period, the amount of an impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is recognised as revenue in the income statement.

7. contd.:

b) *Calculation of recoverable amount*
The recoverable amount of the Bank's investments in financial assets carried at amortised cost is calculated as the present value of estimated future cash flows, discounted at the original effective interest rate.

The recoverable amount of other assets is the greater of their fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

8. Income tax expense

Income tax expense comprises current tax and deferred tax. Income tax expense is recognised in the income statement, except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the period, using tax rates enacted at the Balance Sheet date, and any adjustment to tax payable in respect of previous years.

The deferred income tax liability has been calculated and recognised in the balance sheet. The calculation is based on the difference between balance sheet items as presented in the tax return on one hand, and in the Financial Statements on the other, taking into consideration tax losses carried forward. This difference is due to the fact that the tax assessment is based on premises that differ from those governing the financial statements, mostly due to temporary differences arising from the recognition of revenues and expenses in the tax returns and in the Financial Statements.

9. Cash and cash equivalents

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

10. Loans and advances

Loans and advances are non-derivative financial instruments with fixed or determinable payments that are not quoted in an active market, other than those that the Bank designates upon initial recognition as at fair value. Loans and advances include loans provided by the Bank to its customers, participation in loans from other lenders and purchased loans that are not quoted in an active market and which the Bank has no intention of selling immediately or in the near future.

Loans and advances are initially recognised at fair value, which is the cash advanced, plus any transaction costs. Subsequently, they are measured at amortised cost using the effective interest method. Accrued interest is included in the carrying amount of the loans and advances.

11. Trading assets

Trading assets are financial assets acquired principally for the purpose of generating profits from short-term price fluctuations or from dealer’s margin. Trading assets consist of bonds, shares and derivatives with positive fair value.

Trading assets are measured at fair value. Realised and unrealised gains and losses on these assets are recognised in the income statement and included in the line item *Net (loss) gain on trading assets and liabilities* . Interest and dividend income on these assets are included in interest income and dividend income line items in the income statement.

12. Derivatives

A derivative is a financial instrument or other contract within the scope of IAS 39, the value of which changes in response to a change in an underlying variable (such as share, commodity or bond prices, an index value or an exchange or interest rate), which requires no initial net investment or initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors and which is settled at a future date.

The Bank uses derivatives for trading purposes and to hedge its financial risk exposure.

12. contd.:

Derivatives are recognised at fair value. Fair value changes are recognised in the income statement as interest and other gains and losses. Interest income is recognised on an accrual basis. Derivatives with positive fair values are recognised as trading assets and derivatives with negative fair values are recognised as trading liabilities (see notes 46 and 57).

Derivatives embedded in other contracts are treated as separate derivatives when their economic characteristics and risks are not closely related to those of the host contracts and when the contracts are not carried at fair value through profit and loss.

The fair value of derivatives is determined in accordance with the accounting policy presented in note 47.

13. Financial assets designated at fair value

The Bank designates certain financial assets upon their initial recognition as financial assets at fair value when doing so results in more relevant information, including information provided internally to key management personnel. Fair value changes are recognised in the income statement.

14. Determination of fair value

The determination of fair value of financial assets and financial liabilities that are quoted in an active market is based on quoted prices. For all other financial instruments fair value is determined by using valuation techniques. A market is considered active if quoted prices are readily and regularly available and those prices represent actual and regularly occurring market transactions on an arm's length basis.

Valuation techniques include recent arm's length transactions between knowledgeable, willing parties, if available, reference to the current fair value of other instruments that are substantially the same, the discounted cash flow analysis and option pricing models. Valuation techniques incorporate all factors that market participants would consider in setting a price and are consistent with accepted methodologies for pricing financial instruments. Periodically, the Bank calibrates the valuation technique and tests it for validity using prices from any observable current market transactions in the same instrument, without modification or repackaging, or based on any available observable market data.

15. Recognition and derecognition of financial assets and financial liabilities

Purchases and sales of financial assets are recognised using trade date accounting, i.e. they are recognised on the date on which the Bank commits to purchase or sell the asset, except for loans and advances, which are recognised when cash is advanced to the borrowers. Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the Bank has transferred substantially all risks and rewards of ownership.

Financial liabilities are recognised when the Bank becomes a party to the contractual provisions of the liability instrument. Financial liabilities are derecognised when the obligation of the Bank is discharged or cancelled or expires.

16. Offsetting financial assets and financial liabilities

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis.

17. Repurchase agreements

Repurchase agreements involve the sale of securities subject to the simultaneous agreement to repurchase the same securities at a certain later date and at an agreed price. Reverse repurchase agreements involves the purchase of securities subject to the simultaneous agreement to resell the same securities at a certain later date and at an agreed price. The cash received initially along with the accrued interest are recognised as deposits from credit institutions and the Central Bank. The cash paid initially along with the accrued interest are recognised as loans to credit institutions. Accrued interest is recognized as interest revenue and expense over the life of each agreement.

In the case of repurchase agreements, the control of the securities remains with the Bank throughout the entire term of the agreements and the securities continue to be presented in the balance sheet as financial assets designated at fair value.

18. **Investments in associates**

Associates are those entities in which the Bank has significant influence over the financial and operating policy decisions but not control over those policies. Significant influence generally exists when the Bank holds between 20% and 50% of the voting power, including potential voting rights, if any. Investments in associates are initially recognised at cost.

