Glitnir banki hf

Consolidated Financial Statements 2006

ISK

GLITNIR

Glitnir banki hf.
Kirkjusandur
155 Reykjavík

Reg. no. 550500-3530

Contents

Endorsement by the Board of Directors and the CEO

The profit from the Bank's operations for the year 2006 amounted to ISK 38,231 million, which corresponds to 39.4% return on equity. The Board of Directors proposes to pay a dividend of ISK 0.66 per share or ISK 9,415 million in the year 2007, and the remaining profit be allocated as indicated in the financial statements. Equity, according to the consolidated balance sheet, amounted to ISK 146,119 million at year end. The Bank's capital adequacy ratio, calculated according to the Act on Financial Undertakings, was 15.0%. Under Icelandic law the minimum requirement is 8.0%.

The Bank's total assets amounted to ISK 2,246,339 million at year end. Furthermore, the Bank held ISK 490,321 million under management for its clients.

Outstanding number of shares was 14,161 million at the year end and was increased by 1,130 million during the year. In January 2006 the Bank sold 1,000 million new shares at ISK 18.60 per share. Shareholders had the option to receive up to half of their dividend for the year 2005 in the form of shares at ISK 18.60 per share, resulting in an issue of 130 million new shares.

In March, the Bank changed its name from Íslandsbanki hf. to Glitnir banki hf. and at the same time adopted a new logo and appearance. The Bank's subsidiaries and offices in five countries also operate under the Glitnir brand since the adoption of the new name.

Late 2005 the Bank acquired all the shares in the Norwegian securities brokerage firm Norse Securities. The effective date of the transaction was 1 January 2006. Consequently, from that date Norse (now Glitnir Securities) is included in the consolidated financial statements of the Bank.

In the first quarter of the year, Glitnir Banki hf. acquired 50.1% share in the Norwegian brokerage firm Union group. Union group is consolidated in the financial statements from 1 January 2006.

At the end of March, the Bank increased its share in Kreditkort hf. (Mastercard) to 55%. In July formal approval from authorities was received and Kreditkort hf. is consolidated from 1 July 2006.

In May the Bank acquired all the shares in the Swedish brokerage firm Fischer Partners Fondkommission AB (Now Glitnir AB). The transaction was finalised on 4 July 2006 and the firm is consolidated from 1 July 2006.

At 31 December 2006 the Bank's shareholders numbered 11,323 as compared to 10,252 at the beginning of the year. Two shareholders owned more than 10.0% of the shares in the Bank. FL Group hf. and related parties owned 30.4% and Milestone ehf. and related parties owned 20.8%.

The Board of Directors and the CEO of Glitnir Banki hf. hereby confirm the Bank's consolidated financial statements for the year 2006 by means of their signatures.

Reykjavík, 29 January 2007.

Board of Directors:

Einar Sveinsson
Jón Sigurðsson
Jón Snorrason
Skarphéðinn Berg Steinarsson
Anna Sigurðardóttir
Guðmundur Ásgeirsson
Katrín Pétursdóttir

Chief Executive Officer:

Bjarni Ármannsson

Independent Auditors' Report

To the Shareholders and Board of Directors of Glitnir banki hf.

We have audited the consolidated accompanying financial statements of Glitnir banki hf and its subsidiaries (the Group) which comprise the consolidated balance sheet as of 31 December 2006 and the consolidated income statement, consolidated statement of changes in equity and consolidated cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory notes. Other auditors, whose unqualified report was dated 31 January 2006, audited the consolidated financial statements as of 31 December 2005.

Management's Responsibility for the Financial Statements
Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards as adopted by the European Union (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 misstatement, 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 consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we comply with 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 the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers 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 audit opinion.

Opinion
In our opinion, the accompanying consolidated financial statements give a true and fair view of the financial position of the Group as of 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 the EU.

Reykjavík, 29 January 2007.

PricewaterhouseCoopers hf.

Sigurður B. Arnþórsson

Kristinn F. Kristinsson

Consolidated Income Statement for the year 2006

	Notes	2006	2005
Interest income		119,115	61,526
Interest expenses		(82,031)	(39,175)
Net interest income	39	37,084	22,351
Net fee and commission income	40	26,459	8,773
Net gains on financial assets and financial liabilities held for trading	41	5,999	3,993
Net gains on financial assets designated at fair value through profit or loss	42	2,097	491
Realised gains on financial assets available-for-sale		0	181
Fair value adjustments in hedge accounting	9	(185)	(59)
Net foreign exchange gains (losses)	4	581	(179)
Net insurance premium		0	229
Dividend income		11	0
Other net operating income		555	631
Net operating income		72,601	36,411
Administrative expenses	43-47	(27,301)	(15,731)
Impairment losses	28,48	(4,759)	(2,205)
Share of profit of associates	3,61	1,470	1,262
Net gains on non-current assets classified as held for sale	49	4,244	3,323
Profit before income tax		46,255	23,060
Income tax	29,50	(8,024)	(4,174)
Net profit		38,231	18,886
Attributable to:			
Shareholders of Glitnir banki hf.		37,360	18,886
Minority interest		871	0
Net profit	31	38,231	18,886
Earnings per share	51	2.68	1.47
Diluted earnings per share	51	2.66	1.47

Amounts are in ISK millions

Consolidated Balance Sheet as at 31 December 2006

	Notes	31.12.2006	31.12.2005
Assets			
Cash and cash balances with central banks	26,52	20,417	20,861
Loans and receivables	37,53-56	1,760,368	1,174,428
Financial assets held for trading	11,34,57	227,251	151,897
Financial assets designated at fair value through profit or loss	12,58	200,864	96,438
Financial assets available-for-sale	13,59	3,746	3,611
Derivatives used for hedging	8,9,33	5,721	2,352
Investments in associates	3,60-61	4,379	8,081
Property and equipment	15,64	3,296	1,987
Intangible assets	16,65	18,310	10,824
Tax assets	73-75	264	268
Non-current assets held for sale	17	409	551
Other assets		1,314	647
Total Assets		2,246,339	1,471,945
Liabilities			
Deposits from credit institutions and central banks	66	78,576	30,656
Other deposits	67-68	438,272	304,136
Borrowings	69	1,377,787	937,794
Subordinated loans	70	108,998	47,464
Financial liabilities held for trading	21,71	51,729	28,791
Derivatives used for hedging	8,9,33	13,869	7,233
Post-employment obligations	72	529	418
Tax liabilities	73-75	10,647	5,086
Other liabilities	76	19,813	25,830
Total Liabilities		2,100,220	1,387,408
Equity			
Share capital	25,77,84	14,161	13,112
Share premium		51,847	32,888
Other reserves	78	6,733	(465)
Retained earnings		71,837	39,002
Total Shareholders' Equity		144,578	84,537
Minority interest		1,541	0
Total Equity	79	146,119	84,537
Total Equity and Liabilities		2,246,339	1,471,945

Amounts are in ISK millions

Consolidated Statement of Changes in Equity for the year 2006

	Share capital	Share premium	Other reserves	Retained earnings	Share-holders equity	Minority interest	Total equity
Equity at 1.1.2005	11,081	12,676	287	24,430	48,474		48,474
Translation differences			(1,357)		(1,357)		(1,357)
Net gains on hedges of net investments in foreign operations			915		915		915
Fair value changes of financial assets available-for-sale			(18)		(18)		(18)
Income tax on equity items			(195)		(195)		(195)
Net income recognised directly in equity	0	0	(655)	0	(655)		(655)
Profit for the year				18,886	18,886		18,886
Total recognised income and expense for the year	0	0	(655)	18,886	18,231		18,231
Dividends paid				(4,525)	(4,525)		(4,525)
Issued new shares	1,935	18,669			20,604		20,604
Purchased and sold own shares	96	1,543			1,639		1,639
Accrued stock options			52		52		52
Revaluation of associates				62	62		62
Transferred due to sale of subsidiary			(149)	149	0		0
Equity as at 31.12.2005	13,112	32,888	(465)	39,002	84,537		84,537
Translation differences			10,187		10,187	(6)	10,181
Net loss on hedges of net investments in foreign operations			(4,462)		(4,462)		(4,462)
Fair value changes of financial assets available-for-sale			70		70		70
Income tax on equity items			791		791		791
Net income recognised directly in equity	0	0	6,586	0	6,586	(6)	6,580
Profit for the year				37,360	37,360	871	38,231
Total recognised income and expense for the year	0	0	6,586	37,360	43,946	865	44,811
Dividends paid				(4,525)	(4,525)		(4,525)
Issued new shares	1,130	19,752			20,882		20,882
Change in minority interest						676	676
Purchased and sold own shares	(81)	(793)			(874)		(874)
Accrued stock options			612		612		612
Equity as at 31.12.2006	14,161	51,847	6,733	71,837	144,578	1,541	146,119

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Consolidated Statement of Cash Flows for the year 2006