The Financial Statements include the Bank's share of the total recognised gains and losses of associates on an equity accounted basis, from the date the significant influence commences until the date it ceases. When the Bank's share of loss exceeds its interest in an associate, the Bank's carrying amount is reduced to zero and recognition of further losses is discontinued except to the extent that the Bank has incurred legal or constructive obligations or made payments on behalf of the associate. If the associate subsequently reports profits, the investor resumes recognising its share of those profits only after its share of the profits equals the share of losses not recognised.

19. **Property and equipment**

Items of property and equipment are measured at cost less accumulated depreciation and impairment losses.

The Bank recognises in the carrying amount of an item of property and equipment the cost of replacing part of such an item when that cost is incurred if it is probable that the future economic benefits embodied with the item will flow to the Bank and the cost of the item can be measured reliably. All other costs are expensed in the income statement when incurred.

Depreciation is recognised in the income statement on a straight-line basis over the estimated useful lives of each component of an item of property and equipment. The estimated useful lives are as follows:

Property	20 - 50 years
Machinery and equipment	3-5 years

As long as the residual value is not immaterial, it is reassessed annually.

20. **Deposits**

Deposits are measured initially at fair value and subsequently at amortised cost.

21. **Borrowings and subordinated loans**

The Bank´s borrowings consist of issued bonds and loans from credit institutions. Subordinated loans are bonds issued by the Bank with subordinated terms. Subordinated loans have the characteristics of equity in being subordinated to other liabilities of the Bank. In the calculation of equity ratio, these bonds are included in equity, as shown in note 56.

Borrowings and subordinated loans are initially recognised at fair value less attributable transaction costs. Subsequently, they are measured at amortised cost using the effective interest method. Accrued interest is included in their carrying amount.

22. **Trading liabilities**

Trading liabilities consist of derivatives with negative fair values, as shown in note 57.

23. **Other assets and other liabilities**

Other assets and other liabilities are measured at cost.

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24. Equity

a) *Share capital*

The consideration paid to shareholders for the acquisition of own shares are deducted from equity, including transaction costs.

b) *Reserves*

The value of paid-in capital which exceeds nominal value is recognised in reserves. In accordance with the Financial Statement Act, part of profit for previous years has been transferred to statutory reserve.

c) *Dividends*

Dividends on shares are recognised as a decrease in equity in the period in which they are approved by the Bank's shareholders.

25. New standards and interpretations not yet adopted

At the date of approval of these financial statements, the European Union has adopted the following IFRS and amendments to IFRS which are effective for annual periods beginning after 31 December 2006. The Bank did not apply these IFRS and amendments to IFRS in its financial statements for the year 2006 even though their earlier application is allowed:

- IFRS 7 (Financial Instruments: Disclosures, effective from 1 January 2007)
- Amendments to IAS 1 (Capital Disclosures, effective from 1 January 2007)

26. Critical accounting estimates and judgements in applying accounting policies

a) Impairment losses on loans and advances

The Bank reviews its loan portfolios to assess impairment at least on a three months basis. In determining whether an impairment loss should be recorded in the income statement, the Bank makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there have been changes in the payment status of borrowers in a group or economic conditions. Management uses estimates based on historical loss experience for assets with similar credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

b) Fair value of financial instruments

The fair value of financial instruments that are not quoted in active markets are determined by using valuation techniques which are reviewed regularly by qualified independent personnel. All models that are used must be approved and calibrated to ensure that outputs reflect actual data.

Notes to the Income Statement

Net interest income

27. Interest income and expense are specified as follows:

2006	Interest income	Interest expense	Net interest income
Cash and deposits from credit institutions and the Central Bank	2,302,175	2,502,433	(200,258)
Loans and deposits	2,110,480	225,764	1,884,716
Borrowings		1,028,807	(1,028,807)
Subordinated loans	4,901	180,805	(175,904)
Trading assets and liabilities	817,066	43,004	774,062
	5,234,622	3,980,813	1,253,809

2005	Interest income	Interest expense	Net interest income
Cash and deposits from credit institutions and the Central Bank	1,659,196	1,349,120	310,076
Loans and deposits	1,179,520	170,443	1,009,077
Borrowings		747,763	(747,763)
Subordinated loans	3,712	128,845	(125,133)
Trading assets and liabilities	502,042	125,013	377,029
	3,344,470	2,521,184	823,286

Net fee and commission income

28. Fee and commission income and expense are specified as follows:

	2006	2005
Securities commission	27,138	3,237
Payment service commission	14,321	10,399
Other commission income	168,038	181,806
Total fee and commission income	209,497	195,442
Securities commission	5,655	0
Other commission expense	67,706	76,595
Total fee and commission expense	73,361	76,595
Net fee and commission income	136,136	118,847

Dividend income

29. Dividend income is specified as follows:

Dividend income on trading assets	300,294	0
Dividend income on financial assets designated at fair value	2,494	1,346
Total dividend income	302,788	1,346

Net (loss) gain on trading assets and liabilities

30. Net (loss) gain on trading assets and liabilities is specified as follows:

Bonds and related derivatives	(391,925)	1,272,072
Net (loss) gain on trading assets and liabilities	(391,925)	1,272,072

Icebank hf. Financial Statements 2006 16 Amounts are in ISK thousands

Net gain on financial assets designated at fair value

31. Net gain on financial assets designated at fair value is specified as follows:

	2006	2005
Shares	6,230,058	1,402,671
Net gain on financial assets designated at fair value	6,230,058	1,402,671

Other operating revenue

32. Other operating revenue is specified as follows:

Gain on disposals of assets	30,458	0
Other operating revenue	43,726	28,330
Other operating revenue	74,184	28,330

Personnel

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

Average number of full time equivalent positions during the year	67	56
Full time equivalent positions at year-end	71	58

34. Salaries and related expenses are specified as follows:

Salaries	471,772	296,702
Salary related expenses	103,462	76,598
Salaries and related expenses	575,234	373,300

Employment terms of executive officers

Managing Director:		
Finnur Sveinbjörnsson	54,261	22,135
Board of Directors:		
Geirmundur Kristinsson, Chairman	1,755	1,725
Friðrik Friðriksson	878	863
Guðmundur Hauksson	878	863
Magnús Ægir Magnússon	878	863
Ragnar Zophonías Guðjónsson	878	863
Managing Directors (4) (3 in the year 2005)	75,332	28,670

Auditor's fee

35. Auditor's fee is specified as follows:

Audit of the Financial Statements	4,391	3,480
Review of the Interim Financial Statements	2,992	1,434
Other service	3,287	1,634
Auditor's fee	10,670	6,548

Amounts are in ISK thousands

Notes, contd.:

Income tax expense

36. Income tax expense recognised in the income statement is specified as follows:

	2006	2005
Current tax	87,560	
Deferred tax	1,090,397	542,236
Total income tax expense	1,177,957	542,236

Reconciliation of effective tax rate:		2006		2005
Profit before income tax		6,839,582		2,922,810
18% income tax calculated on the profit for the year	18.0%	1,231,125	18.0%	535,430
Dividends received, exempt from tax	(0.8%)	(54,502)	(0.4%)	(10,350)
Other changes	0.0%	1,334	0.6%	17,156
	17.2%	1,177,957	18.6%	542,236

Earnings per share

37. Earnings per share are specified as follows:

	2006	2005
Net earnings	5,661,625	2,380,574
Equity according to Financial Statements at the beginning of the period	609,944	604,465
Effects of increase/sale of share during the period	55,347	3,653
Weighted average of outstanding shares for the period	665,291	608,118
Basic and diluted earnings per share	8.5	3.9

Earnings per share

Earnings per share are calculated by dividing the net earnings attributable to equity holders of the Bank by the weighted average number of ordinary shares outstanding during the period.

Notes to the Balance Sheet

Cash and balances with the Central Bank

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

	2006	2005
Cash and balances	5,515,484	8,243,447
Cash equivalents	1,777,037	2,143,510
Cash and balances with the Central Bank	7,292,521	10,386,957

Loans and advances

39. Loans and advances are specified as follows:

Loans to credit institutions	30,270,492	24,600,890
Loans to customers	31,658,748	21,455,633
Provision for impairment	(408,816)	(501,039)
Loans and advances	61,520,424	45,555,484

Icebank hf. Financial Statements 2006 18 Amounts are in ISK thousands

Notes, contd.:

Loans to credit institutions

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

	2006	2005
Bank accounts	178,293	313,725
Money market loans	8,639,411	1,457,652
Repurchase agreements	13,425	900,734
Other loans	21,439,363	21,928,779
Loans to credit institutions	30,270,492	24,600,890

41. Loans to credit institutions specified by maturity:

Up to 3 months	9,267,655	7,487,914
Over 3 months and up to a year	9,470,845	6,384,256
Over 1 year and up to 5 years	8,070,267	7,686,475
Over 5 years	3,461,725	3,042,245
Loans to credit institutions	30,270,492	24,600,890

Loans to customers

42. Loans to customers specified by types of loans:

Overdrafts	2,424,290	170,417
Bills of exchange	0	880,738
Bonds and loan agreements	12,243,724	2,608,475
Other loans	16,581,918	17,294,964
Loans to customers	31,249,932	20,954,594

43. Loans to customers specified by sectors:

Municipalities	0.1%	0.3%
Business enterprises:		
Agriculture and Fishing	6.4%	9.8%
Industry	21.1%	15.4%
Commerce	8.4%	5.0%
Service	48.0%	43.9%
Other	16.0%	25.6%
Loans to customers	100.0%	100.0%

44. Loans to customers specified by maturity:

On demand	76,746	40,732
Up to 3 months	7,097,036	5,591,884
Over 3 months and up to a year	2,861,849	2,653,083
Over 1 year and up to 5 years	16,170,604	8,933,092
Over 5 years	5,043,697	3,735,803
Loans to customers	31,249,932	20,954,594

Icebank hf. Financial Statements 2006 19 Amounts are in ISK thousands

Provision for impairment of loans and advances

45. Changes in the provision for impairment of loans and advances are specified as follows:	2006	2005
Balance at the beginning of the year	501,039	514,669
Impairment for the year	(15,096)	141,578
Write-offs	(77,422)	(168,770)
Recoveries of loans previously written off	295	13,562
Provision for impairment of loans and advances	408,816	501,039

Included within interest income is ISK 9 million with respect of interest income accrued on impaired financial assets and ISK 1 million with respect to the unwind of the impairment provision discount.