	Notes	2006	2005
Cash flows from operating activities:			
Profit for the year		38,231	18,886
Adjustments to reconcile profit for the year to cash flow used in operating activities:			
Non-cash items included in net profit and other adjustments		29,423	(12,691)
Changes in operating assets and liabilities:			
Required reserves with central banks		(1,238)	(919)
Loans and receivables		(188,917)	(287,471)
Trading assets		(35,094)	(50,256)
Financial assets designated at fair value through profit or loss		9,968	(81,415)
Deposits		101,204	32,210
Borrowings		188,080	386,198
Trading financial liabilities		22,937	13,899
Derivatives used for hedging		3,266	2,999
Post-employment obligations		99	(1,889)
Other operating assets and liabilities		(20,089)	23,818
Net cash provided by operating activities		147,870	43,369
Cash flows from investing activities:			
Financial assets available-for-sale		0	414
Investments in associates		9,344	2,173
Investments in subsidiaries, net of cash acquired		(6,476)	(15,130)
Property and equipment		(875)	(1,042)
Net cash provided by (used in) from investing activities		1,993	(13,585)
Cash flows from financing activities:			
Subordinated loans		44,401	20,995
Issued new shares		20,882	20,604
Treasury stock		(873)	1,726
Dividends paid		(5,296)	(4,525)
Net cash provided by financing activities		59,114	38,800
Net increase in cash and cash equivalents		208,977	68,584
Translation difference on cash and cash equivalents		536	0
Cash and cash equivalents at the beginning of the year		95,135	26,551
Cash and cash equivalents at year-end		304,648	95,135
Reconciliation of cash and cash equivalents:			
Cash in hand	52	1,044	864
Cash balances with central banks	52	14,967	18,369
Treasury bills	52	1,954	414
Balances with credit institutions	53	32,027	32,063
Loans to credit institutions		144,983	43,425
Financial assets designated at fair value through profit and loss	58	109,673	0
		304,648	95,135

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Notes to the Consolidated Financial Statements

Accounting policies

General information

Glitnir hf. is a company incorporated and domiciled in Iceland. The consolidated financial statements for the year 2006 comprise Glitnir hf. (the parent) and its subsidiaries (together referred to as "the Bank"). A list with the Glitnir hf.'s subsidiaries is provided in note 62.

The consolidated financial statements are presented in Icelandic krona (ISK), rounded to the nearest million.

The consolidated financial statements have been authorized for issue by the board of directors of Glitnir hf. on 29 January 2007.

Summary of significant accounting policies

1. Statement of compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU. The accounting policies set out below have been applied consistently to all periods presented in the consolidated financial statements and to each of the Bank's entities.

2. Basis of preparation

The consolidated financial statements are prepared on the historical cost basis except that the following assets and liabilities are measured at fair value: financial assets and liabilties held for trading, financial assets designated at fair value through profit and loss, financial assets available-for-sale and derivatives used for hedging.

Non-current assets and disposal groups held for sale are measured at the lower of carrying amount and fair value less costs to sell, unless IFRS 5 requires that another measurement basis shall be used.

The preparation of the consolidated financial statements in conformity with IFRS requires management to make judgements and to use accounting estimates and assumptions that affect the amounts recognised in the consolidated financial statements. The accounting estimates and underlying assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates.

The accounting 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.

The application of the amendments and interpretations listed below did not result in substantial changes to the Bank’s accounting policies:

IAS 19 Amendment – Actuarial Gains and Losses, Group Plans and Disclosures;
IAS 21 Amendment – Net Investment in a Foreign Operation;
IAS 39 Amendment – Cash Flow Hedge Accounting of Forecast Intragroup Transactions;
IAS 39 Amendment – The Fair Value Option;
IAS 39 and IFRS 4 Amendment – Financial Guarantee Contracts;
IFRIC 4, Determining whether an Arrangement contains a Lease;
IFRIC 5, Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds.

Where applicable, comparative amounts in the income statement have been transferred between items to reflect changes in the presentation for this period. This does not affect the net operating income for these periods.

The critical judgements made by management in the application of IFRS and the key assumptions and sources of estimation uncertainty are as follows:

a) *Determination of fair value*

As disclosed in note 5, the Bank determines the fair value of financial assets and financial liabilities that are not quoted in active markets by using valuation techniques. These valuation techniques are validated and periodically reviewed by qualified personnel. All models are calibrated to ensure that outputs reflect actual data and comparative market prices. To the extent practical, models use only observable data, however areas such as credit risk (both own and counterparty), volatilities and correlations require management to make estimates.

b) *Impairment losses on loans and receivables*

As disclosed in note 28, the Bank recognises losses for impaired loans and receivables. For this purpose the Bank's management reviews its loan portfolios to assess impairment on a semi-annually basis. In determining whether an impairment loss should be recognised in the income statement, the Bank's management makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from loans and receivables. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group.

The Bank's management uses estimates based on historical loss experience for loans and receivables 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.

3. Basis of consolidation

a) *Subsidiaries*

Subsidiaries are entities controlled by the Bank. Control exists when the Bank has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Control usually exists when the Bank holds more then the 50% of the voting power of the subsidiaries. In assessing control, potential voting rights that presently are exercisable or convertible, if any, are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

The purchase method of accounting is used to account for the acquisition of subsidiaries by the Bank. The cost of an acquisition is measured as the fair values, at the date of exchange, of the assets given, liabilities incurred or assumed, and equity instruments issued, plus cost directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Bank's share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised immediately as income in the income statement.

b) *Associates*

Associates are those entities for which the Bank has significant influence, which is the power to participate in the financial and operating policy decisions of the associates but is not control or joint 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.

Initially, investments in associates are recognised at cost. Subsequently, their carrying amount is adjusted for post-acquisition changes in the Bank's share in the net assets of the associates and for impairment losses, if any. Therefore, the consolidated financial statements include the Bank's share of the total recognised gains and losses of associates, from the date that significant influence commences until the date that significant influence ceases. When the Bank's share of losses exceeds its interest in an associate, the Bank's carrying amount is reduced to nil 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 an 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.

If an investment in an associate is classified as held for sale the equity method is no longer applied and the investment is accounted for under IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations,* see note 17.

Investments in associates held by the venture capital organisation of the Bank are not accounted on an equity basis but instead they are designated upon initial recognition as financial assets at fair value through profit or loss and accounted for in accordance with IAS 39 *Financial Instruments: Recognition and Measurement,* see note 12.

c) *Transactions eliminated on consolidation*
Intrabank balances, and any unrealised gains and losses or income and expenses arising from intrabank transactions, are eliminated in preparing the consolidated financial statements. Unrealised gains arising from transactions with associates are eliminated to the extent of the Bank's interest in the associates. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

4. Foreign currencies

a) *Functional currencies*
Items included in the financial statements of each of the Bank's entities are measured using the functional currency of the respective entity.

b) *Foreign currency translations*
Transactions in foreign currencies are translated into functional currencies at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated into functional currencies at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the income statement in a separate line. 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 stated at fair value are translated at foreign exchange rates ruling at the dates the fair value was determined.

c) *Financial statements of foreign operations*
The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on consolidation, are translated to the presentation currency, Icelandic krona, at foreign exchange rates ruling at the balance sheet date. The revenues and expenses of foreign operations are translated to Icelandic kronas at rates approximating the foreign exchange rates ruling at the dates of the transactions. Foreign exchange differences arising on translation are recognised directly in a separate component of equity.

5. Determination of fair value of financial assets and financial liabilities

The determination of fair value of financial assets and financial liabilities that are quoted in an active market is based on quoted prices. 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. For all other financial instruments fair value is determined by using valuation techniques.

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.

For more complex financial instruments, the Bank uses proprietary models, which usually are developed from recognised valuation models. Some or all of the inputs into these models may not be market observable, and are derived from market prices or rates or estimated based on assumptions. The value produced by a model or other valuation technique is adjusted to allow for a number of factors as appropriate, because valuations techniques cannot appropriately reflect all factors market participants take into account when entering into a transaction. Valuation adjustments are recorded to allow for model risks, bid-ask spreads, liquidity risks, as well as other factors. Management believes that these valuation adjustments are necessary and appropriate to fairly state financial instruments carried at fair value on the balance sheet.

The best evidence of the fair value of a financial instrument at initial recognition is the transaction price (i.e. the fair value of the consideration given or received) unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument (i.e. without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets. When such evidence exists, the Bank recognises profits or losses on initial recognition.

6. 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, which are recognised when cash is advanced to the borrowers. For a financial asset purchased, the Bank recognises on the trade date a financial asset to be received and a financial liability to pay. For a financial asset sold, the Bank derecognises the asset on the trade date, it recognises any gains or losses on disposal and it recognises a receivable from the buyer.

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 specified in the contract is discharged or cancelled or expires.

7. 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, or realise the asset and settle the liability simultaneously.

8. 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 variables (such as share, commodity or bond prices, an index value or an exchange or interest rate), which requires no initial net investment or an 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 exposure to market price risk, currency risk and interest rate risk arising from operating, financing and investing activities. Derivatives which are not own equity instruments of the Bank and which are designated and are effective hedging instruments in accordance with IAS 39, are presented as *Derivatives used for hedging* in the balance Sheet. Other derivatives, except for derivatives that are own equity instruments of the Bank, are classified as *Financial assets held for trading* or *Financial liabilities held for trading*, depending on whether their fair value at the balance sheet date is positive (assets) or negative (liabilities), see note 34.

Derivatives which are not own equity instruments of the Bank are measured at fair value both on initial recognition and subsequently. Their fair value changes are recognised in the income statement, except in the case of derivatives that are designated and are effective hedging instruments, whose fair value changes are recognised in accordance with the accounting policies in note 9.

Fair value changes of derivatives are split into interest income or expense, foreign exchange gains or losses and gains or losses on trading and presented in the corresponding line items in the income statement. Interest income and expense is recognised on a accrual basis. Fair value changes of derivatives that are economically linked to financial assets which are designated at fair value through profit or loss in order to avoid an accounting measurement or recognition inconsistency (see Note 12), are presented in the income statement as an offset to the changes in fair value of these financial assets and included in the line item *Net gains on financial assets designated at fair value through profit or loss* .

Derivatives embedded in host contracts are treated as separate derivatives when their economic characteristics and risks are not closely related to those of the host contracts and the host contracts are not carried at fair value through profit and loss. These embedded derivatives are measured and presented in the consolidated financial statements as if they were free-standing derivatives.

The fair value of derivatives is determined in accordance with the accounting policy presented in note 5.

9. Hedge accounting

As presented in the risk management section of the notes to the consolidated financial statements, there are various financial risks that arise from the Bank's activities, such as interest rate risk, credit risk, currency risk and equity risk. In order to manage the Bank's exposure to these risks, the Bank uses various hedging instruments, such as interest rate and currency swaps, options, futures and forward contracts. In accordance with the Bank's risk management objectives and strategies, the Bank enters into hedging transactions to ensure that it is economically hedged. When deemed necessary and subject to hedging relationships meeting the requirements in IAS 39, the Bank uses hedge accounting in order to recognise the offsetting effects on profit or loss of changes in the fair value of the hedging instruments and the hedged items.

Where hedge accounting is applied the Bank assesses, both at the inception of the hedge and each time the Bank prepares its annual or interim financial statements, whether the hedging instruments are highly effective in offsetting the changes in value or cash flows associated with the hedged items. A hedge is normally regarded as highly effective if the changes in fair value or cash flows of the hedged item are expected to almost fully offset the changes in fair value or cash flows of the hedging instrument. Actual effectiveness results must be within a range of 80 to 125 percent on a cumulative basis. The designation and effectiveness measurement follows the methodologies that management has in place for risk identification and measurement. The ineffective portion of any gain or loss on a hedging instrument is recognised in the income statement.

The Bank applies hedge accounting for hedges of the exposure to changes in the fair value of recognised financial assets and liabilities and for hedges of currency risk arising from net investments in foreign subsidiaries and associates.

a) Fair value hedges

Fair value hedges seek to eliminate risks of changes in the fair value of recognised financial assets or financial liabilities that will give rise to a gain or loss that will be recognised in the income statement.

When a derivative financial instrument hedges the changes in fair value of recognised financial assets or financial liabilities or an identified portion of such assets or liabilities, any gain or loss on the hedging instrument is recognised in the income statement. The changes in fair value of hedged items that are attributable to the hedged risks are also recognised in the income statement. The gains and losses on the hedging instruments and hedged items are presented as *Fair value adjustments in hedge accounting* in the income statement.

b) Hedges of net investments in foreign operations

Hedges of net investments in foreign operations seek to eliminate the exposure to currency risks arising from net investments in foreign subsidiaries and associates.

The exchange differences arising from the translation of net investments in foreign subsidiaries and associates into the presentation currency are recognised directly in the *Translations reserve* in equity. The effective portion of the gain or loss on hedging insturments are also recognised directly in the *Translations reserve* in equity, net of related income tax. These gains and losses are tranferred from the *Translations reserve* and recognised in the income statement upon disposal of the net investments in foreign subsidiaries and associates. The ineffective portion of the gain or loss on hedging insturments is recognised immediately in the income statement.

10. Loans and receivables

Loans and receivables are non-derivative financial instruments with fixed or determinable payments that are not quoted in an active market, other than those that the Bank upon initial recognition designates as at fair value through profit or loss. Loans and receivables 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 for which the Bank has no intention to resell immediately or in the near future.

Loans and receivables are recognised when cash is advanced to borrowers. They are measured at fair value on initial recognition, which is the cash given to originate the loan, including any transaction costs, and subsequently are measured at amortised cost using the effective interest method. Accrued interest is included in the carrying amount of the loans and receivables.

11. Financial assets held for trading

Financial assets held for trading are financial assets acquired principally for the purpose of generating profits from short-term price fluctuations or from dealer’s margin.

Financial assets held for trading consist of bonds, shares and derivatives with positive fair value that are not designated as hedging instrument or are not effective hedging instruments.

12. Financial assets designated at fair value through profit or loss

The Bank classifies certain financial assets upon their initial recognition as financial assets at fair value with fair value changes recognised in profit or loss when doing so results in more relevant information because:
- it eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases; or
- financial assets and/or financial liabilities are managed and their performance is evaluated on a fair value basis, in accordance with the Bank's risk management or investment strategy, and information about it is provided internally on that basis to the Bank's key management personnel.

The assets classified according to the above-mentioned conditions consist of:
- fixed interest rate loans originated by the Bank whose fixed interest has been swapped into floating by entering into corresponding interest rate swaps, and
- equity and debt instruments which are acquired by the Bank with a view to profiting from their total return and which are managed and evaluated on a fair value basis.

Financial assets designated at fair value through profit or loss are measured at fair value and changes in their fair value are recognised in the income statement as *Net gains on financial assets designated at fair value through profit or loss as well as dividends received*. Interest income that arises from these assets is included in *Interest income* in the income statement. Interest income on debt instruments is calculated using the effective interest method.

13. Financial assets available-for-sale

Financial assets available-for-sale consist primarily of debt instruments held for long-term investment purposes.

Financial assets available-for-sale are measured at fair value. Unrealised gains or losses on these assets are recognised in equity, net of income taxes, until they are disposed of or until they are determined to be impaired. On disposal of a financial asset available-for-sale, the accumulated unrealised gain or loss recognised in equity is transferred to the income statement and presented as *Realised gains on financial assets available-for-sale* . Gains and losses on disposals are determined using the average cost method.

Interest and dividend income on financial assets available-for-sale are included in *Interest income* and *Dividend income* line items in the income statement. Exchange differences arising on equity instruments are recognised in equity while exchange differences arising on debt instruments are recognised in the income statement and included within *Net foreign exchange (losses) gains* .

14. Leases

The Bank classifies leases based on the extent of the transfer of risks and rewards incidental to ownership of leased assets. A lease is classified as a finance lease if the lessor transfers substantially all the risks and rewards incidental to ownership. A lease is classified as operating lease if the lessor does not transfer substantially all the risks and rewards incidental to ownership.

a) *Finance leases*
The Bank's receivables from leases classified as finance leases are included in the balance sheet in the line item *Loans and receivables* . Finance leases are initially recognised at an amount equal to the net investment in the lease and subsequent lease payments are applied against the gross investment in the lease to reduce both the principal and the unearned finance income.

The Bank recognises its finance income as interest income based on a pattern reflecting a constant periodic rate of return on the Bank's net investment in the finance lease. The interest rate implicit in the lease is defined in such a way that the initial direct costs are included automatically in the finance lease receivable and therefore the initial direct costs are recognised over the lease term.

b) *Operating leases*
Lease payments under operating leases where the Bank is the lessee are recognised as an expense on a straight-line basis over the lease term.

15. Property and equipment

a) *Owned assets*
Items of property and equipment are measured at cost less accumulated depreciation and impairment losses, according to the cost model in IAS 16.

Where parts of an item of property and equipment have different useful lives, those components are accounted for as separate items of property and equipment.

b) *Subsequent costs*
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. The decision if subsequent costs is added to the acquisition cost of the property or equipment, is based on whether an identified component, or part of such component, has been replaced or not, or if the nature of the subsequent cost means a contribution of a new component. All other costs are recognised in the income statement as an expense as incurred.

c) *Depreciation*

The depreciable amount of property and equipment is determined after deducting its residual value. Depreciation is charged to the income statement on a straight-line basis over the estimated useful lives of each part of an item of property and equipment. The estimated useful lives are as follows:

Buildings	50 years
Fixtures	6 - 12 years
Machinery and equipment	4 years
Vehicles	3 years

The residual value is reassessed annually.

16. Intangible assets

a) *Goodwill*

Goodwill has been recognised as an asset in relation to the acquisition of subsidiaries. Goodwill relating to acquisition of associates is not recognised separately as an asset but is included in the carrying amount of the investments in associates.

All business combinations after 1 January 2004 are accounted for by applying the purchase method. In this respect, goodwill represents the difference between the cost of the acquisition and the fair value of the net identifiable assets acquired.

Goodwill is measured at cost less any accumulated impairment losses. Goodwill is allocated to cash-generating units and is tested annually for impairment, at each balance sheet date.

b) *Other intangible assets*

Intangible assets other than goodwill that are acquired by the Bank are measured at cost less accumulated amortisation and impairment losses.
Expenditure on internally generated goodwill and brands is recognised in the income statement as an expense as incurred.

c) *Subsequent expenditure*

Subsequent expenditure on capitalised intangible assets is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred.

d) *Amortisation*

Amortisation is charged to the income statement on a straight-line basis over the estimated useful lives of intangible assets. Goodwill with an indefinite useful life is systematically tested for impairment. Other intangible assets are amortised from the date they are available for use. The Bank's amortisable intangible assets consist of software, whose estimated useful live is 4 years.

17. Non-current assets and disposal groups held for sale

Immediately before classification as held for sale, the measurement of all assets and liabilities in a disposal group is measured in accordance with applicable IFRS.

On initial classification as held for sale, non-current assets and disposal groups are recognised at the lower of carrying amount and fair value less costs to sell. Impairment losses on initial classification as held for sale are included in the income statement, even when there is a revaluation. The same applies to gains and losses on subsequent remeasurement.

Non-current assets and disposal groups held for sale are mainly mortgages foreclosed.

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18. Repurchase agreements

A repurchase agreement involves the sale of securities owned by the Bank subject to simultaneous agreement to repurchase the same securities at a certain later date and at an agreed price. The control of the securities remains with the Bank throughout the entire term of the agreement and therefore the securities continue to be reported as assets in the Bank’s balance sheet. The cash received by the Bank from the legal sale of these securities is recognised as financial liability and included in the *Deposits from credit institution and Central Bank* line item in the balance sheet. Interest incurred on repurchase agreements is recognised as interest expense over the life of each agreement.