Trading assets

46. Trading assets are specified as follows:	2006	2005
Market securities and other bonds with fixed income	4,904,111	3,650,136
Shares and other securities with variable income	1,165,553	1,335,919
Derivatives	2,800,025	137,495
Trading assets	8,869,689	5,123,550

Derivatives

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

2006	Principal					
	Up to 3 months	Over 3 months and up to a year	Over 1 year	Total	Assets	Liabilities
OTC currency and interest rate derivatives:						
Forward currency agreements	50,189,052	2,936,471		53,125,523	595,937	538,255
Interest rate agreements	8,000,000	4,000,000	5,186,660	17,186,660	106,786	98,946
	58,189,052	6,936,471	5,186,660	70,312,183	702,723	637,201
OTC equity derivatives:						
Forward equity agreements	230,865	2,654,486		2,885,351	457,626	323,213
	230,865	2,654,486	0	2,885,351	457,626	323,213
Total	58,419,917	9,590,957	5,186,660	73,197,534	1,160,349	960,414

2005						
OTC currency and interest rate derivatives:						
Forward currency agreements	18,929,069	1,382,766		20,311,835	147,718	137,560
Interest rate agreements	0	2,128,779		2,128,779	1,238	33,465
	18,929,069	3,511,545	0	22,440,614	148,956	171,025
OTC equity derivatives:						
Forward equity agreements	6,914	122,823	0	129,737	4,875	151
	6,914	122,823	0	129,737	4,875	151
Total	18,935,983	3,634,368	0	22,570,351	153,831	171,176

Amounts are in ISK thousands

Financial assets designated at fair value

48. Financial assets designated at fair value are specified as follows:

	2006	2005
Securities	261,528	176,806
Shares	8,525,423	4,024,349
Financial assets designated at fair value	8,786,951	4,201,155

Investments in associates

49. Investments in associates are specified as follows:

	2006	2005
Carrying amount at the beginning of the year	24,619	24,750
Sales of share in associates	(670)	
Share of results	(5,904)	(131)
Carrying amount at the end of the year	18,045	24,619

Main associates are specified as follows:	Owner-ship	Profit share	Nominal value	Book value
Reiknistofa bankanna, Reykjavík	0.6%	0	9,451	9,451
Tölvumiðstöð sparisjóðanna, Kópavogi	5.3%	(5,904)	17,486	8,594
		(5,904)		18,045

Property and equipment

50. Property and equipment are specified as follows:

	Property	Machinery and equipm.	Total 2006	Total 2005
Balance 1 January	414,254	12,498	426,752	700,329
Additions during the period	20,380	4,828	25,208	0
Disposals during the period	0	0	0	(273,577)
Gross carrying amount at the end of the period	434,634	17,326	451,960	426,752
Previously depreciated	90,504	6,254	96,758	312,942
Depreciated during the period	8,988	3,378	12,366	46,758
Disposals during the year	0	0	0	(262,942)
Total depreciation at the end of the period	99,492	9,632	109,124	96,758
Carrying amount at the end of the period	335,142	7,694	342,836	329,994
Depreciation ratios	2-4%	20-25%		

Other assets

51. Other assets are specified as follows:

	2006	2005
Sundry assets	68,675	42,504
Prepaid expenses and accrued income	26,118	2,511
Other assets	94,793	45,015

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Deposits from credit institutions and the Central Bank

52. Deposits from credit institutions and the Central Bank mature as follows:

Up to 3 months	12,705,456	13,675,151

Other deposits

53. Other deposits mature as follows:

Up to 3 months	4,122,008	4,165,338
Over 1 year and up to 5 years	8,828	0
Other deposits	4,130,836	4,165,338

Borrowings

54. Borrowings are specified as follows:

Bonds issued	4,999,757	5,116,307
Bills issued	1,045,475	2,933,260
Loans from credit institutions	47,212,728	31,778,298
Borrowings	53,257,960	39,827,865

55. Borrowings mature as follows:

Up to 3 months	12,667,291	15,275,605
Over 3 months and up to a year	3,399,093	5,518,475
Over 1 year and up to 5 years	32,191,819	14,421,780
Over 5 years	4,999,757	4,612,005
Borrowings	53,257,960	39,827,865

Subordinated loans

56. Subordinated loans are specified as follows:

				2006	2005
	Currency	Interest	Maturity date	Book value	Book value
Loans that qualify as Tier II capital:					
Issued in 2006	ISK	5.0%	2016	1,017,842	0
Issued in 2005	EUR	5.2%	2015	1,412,497	1,126,393
Subordinated loans				2,430,339	1,126,393

Trading liabilities

57. Trading liabilities are specified as follows:

Derivatives with credit institutions	6,965	17,345
Trading liabilities	6,965	17,345

Deferred income tax liability

58. Deferred income tax liability is specified as follows:

Deferred income tax liability at the end of previous year	915,825	354,045
Changes due to adoption of IFRS		19,544
Deferred income tax liabilities 1.1., IFRS	915,825	373,589
Calculated income tax for the year	1,177,957	542,236
Income tax for the year to be paid next year	(87,560)	0
Deferred income tax liability at the end of the year	2,006,222	915,825

Icebank hf. Financial Statements 2006 22 Amounts are in ISK thousands

59. Deferred incom tax liability is attributable to the following items:

	2006	2005
Shares in other companies	1,993,421	908,765
Property and equipment	12,801	12,216
Other assets and liabilities		0
Tax loss carryforward		(5,156)
Deferred income tax liability at the end of the year	2,006,222	915,825

Other liabilities

60. Other liabilities are specified as follows:

	2006	2005
Sundry liabilities	58,281	75,080
Unpaid expenses	224,349	94,340
Accrued expenses and deferred income	10,649	34,364
Other liabilities	293,279	203,784

Capital

61. According to the Bank's Articles of Association the share capital amounted to ISK 691 million. One vote is attached to each share of one ISK. During the year, the Bank's equity was increased by nominal value of ISK 81 million and market value of ISK 610 million. The Bank is authorized to issue a non-taxable stock dividend amounting to ISK 449 million, which means that share capital could be multiplied by a factor of 1.65.