19. Borrowings

Borrowings are financial liabilities of the Bank which consist of issued bonds, loans from credit institutions and other loans. They are measured at fair value less attributable transaction costs when they are recognised initially. Subsequently, they are measured at amortised cost using the effective interest method. Accrued interest is included in the carrying amount of the borrowings.

20. Subordinated loans

Subordinated loans are financial liabilities of the Bank which consist of liabilities in the form of subordinated loan capital which, in case of the Bank's voluntary or compulsory winding-up, will not be repaid until after the claims of ordinary creditors have been meet. In the calculation of the capital ratio, the bonds are included within Tier I and Tier II, as shown in Note 70. On the one hand, there are subordinated loans with no maturity date that the Bank may retire only with the permission of the Financial Supervisory Authority. These loans qualify as Tier I capital in the calculation of the equity ratio. On the other hand, there are subordinated loans with various dates of maturity.

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

21. Financial liabilities held for trading

Trading liabilities consist of derivatives with negative fair values and short positions in securities.

22. Post-employment obligations

The liability recognised in the balance sheet in respect of defined benefit pension obligation is the present value of the obligation at the balance sheet date less the fair value of plan assets. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of government bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension liability. The discount rate used for the pension liability is 2.0%.

23. Stock option contracts

The Bank has entered into stock option contracts with its employees which enable them to acquire shares in the Bank at an exercise price corresponding to the market value of the shares at grant date.

The fair value of the options granted is measured at the grant date and is recognised as a salary expense during the vesting period, with a corresponding increase in equity, taking into account the estimated number of equity instruments expected to vest. The fair value of the stock options is estimated by using the Black-Scholes valuation method.

24. Provisions

A provision is recognised in the balance sheet when the Bank has a present legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

25. Share Capital

a) *Treasury shares*
Acquired own shares and other own equity instruments (treasury shares) are deducted from equity. No gain or loss is recognised in income statement on the purchase, sale, issue or cancellation of treasury shares. The consideration paid or received is recognised directly in equity and incremental transaction costs are accounted for as a deduction from equity (net of any related income tax).

When classifying a financial instrument (or component of it) in the consolidated financial statements, all terms and conditions are considered. To the extent there is an obligation that would give rise to a financial liability, the Bank classifies the instrument as a financial liability, rather than an equity instrument.

b) *Dividend on shares*
Dividends are recognised as a deduction to equity in the period in which they are approved by the Bank's shareholders. Dividends declared after the balance sheet date are not recognised as a liability at the balance sheet date.

26. Cash and cash equivalents

Cash and cash equivalents in the consolidated statement of cash flows consist of cash in hand, treasury bills, demand deposits with the central banks and with other credit institutions, short term loans to credit institutions and other liquid debt securities at floating interest rates. Cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition.

27. Income and Expenses

a) *Interest income and expense*
Interest income and expense is recognised in the income statement as it accrues, taking into account the effective yield of the asset or an applicable floating rate. Interest income and expense includes the amortisation of any discount or premium or other differences between the initial carrying amount of an interest bearing instrument and its amount at maturity, calculated according to the effective interest method.

The effective interest rate method is a method of calculating the amortised cost of a financial asset or a financial liability (or group of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts 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 cash flows, considering all contractual terms of the financial instrument, but does not consider future credit losses. The calculation generally includes all fees and amounts paid or received between parties to the contract that are an integral part of the effective interest rate, as well as transaction costs and all other premiums or discounts.

Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised at the rate of interest used to discount the impairment loss. Interest income on financial assets which have been written down as a result of impairment is calculated based on the net amount of the financial asset taking the write-down into consideration.

b) *Fee and commission income*
The Bank provides various services to its clients and earns income there from, such as income from investment banking, corporate banking, securities brokerage, asset management and retail banking. Fees earned from services that are provided over a certain period of time are recognised as the services are provided. Fees earned from transaction-type services are recognized when the service has been completed. Fees that are performance-linked are recognised when the performance criteria are fulfilled.

c) *Dividend income*
Dividend income is recognised in the income statement on the date that the dividend is declared.

d) *Net gains on financial assets and financial liabilities held for trading*
Net gains on financial assets and financial liabilities held for trading include gains and losses arising from disposals, extinguishments and changes in the fair value of financial assets and financial liabilities held for trading.

e) *Net gains on financial assets designated at fair value through profit or loss*
Net gain on assets at fair value through profit or loss consists of gains and losses arising from disposals of and changes in the fair value of the financial assets designated as at fair value through profit or loss. Fair value changes of derivatives that are economically linked to financial assets which are designated at fair value through profit or loss in order to avoid an accounting measurement or recognition inconsistency, are also included in this line item in the income statement, see note 42.

f) *Administrative expenses*
Administrative expenses consist of salary and related expenses, depreciation of property and equipment, amortisation of intangible assets and other administrative expenses, such as housing costs, advertising expenses and IT-related expenses.

28. Impairment

The carrying amount of the Bank's assets, other than tax assets and financial assets measured at fair value with changes recognised in the income statement 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 loss is recognised in the income statement whenever the carrying amount of an asset or of a cash-generating unit exceeds its recoverable amount.

a) *Impairment on loans and receivables*

If there is objective evidence that an impairment loss has been incurred on loans and receivables, their carrying amount is reduced through the use of an allowance account to the present value of expected future cash flows, discounted at their original effective interest rate.

The criteria that the Group uses to determine that there is objective evidence of an impairment loss include:
• Delinquency in contractual payments of principal or interest;
• Cash flow difficulties experienced by the borrower (for example, equity ratio, net income percentage of sales);
• Breach of loan covenants or conditions;
• Initiation of bankruptcy proceedings;
• Deterioration of the borrower’s competitive position;
• Deterioration in the value of collateral; and
• Downgrading below investment grade level.

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 reversed to the extent it is now excessive by reducing the loan impairment allowance account. The amount of any reversal is recognised in the income statement.

The Bank's management first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant. Loans and receivables that are not impaired individually become a part of a portfolio which is assessed for impairment. Collective assessment based on a portfolio assumes that loans and receivables have similar credit risk characteristics. Objective evidence of impairment of a group of loans and receivables exists if objective data indicates a decrease in expected future cash flows from a portfolio of loans and the decrease can be measured reliably but cannot be identified with the individual loans in the portfolio.

The recognition of interest income on impaired loans and receivables is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring impairment losses.

b) *Impairment on goodwill*

The Bank assesses whether there is any indication of impairment of goodwill on annual basis, with expert analysis being commissioned if necessary. Goodwill is written down for impairment. Gains or losses realised on the disposal of subsidiaries include any unamortised balance of goodwill relating to the subsidiary disposed of.

c) *Impairment on financial assets available-for-sale*

The Bank determines that available-for-sale equity investments are impaired when there has been a significant or prolonged decline in the fair value below its cost. This determination of what is significant or prolonged requires judgement. In making this judgement, the Bank evaluates among other factors, the normal volatility in share price. In addition, impairment may be appropriate when there is evidence of deterioration in the financial strength of the investee, industry and sector performance, changes in technology, and operational and financing cash flows. The amount of impairment loss is recognised in the Income Statement.

d) *Calculation of recoverable amount*

The recoverable amount of the Bank’s loans and receivables is calculated as the present value of estimated future cash flows. The discount rate used for fixed rate loans and receivables is the effective interest rate computed at initial recognition while for variable rate loans and receivables the discount rate is the current effective interest rate.

The recoverable amount of other assets is the greater of their net selling price 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.

e) *Reversals of impairment*

An impairment loss in respect of financial assets carried at amortised cost is reversed if the subsequent increase in recoverable amount can be related objectively to an event occurring after the impairment loss was recognised.

An impairment loss in respect of an investment in a debt instrument classified as available-for-sale is reversed through the income statement while an impairment loss in respect of an investment in an equity instrument classified as available-for-sale is not reversed through income statement.

An impairment loss in respect of goodwill is not reversed.

In respect of other assets, an impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount.

An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

29. Income tax

Income tax on the profit or loss for the period comprises current and deferred tax. Income tax 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 or substantially enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

The deferred income tax asset / liability has been calculated and entered in the balance sheet. The calculation is based on the difference between balance sheet items as presented in the tax return on the one hand, and in the consolidated financial statements on the other, taking into consideration a carryforward tax loss. This difference is due to the fact that tax assessments are based on premises that differ from those governing the financial statements, mostly because revenues, especially of financial assets, are recognised earlier in the financial statements than in the tax return. A calculated tax asset is offset against income tax liability only if they are due to tax assessment from the same tax authorities.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

Notes to the Consolidated Financial Statements

Changes within the Group

30. The Bank acquired five subsidiaries during the year 2006. The effects of the Bank's consolidated balance sheet are presented in the following table. The shares were paid for in cash.

Assets	Glitnir Securities	Glitnir Kapital-forvaltning	Union Group	Glitnir AB	Kredit-kort hf.	Total
Cash and cash balances with central banks	1		1,210		2	1,213
Loans and receivables	4,629	191		15,680	8,701	29,201
Financial assets held for trading	4			208		212
Financial assets at fair value through P&L			11		34	45
Investments in associates					14	14
Property and equipment	19	3	18	56	735	831
Intangible assets	9		299			308
Tax assets	19		3			22
Other assets	6		540	1,946	86	2,578
Total assets	4,687	194	2,081	17,890	9,572	34,424
Liabilities						
Borrowings	20	1	116	12,068	2,167	14,372
Subordinated loans			60			60
Post-employment obligations	7		5			12
Tax liabilities	42	7		59	27	135
Other liabilities	4,152	166	1,483	3,839	6,345	15,985
Total liabilities	4,221	174	1,664	15,966	8,539	30,564
Minority interest			205		464	669
Net estimated value	466	20	212	1,924	569	3,191
Goodwill	559	77	1,473	1,924	465	4,498
Total acquisition price	1,025	97	1,685	3,848	1,034	7,689
Ownership	100%	100%	50.1%	100%	55%	
Consolidated from	1.1.2006	1.1.2006	1.1.2006	1.7.2006	1.7.2006	

Correction of previous year's figures

31. In 2005 one subsidiary of the Bank did not apply the rules set out in IAS 39 about calculating portfolio provision for loan impairment. This has been corrected in these financial statements and prior year's figures restated accordingly. IAS 8 was followed when correcting the error and the effects are as follows:

Income statement 2005	Previously reported	Correction	Restated
Impairment	(1,900)	(305)	(2,205)
Income tax	(4,266)	92	(4,174)
Net profit	19,099	(213)	18,886

Balance sheet at 31 Desember 2005			
Loans and receivables	1,174,733	(305)	1,174,428
Income tax liabilities	5,178	(92)	5,086
Shareholders equity	84,750	(213)	84,537

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Risk management

32. Risk assessment and prudent evaluation and pricing of risk are key elements in Glitnir's operations. Efficient risk assessment procedures and processes are the foundations of the Bank's risk management. The board of directors determines the general risk management policy and defines the acceptable levels of risk in the Bank's daily operations, sets targets regarding risk management and monitoring of major risk factors, i.e. credit risk, liquidity risk, market risk and operational risk.

Risk management procedures

The Bank operates centralized departments within the parent company for monitoring and reporting on different types of risks. Subsidiaries operate their own risk management functions and determine internal risk policies that reflect the nature of their operations. The individual risk management functions report to their respective board of directors, local regulators and to the parent company.

Decision making is based on a committee structure where the board of directors has granted authority to specially appointed committees that issue specific guidelines and targets regarding acceptable risk limits and decide on individual positions depending on size and risk level. Risk positions regarding credit risk and market risk are reported to the Risk Committee. Risk positions regarding refinancing risk, liquidity, interest rate risk and capital management are reported to the Asset and Liability Committee. The Operational Risk Committe supervises operational risk.

Central Risk Management is responsible for consolidated reporting to management and regulators. The risk procedures and risk management for each subsidiary is subject to the approval from the Risk Committee, Operational Risk Committee and the Asset and Liability Committee. Risk procedures and risk management are monitored and supervised from the parent company. Central Risk Management reviews the risk management procedures of subsidiaries. Frequency and detail of reporting depends on risk profile in each case. Two departments are responsible for the daily monitoring and evaluation of the Bank's credit risk, other financial risk and operational risk, i.e. Credit Control and Risk Management.

Credit risk

Credit Risk is a dominant eliment in the Bank's operations. The Bank seeks to maintain the quality of its credit portfolio by actively diversifying credit risk within the portfolio and by prudently managing concentration risk. The Bank emphasises the distribution of credit risk within its consolidated portfolio by counterparties, sectors and country, as well as within sectors and country for individual portfolios.

Credit Control is responsible for the implementation, enforcement, and monitoring of the Bank's consolidated credit risk policies and procedures. Credit Risk is reported regularly to the Risk Committee. Credit Control administers the Bank's credit committees and is responsible for the implementation of the Bank's risk assessment models.

Credit risk within the Bank's subsidiaries is independently managed by each subsidiary and reported to the respective board of directors. Each subsidiary has a separate operational function that is responsible for the implementation, enforcment and monitoring of its Credit Risk which is reported to the respective board of directors and top management. However, Credit risk policies and procedures for each subsidiary must adhere to the Bank's overall credit risk policy and procedures. Credit risk at the subsidiary level is monitored by Credit Control and regularily reported to the Bank's Risk Committee.

The Bank uses specially designed risk assessment models for the different types of credit risk assessments in its portfolio to ensure that risk evaluation measures used capture and reflect the underlying credit risk elements in the transactions involved. For the parent company and BNbank a separate operational unit, Credit Risk Control Unit (CRCU), within the Risk Management function is responsible for the design, validation and calibration of the Bank's risk assessment models.

Credit Control monitors defaults and issues guidelines on default monitoring and provisioning on a consolidated basis. Provisioning guidelines are determined for each subsidiary and reflect their diversified risk profiles and reflect the historical losses within each portfolio. Non perfoming loans, i.e. loans exceeding 90 days in arrears or loans against which specific provisions have been made, are managed and monitored on a consolidated basis. Credit Control is responsible for the overall management of non performing assets and must endevour to proactively and responsibly take measures to minimize the Bank's losses whenever possible.

Notes to the Consolidated Financial Statements

Liquidity risk

Liquidity risk management is an important element in the Bank's operations since the Bank is in large part wholesale funded. Liquidity risk is monitored within Risk Management and reported to the Asset and Liability Committee. The Bank has strict limits on liquidity and has back-up funding and liquid assets in place to deal with unforeseen events.

At year-end 2006, the Bank had ample liquidity, both according to internal measures and regulatory measures imposed by the Central Bank of Iceland. The Bank's policy is to have immediate liquidity covering all maturing debt of the parent company other than deposits for the following 6 months. In addition, all debt maturing within the following 12 months must be covered with immediate liquidity and other liquid assets. Immediate liquidity is defined as cash and cash equivalents, unused bonds eligible for repurchase agreements at central banks, regulatory liquidity reserves and committed credit facilities.

The Bank's subsidiaries are to a large extent self-sufficient in their funding, through their deposit base, by bond issuance in local markets or through their lines in the money market. All international funding is however co-ordinated by the parent company.

The following table analyses the Bank's assets and liabilities according to their maturity. The classification is based on the remaining maturity as of the date of the financial statements.

At 31 December 2006

Assets	Up to 1 month	1 - 3 months	3 - 6 months	6 - 12 months	1 - 2 years	2 - 5 years	Over 5 years	Undefined maturity	Total
Cash	20,417	0	0	0	0	0	0	0	20,417
Loans and receivables	182,298	17,400	46,305	151,316	158,283	351,801	785,065	67,900	1,760,368
Financial assets held for trading	82,079	777	254	9	92	7,252	1,645	135,143	227,251
Financial assets at fair value	81,085	2,069	3,117	2,331	3,972	33,072	49,136	26,082	200,864
Financial assets available for sale	0	0	0	0	0	0	0	3,746	3,746
Derivatives held for hedging	0	0	0	0	0	0	0	5,721	5,721
Investments in associates	0	0	0	0	0	0	1,097	3,282	4,379
Property and equipment	0	0	0	0	0	23	1,172	2,101	3,296
Intangible assets	0	0	0	0	241	0	169	17,900	18,310
Tax assets	0	0	0	0	0	0	2	262	264
Assets held for sale	0	0	0	0	0	172	0	237	409
Other assets	219	0	0	4	2	0	0	1,089	1,314
Total	366,098	20,246	49,676	153,660	162,590	392,320	838,286	263,463	2,246,339
Liabilities and equity									
Deposits from credit inst.	78,576	0	0	0	0	0	0	0	78,576
Other deposits	232,927	28,439	15,191	26,668	12,331	11,529	4,641	106,546	438,272
Borrowing	116,722	50,261	79,837	162,485	239,235	630,097	97,852	1,298	1,377,787
Subordinated loans	1,808	980	0	0	241	34,684	31,431	39,854	108,998
Trading financial liabilities	5,002	1,006	233	34	314	7,356	1,596	36,188	51,729
Derivatives held for hedging	0	0	0	0	0	0	0	13,869	13,869
Post-employment obligations	0	0	0	147	51	0	306	25	529
Tax liabilities	47	396	758	1,154	0	0	85	8,207	10,647
Other liabilities	6,539	107	911	47	93	0	0	12,116	19,813
Total equity	3,284	0	2,782	0	0	0	0	140,053	146,119
Total liabilities and equity	444,905	81,189	99,712	190,535	252,265	683,666	135,911	358,156	2,246,339
Maturity gap	(78,807)	(60,943)	(50,036)	(36,875)	(89,675)	(291,346)	702,375	(94,693)	

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At 31 December 2005	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	No stated maturity	Total
Total assets	205,392	172,308	109,205	335,757	627,851	21,432	1,471,945
Total liabilities and equity	179,748	249,769	172,848	679,307	101,807	88,466	1,471,945
Maturity gap	25,644	(77,461)	(63,643)	(343,550)	526,044	(67,034)	

	31.12.2006	31.12.2005
Liquidity position		
Cash and balances with central banks	16,011	19,233
Short-term placements with credit institutions	33,981	32,477
Loans to credit institutions	144,983	43,425
Liquid debt securities at floating interest rates	109,673	0
Cash and cash equivalents	304,648	95,135
Unused bonds eligible for repurchase agreements at central banks	17,030	33,092
Regulatory liquidity reserves	22,274	16,960
Committed credit facilities	113,532	39,965
Immediate liquidity	457,484	185,152

Interest rate risk

Interest rate risk in the Bank is twofold. On the one hand, the Bank generally has a trading portfolio of bonds, where market rates affect prices and any fluctuations are immediately recognized in Profit and Loss. VaR figures for the bond trading portfolio are presented in the market risk chapter. On the other hand, mismatch in assets and liabilities with fixed interest terms in the banking book can generate interest rate risk which is not neccessarily recognized in Profit and Loss but nevertheless affects the Bank's economic value.