62. Equity at the end of the period amounted to ISK 12,007 million. Equity ratio, calculated in accordance to Article 84 of the Act on Financial Undertakings, was 17.0%. According to law the ratio may not be lower than 8.0%.

The ratio is calculated as follows:

	2006		2005	
	Book value	Weighted value	Book value	Weighted value
Risk I:				
Assets recorded in the Accounts	86,925,259	56,628,605	65,609,999	32,829,418
Assets deducted from capital		(5,209,492)		(2,713,809)
Guarantees and other items not included in the Balance Sheet		2,876,259		2,587,202
		54,295,372		32,702,811
Capital:				
Tier I capital:				
Equity		12,006,642		5,688,518
Tier II capital:				
Subordinated loans		2,430,338		1,126,393
Investment in credit institutions		(5,209,492)		(2,713,809)
		9,227,488		4,101,102
Equity ratio		17.0%		12.5%
Thereof Tier I ratio		22.1%		17.4%

Off-balance sheet information

63. The bank has granted its customers guarantees. These items are specified as follows:

	2006	2005
Guarantees	4,502,023	3,773,557
Unused overdrafts	57,521	61,658

Icebank hf. Financial Statements 2006 23 Amounts are in ISK thousands

Notes, contd.:

Operating lease commitments

64. At 31 December 2006, the Bank was obligated under operating leases for cars and IT-equipment.

Pledged assets

65. Assets have been pledged as security in respect of the following liabilities:

Liabilities		
Repurchase agreements with the Central Bank	3,624,643	900,734
Assets		
Reverse repurchase agreements with credit institutions	13,425	898,123

Related parties

66. The Bank has a related party relationship with its associates, the Board of Directors, the Managing Directors of the Bank, close family members of individuals referred to herein, and entities with significant influence as the largest capital holders of the Bank, which are Sparisjódur vélstjóra (28.7%), SPRON (24.5%), and Sparisjódurinn in Keflavík (12.2%). This definition is based on IAS 24. Information regarding related parties are as follows:

	2006	2005
Loans to the managing director and management board members	0	0
Loans to members of the board and companies related to members of the board	0	0
Loans to associated companies	50,000	0

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

The Bank has entered into forward contracts with the CEO and the nominal value of the contracts amounts to ISK 95,430 thousand. At the end of the period the net balance of the contracts was negative to the amount of ISK 13,120 thousand.

Icelandic savings banks are among the Bank's main customers but their transactions are not included in the aforementioned amounts.

Events after the Balance Sheet date

67. There have been no material post Balance Sheet events which would require disclosure or adjustment to the Financial Statements for the year 2006. On 6th February 2006 the Board of Directors reviewed the Financial Statements and authorised them for publication.

Risk Management Disclosure

68. The Bank faces various types of risks related to its business as a financial institution, which arise from its day to day operations. Management devotes a significant portion of its time to the management of these risks. The mainstays of effective risk management are the identification of significant risk, the quantification of the Bank's risk exposure, actions to limit risk and the constant monitoring of risk. The most significant of these risks are discussed below. The most important types of financial risk to which the Bank is exposed are credit risk, liquidity risk and market risk. Market risk includes currency risk, interest rate risk and equity price risk.

Risk policy of Icebank

The assessment of risk, in particular the determination of its true price along with actions aimed at limiting the risk with sensible credit and investments in other assets, is one of the major tasks of banks and other financial institutions. Many risk factors can adversely affect the Bank. It is the policy of the Board of Directors that the various risks that the Bank faces in its business are to be constantly monitored and managed. For these purposes Icebank operates a centralised risk management department. In addition, Bank's internal auditor oversees the operations in order to ensure that its rules are implemented in accordance with resolutions made by the board of directors.

Icebank hf. Financial Statements 2006 24 Amounts are in ISK thousands

68. contd.:

The Bank's risk management aims at identifying all significant risk factors related to its operation, implementing risk monitoring methods, making regular risk assessments, maintaining control and regulations in order to keep the relevant risk factors within defined limits and thereby reach an acceptable equilibrium between the minimisation of risk on the one hand and maximisation of the Bank's income on the other hand.

The Bank's Board of Directors establishes rules on the Bank's risk management and is responsible for the enforcement of those rules towards the shareholders. The CEO of the Bank is responsible for the Bank's risk management towards the Board of Directors. He establishes further risk management rules, defines risk criterion when needed in accordance with provisions of these rules and, having received the Finance Committee's opinion, controls the enforcement of the rules.

Managing Directors of single divisions are responsible towards the CEO of the Bank for the risk management relevant to their division, including enforcement of these rules in addition to other risk management rules and limits, which might be established.

The Manager of Risk Management and Credit Control carries out the task of risk management by the authority of the CEO of the Bank, including identifying the significant risk factors, assessing and measuring thereby the Bank's overall risk, maintaining rules and effective control, controlling that single sectors of the Bank do not exceed risk criterion and making evaluation on how undesirable risk may be reduced. Risk Management remits to the Bank's Board of Directors, the CEO and the Finance Committee information relating to significant risk factors, including risk limits so that the Bank's management is at each time aware of all significant risks and can react to them if necessary.