It is the Bank's policy to minimize foreign currency interest rates risk in the banking book. This holds true for the group as a whole. Assets or liabilities with fixed terms are hedged with interest rate swaps or other derivatives and hedge accounting is utilized where possible to reduce fluctuations in Profit and Loss. Those hedging derivatives are marked to market as all other derivatives.

Interest rate exposures in Icelandic kronas (ISK), are not hedged to the same extent and the Bank has banking book exposure to interest rate movements. To maintain a balance between assets and liabilites, the Bank needs to hold more assets than liabilities in ISK since equity of the Bank is denominated in ISK. This mismatch is partly invested in the Bank's Icelandic CPI linked mortgage portfolio. To reduce interest rate sensitivity, all the Bank's fixed rate mortgage lending in Iceland has a an interest rate reset in 5 years from issuance.

Interest rate risk in the banking book is reported to the Asset and Liability Committee

Inflation risk

The Bank is exposed to Icelandic inflation since Consumer Price Index (CPI) index-linked assets exceed CPI index-linked liabilities. All indexed assets and liabilities are valued according to the CPI measure at any given time and changes in the CPI are therefore recognised in profit and loss. Those exposures are limited to the parent company.

Inflationary position of the Bank is reported to the Asset and Liability Committee.

Assets and liabilities linked to Consumer Price Index:	Total assets	Total liabilities	Net position
31.12.2006	302,090	(175,475)	126,615
31.12.2005	241,097	(152,356)	88,741

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Currency risk

The majority of the Bank's assets and liabilities is denominated in foreign currency. The Bank aims to keep foreign assets and liabilities in balance in terms of currencies. Any mismatch is monitored closely.

Since the Bank's assets are largely denominated in foreign currency, but equity is issued in ISK, the exchange rate of the Icelandic krona has an effect on the measured CAD ratio. This is taken into account in the Bank's capital strategy and the Bank uses various methods to reduce this effect. At the end of 2006 the Bank held long positions in NOK, SEK and EUR amounting to ISK 27.8 billion for the purpose of limiting exchange rate sensitivity of its capital ratios. Other foreign currency positions are viewed as trading positions.

Trading positions in currencies, above certain limits, are reported to the Risk Committee. The sensitivity of capital ratios to changes in exchange rates is reported to the Asset and Liability Committee.

The table below summarises the Bank's exposure to currency risk at 31 December 2006. Included are both on-balance sheet and off-balance sheet positions. Off-balance sheet positions represent notional amounts of foreign currency derivative financial instruments.

Assets and liabilities denominated in foreign currency:

	ISK	NOK	SEK	EUR	USD	GBP	CHF	JPY	Other	Total
Assets										
Cash................................	12,938	6,625	278	167	206	74	62	7	60	20,417
Loans and receivabl.........	412,595	587,758	47,129	279,396	131,384	111,783	82,451	50,492	57,380	1,760,368
Trading assets..................	190,380	14,416	797	5,318	2,461	2,775	2	1	11,101	227,251
FV financial assets...........	12,377	57,591	156	74,153	47,676	8,640	0	0	271	200,864
AFS financial assets.........	3,732	8	0	0	0	0	0	0	6	3,746
Hedging derivatives.........	5,622	0	0	99	0	0	0	0	0	5,721
Associates........................	2,448	1,336	0	595	0	0	0	0	0	4,379
Fixed assets......................	1,578	1,514	0	157	0	0	0	0	47	3,296
Intangible assets..............	1,361	14,905	1,959	85	0	0	0	0	0	18,310
Tax assets.........................	0	28	0	198	0	0	0	0	38	264
Assets held for sale..........	237	172	0	0	0	0	0	0	0	409
Other assets......................	615	238	0	43	24	0	3	0	391	1,314
Total	643,883	684,591	50,319	360,211	181,751	123,272	82,518	50,500	69,294	2,246,339
Liabilities and equity										
Deposits, credit inst.........	32,227	3,349	3,721	13,795	16,319	772	2,117	36	6,240	78,576
Other deposits..................	142,736	217,697	181	11,374	11,333	53,401	153	161	1,236	438,272
Borrowings......................	78,474	245,387	18,651	477,823	340,039	41,437	69,349	19,999	86,628	1,377,787
Subordinated loans..........	5,339	16,081	0	29,708	57,870	0	0	0	0	108,998
Trading liabilities............	40,833	10,826	63	0	0	0	4	0	3	51,729
Hedging derivatives.........	13,718	0	0	151	0	0	0	0	0	13,869
Pension liability...............	0	529	0	0	0	0	0	0	0	529
Tax liabilities..................	6,560	2,753	0	1,334	0	0	0	0	0	10,647
Other liabilities................	9,381	5,673	4,721	38	0	0	0	0	0	19,813
Total equity......................	139,199	5,647	125	1,148	0	0	0	0	0	146,119
Total	468,467	507,942	27,462	535,371	425,561	95,610	71,623	20,196	94,107	2,246,339
Net on-balance sheet	175,416	176,649	22,857	(175,160)	(243,810)	27,662	10,895	30,304	(24,813)	0
Net off-balance sheet	(211,721)	(154,171)	(20,601)	178,266	248,125	(26,624)	(11,781)	(29,805)	28,312	0
Net position	(36,305)	22,478	2,256	3,106	4,315	1,038	(886)	499	3,499	0

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Market Risk
Market risk is the risk of loss due to changes in interest rates, foreign exchange and equity prices. The Bank has trading positions in bonds, currency and equities and is therefore exposed to fluctuations in price. Since all positions are marked to market, all price changes are immediately recognised in profit or loss.

For trading positions the Bank uses a daily Value-at-Risk (VaR) method to measure market risk in individual portfolios as well as overall. The overall measure is conservative as diversification effects across the portfolios are not taken into account. Reporting is based on a probability level of 99% and 1-day holding period. The table below summarises VaR measures for 2006, with reference figures for 2005. Backtesting is used to assess the effectiveness of the VaR model.

	Min	Max	End of 2006	Average 2006	Average 2005
Equity risk	14	333	71	136	79
Interest risk	13	67	20	35	41
Currency risk	0	170	88	42	15
Total	73	443	179	213	135

Stress tests are carried out to provide an indication for potential loss in extreme conditions. Non-trading and unlisted equity positions that are not part of the VaR measure are covered under stress testing as well.

Operational Risk
Credit Control, Risk Management and Compliance are jointly responsible for monitoring and reporting on operational risk. Operational risk is supervised by the Operational Risk Committee. Major sources of operational risk are adherence to internal procedures, processes and guidelines, IT security, fraud, error, legal and regulatory compliance as well as business risk.

Derivatives used for hedging

33. The fair value and notional amounts of derivative instruments used for hedging are set out below.

	Notional amount	Fair value Assets	Fair value Liabilities
Interest rate	345,255	5,349	11,004
Foreign currency	15,125	372	2,865
Total	360,380	5,721	13,869

Derivatives held for trading

34. The fair value and notional amounts of derivative instruments held for trading are set out below.

	Notional amount	Fair value Assets	Fair value Liabilities
Interest rate	699,410	3,894	8,535
Equity	186,311	20,514	19,046
Foreign currency	1,624,739	42,474	19,270
Total	2,510,460	66,882	46,851

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Business segments

35. Below is a business segment overview showing the Bank’s performance with a breakdown by business segments. A business segment is a distinguishable component of the Bank that is engaged in providing products or services that are subject to risks and rewards that are different from those of other business segments.

The Bank is organised into six main business segments:

a) Commercial Banking Iceland: Incorporates banking services to private and corporate customers in Iceland. Retail banking, corporate banking, asset-based financing and asset management.

b) Commercial Banking Norway: Incorporates banking services to private and corporate customers in Norway. Retail banking and corporate banking.

c) Corporate Banking: Incorporates Glitnir's international operations, global home market customers and leveraged finance.

d) Investment Banking: Incorporates international corporate finance and equity investments.

e) Markets: Incorporates brokerage services in securites, foreign currencies and derivatives, sale of securities issues and money market lending.

f) Treasury: Incorporates funding and interbank activities.

Among operations that fall outside the defined business segments are the operations of associated companies and other operations of the Bank.

The Bank was reorganised during the year 2006 into the business segments described above. In 2005 the Bank was organised into the following business segments: Commercial Banking Iceland/Norway, Corporate- and Investment Banking, Capital Markets and Treasury.