The Bank's Finance Committee consists of the CEO, Managing Directors, the Manager of Risk Management and Credit Control and other employees in accordance with the CEO's decision. The Committee discusses in general the Bank's risk management, i.e. rules and limits on which risk management is based, risk management effectiveness and the Bank's standing in relation to risk limits. The Committee also discusses the Bank's financing and capital management.

The Bank's Committee on Security consists of the CEO of the Bank, Managing Director of Operations, Managing Director of Business Support, Manager of Risk Management and Credit Control and other employees in accordance with the CEO's decision. The Committee discusses in general the Bank's operating risk, such as the safety of IT systems, housing safety, transfer of valueables, work procedures and methods, training of employees, emergency procedures and insurance issues.

The process for risk management and risk control

a) Products containing credit risk

The Bank’s primary exposure to credit risk arises through its loans and advances. The amount of credit exposure in this regard is represented by the carrying amounts of the assets on the Balance Sheet. The Bank is exposed to credit risk on various other financial assets, including derivative instruments used for hedging and debt investments, the current credit exposure in respect of these instruments is equal to the carrying amount of these assets in the Balance Sheet. In addition, the Bank is exposed to off balance sheet credit risk through commitments to extend credit and guarantees issued.

Loan portfolio: The main assets of the Bank are its loans. To maintain and further improve the quality of the loan portfolio it is imperative to scrutinise all applications and weed out potential problem loans as early as possible, as well as constantly monitor the current loan portfolio. However, it is not the policy of the Bank to solely issue credit of very low risk but it is important that the price of issued credit reflects both risk and costs incurred. This means that a detailed assessment of individual customers, their financial position and the collateral is a prerequisite for granted credits.

Derivatives trading: Derivative financial instruments used by the Bank include swaps, forwards, options and other similar types of contracts whose value changes in response to changes in interest rates, foreign exchange rates, security prices or price indices. Limits on the net open derivative positions on these types of contracts are strictly controlled by the Bank. These limits are generally client specific and may refer specifically to different categories of contracts. Generally, collateral is required to cover potential losses on a contract. Acceptable collateral for margin accounts is in the front of very liquid assets, e.g. cash or traded stocks. In case the net negative position of the contract falls below a certain level a call for added collateral is made. If extra collateral is not supplied the contract is closed.

Commitments and guarantees: The Bank often commits itself to and ensures that funds are available to customers as required. The most common commitments to extend credit are in the form of limits on check accounts, credit cards and credit lines. Potential loss on these accounts is equal to the amount of the limits although they may only be partly used at any one time. In practice, the potential loss is less severe since many of these commitments can be recalled immediately by the Bank in case the clients do not meet credit standards. Guarantees carry the credit risk to the full amount similar as loans, since they represent irrevocable assurances that the Bank will make payments in the event that a customer cannot meet its obligations to third parties.

68. contd.:

b) Credit risk strategy

In recent years, the Bank has emphasised maintaining a healthy loan portfolio and improving the quality of loans. The Bank has in that regard increased its participation in foreign syndicated loans and thereby increased the ratio of syndicated loans in the Bank's loan portfolio.

c) Credit process and authority

According to general credit rules established by the Bank's Board of Directors, the CEO's general lending authority is limited to 15% of the Bank's regulatory capital but thereafter the Board of Directors handles each individual matter. However, the CEO has the authority to exceed the 15% lending authority limit in case of a loan to financial institutions that is preapproved by the Board of Directors. The CEO of the Bank has delegated to specific counterparties the lending authority. All credit issues are handled by the Credit Committee, either by means of discussion and decision (more significant matters) or for informative purposes (minor matters). The risk management rules established by the Board of Directors set forth requirements that limit the CEO's and other employees' lending authorities.

d) Credit risk monitoring

Credit risk is monitored within the department Risk Management and Credit Control. The department performs numerical analysis of the loan portfolio, e.g. estimates expected loss, concentrations within the loan portfolio and maps defaults in a systematic way. These findings are reported to management where possible risk concentrations toward counterparties, sectors etc. are highlighted. Risk Management and Credit Control focuses on distressed clients and in co-operation with the relevant profit center tries to minimise or prevent loss on behalf of the Bank by special monitoring of clients with deteriorating credit worthiness. The integrity of the credit process, i.e. in regard to data collection, limit compliance, application preparation, documentation and collateral registration and valuation is monitored centrally within the Bank.

Loan provisioning

An impairment on loans and advances is established if there is objective evidence that the Bank will be unable to collect all amounts due on a claim, i.e. a loan, commitment, guarantee etc., according to the original contractual terms or the equivalent value. An impairment is reported as a reduction of the carrying value of a claim on the balance sheet, whereas for an off-balance sheet item, such as a commitment, a provision for credit loss is reported in Other liabilities. Additions to the provisions for credit losses are made through impairment on loans. Provisions for credit losses are evaluated at a counterparty-specific level and collectively based on the following principles:

a) Counterparty-specific

A claim is considered impaired when there is an object evidence that it is probable that the Bank will not be able to collect all amounts due according to the original contractual terms or the equivalent value. Individual credit exposures are evaluated based upon the borrower's character, overall financial condition, resources and payment record; the prospects for support from any financially responsible guarantors; and, where applicable, the realisable value of any collateral.

The estimated recoverable amount is the present value, using the loan's original effective interest rate, of expected future cash flows, which may result from restructuring or liquidation. Impairment is measured and allowances for credit losses are established for the difference between the carrying amount and the estimated recoverable amount. Upon impairment, the accrual of interest income based on the original terms of the claim is discontinued, but the increase of the present value of impaired claims due to the passage of time is reported as interest income.

All impaired claims are reviewed and analysed at least every three months. Any subsequent changes to the amounts and timing of the expected future cash flows compared to the prior estimates will result in a change in the allowances for credit losses and be charged or credited through impairment on loans.

An impairment is reversed only when the credit quality has improved such that there is reasonable assurance of timely collection of principal and interest in accordance with the original contractual terms of the claim agreement.

A write-off is made when all or part of a claim is deemed uncollectible or forgiven. Write-offs are charged against previously established provisions for credit losses or directly to credit loss expense and reduce the principal amount of a claim. Recoveries in part or in full of amounts previously written off are credited to credit loss expense.

b) Collectively

All loans for which no impairment is identified on a counterparty-specific level are grouped into economically homogeneous portfolios to collectively assess whether impairment exists within a portfolio. Provision from collective assessment of impairment are recognised as credit loss expense and result in an offset to the loan position. As the provision cannot be allocated to individual loans, interest is accrued on all loans according to contractual terms.

Notes, contd.:

Monitoring and controlling liquidity risk

69. Liquidity risk is the risk of loss arising from the Bank's inability to meet its liabilities as they become due. The Bank monitors its liquidity through a maturity analysis of financial assets and liabilities in order to be able to serve and repay all maturing debts. The Bank must always have sufficient liquidity to meet both foreseeable as well as unexpected payment obligations. The Bank has in place a set of liquidity and funding policies that are intended to maintain flexibility.

Additionally, liquidity risk is monitored through a risk management report on liquidity ratio, which is filed with the Central Bank of Iceland every month. The liquidity ratio measures the ratio of the liquid asset base to liabilities. To determine the liquid asset base the Central Bank assigns weights to each asset class as a conservative measure of liquidity.

70. The breakdown by contractual maturity of financial assets and liabilities, at 31 December 2006.

	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Cash and Central Bank balances	7,292,521					7,292,521
Loans and advances	12,097,483	4,343,954	12,332,694	24,240,871	8,505,422	61,520,424
Trading financial assets	8,869,689					8,869,689
Financial assets measured at fair value	8,786,951					8,786,951
Total financial assets	37,046,644	4,343,954	12,332,694	24,240,871	8,505,422	86,469,585
Deposits from credit inst.	12,705,456					12,705,456
Other deposits	4,122,008			8,828		4,130,836
Borrowings and subordinated loans	10,949,990	1,717,301	3,399,093	32,191,819	7,430,096	55,688,299
Total financial liabilities	27,777,454	1,717,301	3,399,093	32,200,647	7,430,096	72,524,591
Financial assets - financial liabilities	9,269,190	2,626,653	8,933,601	(7,959,776)	1,075,326	13,944,994
Unused overdrafts	57,521					57,521

Monitoring and controlling market risk

71. The Bank's policy is to monitor its market risk closely and to make sure that limits set by the Finance Committe are not exceeded. Market risk is managed by exposure limits and with limits on risk measures, both monitored on a daily basis and reviewed weekly by the Finance Committee.

Derivatives

72. The Bank uses derivatives for trading purposes and to hedge its exposure to market price risk, foreign exchange and interest rate risk arising from operating, financing and investing activities.

Interest rate risk

73. The Bank's operations are subject to the risk of interest rate fluctuations to the extent that interest-earning assets (including investments) and interest-bearing liabilities mature or reprice at different times or in different amounts. In the case of floating rate assets and liabilities the Bank is also exposed to basis risk, which is the difference in repricing characteristics of the various floating rate indices, such as the savings rate and LIBOR-rates and different types of interest. Bank's Treasury division manages the balance between interest-earning assets and interest-bearing liabilities. It is the Bank's policiy to maintain the best balance between maturity on interest-earning assets and interest-bearing liabilities, fixed interest rate and floating interest rate. The Bank's Treasury division is authorized to expose the Bank to interest rate risk, within limits, which reflect the Bank's expectation.

74. The total amount of indexed assets of the Bank amounted to ISK 17,163 million, and the total amount of indexed liabilities amounted to ISK 13,042 million at year-end.

Price risk

75. Price risk is the risk of market price changes. The Bank's shareholding and bond holding are most sensitive to such changes. Price risk management is disassociated with exchange rate risk. Price risk is measured by means of exposure analysis and on 31 December, 2006 (99%, 10 days) amounted to ISK 1,015 million.

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Currency Risk

76. Currency risk is the risk of loss due to adverse movements in foreign exchange rates. Net exposures per currency are monitored centrally in the Bank. The Bank aims at limiting currency risk and monitors its exposure in relation to the Bank´s total capital.

As a general rule the Bank aims for equilibrium between assets and liabilities in foreign currencies. It may however be deviated from, provided that provisions of the Central Bank rules on foreign currency balance, are met. This implies that the open foreign currency balance of the Bank in single foreign currencies shall neither be positive nor negative by an amount corresponding to more than 20% of its capital according to a definition in those rules and according to the last disclosed financial statements. The Bank's total foreign currency balance shall neither be positive nor negative in excess of 30% of its regulatory capital according to the last disclosed financial statements.

If foreign currency balance exceeds the aforementioned limits, adjustment actions shall be taken. The balance must be within set limits within three business days.