The year 2006

Operations	Commercial Banking Iceland	Commercial Banking Norway	Corporate Banking	Investment Banking	Markets	Treasury	Other operations & eliminations	Total
Net interest income	16,778	7,196	9,736	(374)	3,097	2,028	(1,377)	37,084
Other operating income	5,737	47	2,742	8,190	14,759	2,369	1,673	35,517
Administrative exp.	(11,057)	(3,231)	(3,804)	(1,686)	(6,735)	(109)	(679)	(27,301)
Impairment	(2,781)	(68)	(1,846)	(25)	(7)	0	(32)	(4,759)
Other income	0	0	0	0	0	0	5,714	5,714
Profit before tax	8,677	3,944	6,828	6,105	11,114	4,288	5,299	46,255
Income tax expense								(8,024)
Profit for the period	8,677	3,944	6,828	6,105	11,114	4,288	5,299	38,231
Net segment revenue from external customers	53,447	28,067	62,470	11,815	21,626	(107,256)	2,431	72,601
Net segment revenue from other segments	(30,932)	(20,824)	(49,992)	(3,999)	(3,770)	111,653	(2,135)	0

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At 31 December 2006							Other	
	Commercial banking		Corporate	Investment			operations &	
Segment assets	Iceland	Norway	Banking	Banking	Markets	Treasury	eliminations	Total
Cash, balances with central banks, loans and receivables	1,154,960	598,314	287,529	3,987	28,030	1,356,301	(1,648,336)	1,780,785
Other financial assets	72,821	69,200	1,975	28,626	8,565	201,088	55,307	437,582
Other assets	114,366	4,895	15,872	2,031	6,383	0	(115,575)	27,972
Total assets	1,342,147	672,409	305,376	34,644	42,978	1,557,388	(1,708,604)	2,246,339
Segment liabilities								
Deposits, borrowings and subordinated loans	736,107	573,076	0	0	12,782	1,507,593	(825,925)	2,003,633
Trading financial liabilities & hedging derivatives	11,568	11,568	3	0	5,924	43,228	(6,693)	65,598
Other liabilities	522,720	52,164	291,470	27,350	8,548	1,405	(872,668)	30,989
Total liabilities	1,270,395	636,808	291,473	27,350	27,254	1,552,226	(1,705,286)	2,100,220

The year 2005			Corp. &					
	Commercial banking		investm.	Capital		Other	Elimin-	
Operations	Iceland	Norway	banking	markets	Treasury	operations	ations	Total
Net interest income	12,287	4,418	4,441	894	1,325	(1,014)	0	22,351
Other net operating income	4,595	966	2,139	3,062	1,831	2,788	(59)	15,322
Administrative expenses	(8,293)	(1,823)	(2,483)	(984)	(341)	(1,866)	59	(15,731)
Impairment losses	(1,401)	51	(765)	0	0	(90)	0	(2,205)
Other net income	(10)	0	0	0	0	3,333	0	3,323
Profit before tax	7,178	3,612	3,332	2,972	2,815	3,151	0	23,060
Income tax expense								(4,174)
Profit for the period	7,178	3,612	3,332	2,972	2,815	3,151	0	18,886
Net segment revenue from external customers	13,469	3,154	2,228	3,953	12,021	2,848	0	37,673
Net segment revenue from other segments	3,412	2,230	4,352	3	(8,865)	(1,073)	(59)	0

At 31 December 2005								
Segment assets								
Cash, balances with central banks, loans and receivables	562,224	413,240	272,806	10,574	849,504	38,320	(951,379)	1,195,289
Other financial assets	3,518	77,107	21,562	4,795	139,384	7,932	0	254,298
Other assets	823	1,941	345	0	12	48,891	(29,654)	22,358
Total assets	566,565	492,288	294,713	15,369	988,900	95,143	(981,033)	1,471,945
Segment liabilities								
Deposits, borrowings and subordinated loans	535,625	453,731	279,408	4,604	949,805	48,182	(951,305)	1,320,050
Trading financial liabilities & hedging derivatives	0	7,397	6	2,172	26,449	0	0	36,024
Other liabilities	2,019	5,005	760	7,652	11,250	4,501	147	31,334
Total liabilities	537,644	466,133	280,174	14,428	987,504	52,683	(951,158)	1,387,408

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Geographical segments

36. Below is a geographical segment division of assets, liabilities, revenues and expenses. The geographical division has been defined by the management as the Bank's secondary division. The geographical division is based on the location of operations.

At 31 December 2006	Total assets	Total liabilities	Revenues	Expenses
Iceland	1,380,857	1,286,231	52,830	20,065
Norway	638,323	601,238	15,227	7,041
Other countries	227,159	212,751	10,258	4,954
Total	2,246,339	2,100,220	78,315	32,060
At 31 December 2005				
Iceland	684,210	642,790	29,033	12,917
Norway	493,288	466,133	5,384	1,772
Other countries	294,447	278,485	6,580	3,248
Total	1,471,945	1,387,408	40,997	17,937

Loan portfolio - Geographical

37. Geographical sector risk concentrations within the customer loan portfolio were as follows:

	2006		**2005**	
	Loans	%	Loans	%
Iceland	710,169	45%	487,625	45%
Norway	607,057	39%	431,608	40%
United Kingdom	87,330	6%	72,599	7%
Denmark	32,048	2%	37,083	3%
Canada	31,335	2%	18,644	2%
Germany	32,407	2%	7,341	1%
Other countries	71,380	5%	23,483	2%
Total	1,571,726	100%	1,078,383	100%

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Quarterly Statements

38. Operations by quarters:

2006	Q4	Q3	Q2	Q1	Total
Net interest income	8,420	9,310	11,526	7,828	37,084
Other operating income	13,443	5,960	6,650	9,464	35,517
Administrative expenses	(8,705)	(6,431)	(6,293)	(5,872)	(27,301)
Impairment losses	(1,653)	(328)	(1,354)	(1,424)	(4,759)
Other income	89	1,854	2,584	1,187	5,714
Profit before income tax	11,594	10,365	13,113	11,183	46,255
Income tax	(2,278)	(1,563)	(2,101)	(2,082)	(8,024)
Profit for the period	9,316	8,802	11,012	9,101	38,231

2005	Q4	Q3	Q2	Q1	Total
Net interest income	6,140	6,490	5,256	4,465	22,351
Net insurance premium	0	0	0	229	229
Other operating income	2,834	3,084	4,329	3,584	13,831
Administrative expenses	(4,230)	(3,539)	(3,743)	(4,219)	(15,731)
Impairment losses	(645)	(494)	(565)	(501)	(2,205)
Other income	810	284	3,441	50	4,585
Profit before income tax	4,909	5,825	8,718	3,608	23,060
Income tax	(1,381)	(1,024)	(1,199)	(570)	(4,174)
Profit for the period	3,528	4,801	7,519	3,038	18,886

Net interest income

39. Net interest income is specified as follows:

	2006	2005
Interest income on:		
Cash and cash balances with central banks	1,183	592
Loans and receivables	103,292	55,073
Financial assets held for trading	10,377	4,867
Financial assets designated at fair value through profit or loss	3,786	563
Financial assets available-for-sale	435	393
Other assets	42	38
Total interest income	119,115	61,526
Interest expenses on:		
Deposits from credit institutions and central banks	(3,218)	(2,241)
Deposits	(19,508)	(12,441)
Borrowings	(51,250)	(20,152)
Subordinated loans	(4,809)	(1,661)
Financial liabilities held for trading	(3,183)	(2,676)
Other interest expense	(63)	(4)
Total interest expenses	(82,031)	(39,175)
Net interest income	37,084	22,351

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Notes to the Consolidated Financial Statements

Net fee and commission income

40. Net fee and commission income is specified as follows:

	2006	2005
Fee and commission income from:		
Asset management	3,269	1,183
Securities brokerage	6,127	1,043
Payment processing	2,892	1,514
Loans and guarantees	2,905	2,314
Foreign currency brokerage commission	4,230	1,769
Advisory	9,856	1,520
Other fees and commissions income	603	585
Total fees and commission income	29,882	9,928
Commission expenses due to:		
Inter-bank charges	(1,353)	(792)
Brokerage	(736)	(73)
Clearing and settlement	(526)	(145)
Other commission expenses	(808)	(145)
Total commission expenses	(3,423)	(1,155)
Net fee and commission income	26,459	8,773

Net gains on financial assets and financial liabilities held for trading

41. Net gains on financial assets and financial liabilities held for trading are specified as follows:

	2006	2005
Shares and related derivatives	2,334	3,182
Bonds and related derivatives	(1,023)	(463)
Other derivatives	4,688	1,274
Net gains on financial assets and financial liabilities held for trading	5,999	3,993

Net gains on financial assets designated at fair value through profit or loss

42. Net gains on financial assets designated at fair value through profit or loss are specified as follows:

	2006	2005
Shares	2,707	6
Bonds	138	(116)
Loans and related derivatives	(748)	601
Net gains on financial assets designated at fair value through profit or loss	2,097	491

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Administrative expenses

43. Administrative expenses are specified as follows:

	2006	2005
Salaries and related expenses	15,747	8,848
Other administrative expenses	10,892	6,402
Depreciation and amortisation	662	481
Administrative expenses	27,301	15,731

Salaries and related expenses

44. Salaries and related expenses are specified as follows:

Salaries	12,074	7,111
Pension and similar expenses	1,609	1,054
Social security charges	1,140	576
Share based payments	756	88
Other	168	19
Salaries and related expenses	15,747	8,848

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

Average number of employees (full year equivalents)	1,392	1,216
Positions at the end of the year	1,518	1,153

Employement Terms for the Board of Directors and the CEO

46. Employement terms for the Board of Directors and the CEO are specified as follows:

			Number of shares		
2006	Salaries and fringe benefits	Net gain on stock options	Call options	Put options	Ownership at year end
Bjarni Ármannsson, CEO	144	76	15		233
Einar Sveinsson, Chairman of the Board	6				388
Edward Allen Holmes	5				0
Guðmundur Ólason	2				50
Jón Sigurðsson	1				0
Jón Snorrason	2				0
Karl Emil Wernersson	3				13
Skarphéðinn Berg Steinarsson	2				0
Other board members	3				2
Frank Ove Reite, MD of Markets and Com. Banking Norway	50	44	38		0
Haukur Oddsson, MD of Com. Banking Iceland	53		20		48
Four other managing directors on management board	189		70		155
Total	460	120	143	0	889

Call options held by the CEO are excercisable at a price between 3.1 and 3.5. They expire in 2007. Other call options held by management are excercisable in the years 2007-2008 at a price from 10.7 to 19.8.

Ownership at year-end consists of shares owned by the employees and entities controlled by the employees.