77. Breakdown of assets and liabilities by currency:
The total amount of assets in foreign currencies in the Bank´s Financial Statements is ISK 96,564 million, and the total amount of liabilities is ISK 96,162 million respectively, at year-end. Included in these assets and liabilities are forward contracts and interest rate swaps.

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

78. As discussed in note 2 on accounting policies, this is the first time the Bank has prepared its financial statements in accordance with the International Financial Reporting Standards (IFRS) as adopted by the EU.

The accounts for the operating year 2006 will be prepared in accordance with the accounting policies discussed in the notes on accounting policies. This also applies to comparative figures for 2005 and the opening balance sheet of 1 January 2005, as changes become effective as of that date, which is referred to as the transition date.

Amounts in the opening Balance Sheet of 1 January 2005 have been changed in accordance with IFRS, but were previously presented in accordance with legislation on financial statements and Icelandic GAAP (Generally Accepted Accounting Principles). The following tables and notes show the effects the change from Icelandic GAAP (IS-GAAP) to IFRS has had on the financial position of the Bank, its financial results and cash flows. There are no significant changes to the cash flows summary according to IFRS compared with how it was previously under IS-GAAP.

Changes in capital from IS-GAAP to IFRS:		**Capital**
Capital according to IS-GAAP at 31 December 2005		5,688,518
Capital according to IFRS at 1 January 2006		5,735,073
Change in capital from IS-GAAP to IFRS		46,555
Adjustments at the beginning of the year 2005:		
Loans	IAS 39	100,000
Net fee and commission income	IAS 39	8,577
Recalculation of tax liability	IAS 12	(19,544)
Total transition to IFRS 1 January 2005		89,033
Adjustments in 2005:		
Net fee and commission income		(1,802)
Provision for losses		(50,000)
Recalculation of tax liabilities		9,324
Total adjustments in 2005		(42,478)
Changes from preivous GAAP to IFRS		46,555

The total effect on capital of the transition to IFRS is an increase of ISK 47 million. The following describes the effects of these new accounting policies on the Bank's Balance Sheet and Profit and Loss Account.

Origination fees

The main changes resulting from the introduction of the IFRS are as follows: origination fees will be accrued over the term of the loan instead of being recognised as income and interest expenses at the time of disbursement. As a result the Bank's interest income will decrease in the short term but the long term effects will be insignificant.

Impairment of loans and advances

In accordance with IAS 39 the Bank has performed the impairment of loans. As a result the Bank's equity increased by ISK 41 million, when income tax has been taken into consideration.

According to IAS 39 the Bank is obligated to review all loans to ascertain whether there is objective evidence of impairment that affects the size of expected cash flows from the loan. The loan will then be written down to the present value of expected future cash flows.

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Notes, contd.:

From IS-GAAP to IFRS

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

Income Statement for the year 2005, change from IS-GAAP to IFRS

		Change in valuation	Change in presentation		
According to IS-GAAP					**According to IFRS**
Net interest income......................................	823,286			823,286	Net interest income
Fees, commissions and other service charges	207,823	(12,381)			
Fees, commissions and other service charges, paid	(87,174)	10,579		118,847	Net fee and commission income
Dividends from shares and other holdings	1,215		131	1,346	Dividend income
Trading gains...	2,801,037		(1,528,965)	1,272,072	Net gain on trading assets and liabilities
			1,402,671	1,402,671	Net gain on financial assets designated at fair value
			126,294	126,294	Net foreign exchange difference
			(131)	(131)	Share of profit of associates
Other operating income...............................	28,330			28,330	Other operating revenue
Salaries and salary related expenses............	(373,300)			(373,300)	Salaries and related expenses
Other administrative expenses	(288,269)			(288,269)	Administrative expenses
and amortisation	(46,758)			(46,758)	Depreciation
Provision for losses.....................................	(91,578)	(50,000)		(141,578)	Impairment on loans and advances
Income tax...	(551,560)	9,324		(542,236)	Income tax expense
Net earnings according to IS-GAAP	2,423,052	(42,478)	0	2,380,574	**Profit according to IFRS**

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Balance Sheet, change from IS-GAAP to IFRS

IS-GAAP 31 December 2005		Change in valuation	Change in presentation		IFRS 1 January 2006
Cash and amounts due from credit institutions	34,987,847		(24,600,890)	10,386,957	Cash and balances with Central Bank
Loans	20,897,819	56,775	24,600,890	45,555,484	Loans and advances
Bonds, shares and other securities	9,324,705		(4,201,155)	5,123,550	Trading assets
-	0		4,201,155	4,201,155	Financial assets designated at fair value
Shares in associated companies........	24,619			24,619	Investments in associates
Property and equipment....................	329,994			329,994	Property and equipment
Other assets.......................................	45,015			45,015	Other assets
Total Assets	65,609,999	56,775	0	65,666,774	**Total Assets**
Amounts owed to credit institutions	13,675,151			13,675,151	Deposits from credit institutions and Central Bank
Savings deposits................................	4,165,338			4,165,338	Other deposits
Borrowings	39,845,210		(17,345)	39,827,865	Borrowings
Subordinated loans............................	1,126,393			1,126,393	Subordinated loans
-	0		17,345	17,345	Trading liabilities
Provision for deferred income-tax liability	905,605	10,220		915,825	Tax liabilities
Other liabilities.................................	203,784	0		203,784	Other liabilities
Equity..	5,688,518	46,555		5,735,073	Equity
Total Liabilities and Equity	65,609,999	56,775	0	65,666,774	**Total Liabilities and Equity**

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