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Notes to the Consolidated Financial Statements

2005	Salaries and fringe benefits	Net gain on stock options	Number of shares Call options	 Put options	 Owner-ship at year end
Bjarni Ármannsson, CEO	80	53	19		83
Einar Sveinsson, Chairman of the Board	4				400
Other board members	13				216
Haukur Oddsson, MD of Com. Banking Iceland	32				48
Four other managing directors on management board	95		24		127
Total	224	53	43	0	874

Auditors' Fees

47. Auditors' fees are specified as follows:

	2006	2005
Audit of the annual accounts	72	33
Audit and review of interim accounts	41	18
Other services	68	26
Auditors' fees	182	77
Thereof remuneration to others than the auditors of the parent company	91	25

Impairment losses

48. Impairment losses recognised in profit and loss were as follows:

Loans and receivables	4,759	2,125
Goodwill	0	80
Impairment	4,759	2,205

Net gains on non-current assets classified as held for sale

49. Net gains on non-current assets held for sale are specified as follows:

Net (loss) profit from sale of foreclosed mortgages	(6)	12
Net profit from sale of subsidiaries and associates	4,159	3,325
Other	91	(14)
Net gains on non-current assets classified as held for sale	4,244	3,323

Amounts are in ISK millions

Effective income tax rate

50. The corporate income tax rate in Iceland is 18.0% whereas the effective income tax rate in the Bank's income statement is 17.3%. The difference is specified as follows:

	2006		2005	
Profit before tax	46,255		23,060	
18.0% income tax calculated on the profit of the year	8,326	18.0%	4,151	18.0%
Effect of tax rates in foreign jurisdictions	831	1.8%	413	1.8%
Dividends received, exempt from tax	(405)	(0.9%)	(721)	(3.1%)
Change in status of associated company	0	0.0%	161	0.7%
Acquisition price of subsidiaries reduced by gain on sale of shares	(1,311)	(2.8%)	0	0.0%
Correction in accordance with ruling on prior years' taxable income	589	1.3%	14	0.1%
Other differences	(6)	(0.0%)	156	0.7%
Income tax according to income statement	8,024	17.3%	4,174	18.1%

In December 2006, Icelandic tax authorities ruled that the Bank shall pay additional tax of ISK 589 million (including penalties) due to the merger with Framtak fjárfestingabanki hf. in 2004. The ruling will be appealed but the entire amount is charged to income statement in December.

Earnings per Share

51. Earnings per share is calculated by dividing the net profit attributable to shareholders of the Bank by the weighted average outstanding number of shares during the year, excluding the average number of shares purchased by the Bank and held as treasury shares. The calculation of diluted earnings per share takes into consideration the outstanding stock options when calculating the share capital.

	2006	2005
Net profit of the equity holders of the parent, according to the financial statements	37,360	18,886
Average outstanding shares:		
Outstanding shares according to the financial statements at the beginning of the year, millions	13,112	11,081
Issuance of new shares, millions	824	1,787
Average outstanding shares, millions	13,936	12,868
Earnings per share, ISK	2.68	1.47
Diluted Earnings per share, ISK	2.66	1.47

Cash and cash balances with central banks

52. Specification of cash and cash balances with central banks:

	31.12.2006	31.12.2005
Cash in hand	1,044	864
Balances with central banks other than required reserves	14,967	18,369
Required reserves at central banks	2,452	1,214
Treasury bills	1,954	414
Total	20,417	20,861

Amounts are in ISK millions

Notes to the Consolidated Financial Statements

Loans and receivables

53. Loans and receivables are specified as follows:

	31.12.2006	31.12.2005
Balances with credit institutions	32,027	32,062
Loans to credit institutions	144,983	43,425
Loans and leasing contracts to customers	1,571,726	1,078,383
Other receivables	11,632	20,558
Total	1,760,368	1,174,428

54. Loans and leasing contracts to customers are as follows:

Loans to individuals:		
Overdrafts and credit cards	25,452	12,632
Term loans	46,251	43,488
Mortgages	292,768	205,714
Loans and leasing contracts to corporate entities:		
Direct commercial loans	1,187,298	825,643
Other	32,419	97
Gross loans and advances	1,584,188	1,087,574
Less: allowance for losses on loans and advances	(12,462)	(9,191)
Net loans and advances	1,571,726	1,078,383

55. Loans to customers and leasing contracts are specified by borrowers as follows:

Central government and state-owned enterprises	0.3%	0.2%
Municipalities	0.3%	0.8%
Business Sectors:		
Agriculture	0.3%	0.2%
Fishing industries	9.1%	10.4%
Commerce	4.3%	4.8%
Industry and contractors	5.6%	7.6%
Real Estate	30.8%	27.2%
Services	26.0%	21.5%
Individuals	23.3%	27.3%
Total	100.0%	100.0%

56. Allowance for losses on loans and receivables:

	2006	2005
Balance as at 1.1.	9,191	9,643
Transferred into the group	167	526
Transferred from the group	(50)	(917)
Provision for loan impairment	4,759	2,125
Loans written off during the year as uncollectible	(2,010)	(2,174)
Amounts recovered during the year	109	97
Translation difference	296	(109)
Total at year end	12,462	9,191

Provision for losses has been deducted from the following balance sheet items:	31.12.2006	31.12.2005
Loans and leasing contracts to customers	12,462	9,191

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Financial assets held for trading

57. Specification of financial assets held for trading:

	31.12.2006 According to balance sheet	Against derivative contracts	Net position	**31.12.2005** According to balance sheet	Against derivative contracts	Net position
Bonds issued by public bodies	70,532	(66,706)	3,826	59,161	(55,508)	3,653
Bonds issued by others	10,667	(10,667)	0	1,901	(1,901)	0
Shares	79,170	(67,074)	12,096	74,335	(59,627)	14,708
	160,369	(144,447)	15,922	135,397	(117,036)	18,361
Carrying amount of derivatives	66,882			16,500		
Total	227,251	(144,447)	15,922	151,897	(117,036)	18,361

Financial assets designated at fair value through profit or loss

58. Financial assets designated at fair value through profit and loss are specified as follows:

	31.12.2006	31.12.2005
Cash equivalents	109,673	0
Bonds issued by public bodies	292	1,824
Bonds issued by others	33,728	29,933
Loans	24,457	49,654
Mutual funds	7,049	0
Shares	6,275	1,315
Preferred shares	19,390	13,712
Financial assets designated at fair value through profit or loss	200,864	96,438

Financial assets available-for-sale

59. Financial assets available-for-sale are specified as follows:

Bonds issued by public bodies	239	479
Bonds issued by others	3,507	3,132
Financial assets available-for-sale	3,746	3,611

Investments in associates

60. Changes in investments in associates:

	2006	2005
Investments in associates at the beginning of the year	8,081	2,605
Purchases of shares in associates	3,863	36
Sales of shares in associates	(8,020)	(104)
Transfers	(1,019)	6,458
Share of results	1,470	1,262
Dividends paid	(157)	(2,106)
Foreign exchange translation differences	161	(70)
Investments in associates at year-end	4,379	8,081

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61. The Bank's interest in its principal associates, which are unlisted, are as follows:

	Ownership at year-end	Book value 31.12.2006	Share of results 2006	Book value 31.12.2005	Share of results 2005
Eignarhaldsfélagið Fasteign hf.	32.7%	731	77	548	71
Farsímagreiðslur ehf.	27.0%	11	(1)	12	(5)
Fjárfestingafélagið Máttur ehf.	50.0%	1,984	(27)	0	0
Greiðslumiðlun hf.	0.0%	0	27	338	77
Klasi hf.	0.0%	0	185	450	172
Klasi AS	20.0%	15	0	0	0
Kreditkort hf.	55.0%	0	46	392	81
Mens Mentis hf.	44.6%	78	7	71	11
Reiknistofa Bankanna	23.0%	345	0	331	0
Sjóvá-Almennar tryggingar hf.	0.0%	0	1,123	5,932	846
Bolig- og Næringsmægler AS	25.0%	43	13	0	0
Norsk Privatøkonomi ASA	45.0%	1,070	20	0	0
Auðkenni hf.	25.0%	11	0	0	0
Median - Rafræn miðlun hf.	23.5%	91	0	0	0
Other		0	0	7	9
Total		4,379	1,470	8,081	1,262

Investment in subsidiaries

62. The parent's interest in its subsidiaries are as follows:

	Location	Ownership	Assets	Liabilities	Revenue	Results
Bolig- og Næringsbanken ASA	Norway	100%	289,738	261,288	1,187	35
Bolig- og Næringskreditt ASA	Norway	100%	295,097	266,647	3,474	1,904
Bolig- og Næringsbanken Invest AS	Norway	100%	515	2	0	0
Glitnir Bank ASA	Norway	100%	64,120	58,854	1,497	656
Glitnir Factoring ASA	Norway	100%	3,338	2,991	305	47
Glitnir Norway AS	Norway	100%	370	360	432	9
Glitnir Securities ASA	Norway	100%	2,563	1,489	2,732	501
Glitnir Kapitalforvaltning AS	Norway	100%	274	125	389	120
Union Group AS	Norway	50.1%	4,278	1,308	2,585	2,431
Glitnir AB	Sweden	100%	19,861	17,787	1,257	64
Glitnir Luxembourg SA	Luxembourg	100%	152,497	146,604	2,660	1,083
Kreditkort hf.	Iceland	55%	10,644	9,468	686	143
Glitnir Capital Investment ehf.	Iceland	100%	814	779	50	45
Glitnir sjóðir hf.	Iceland	100%	215	130	257	31
Glitnir eignarhaldsfélag ehf.	Iceland	100%	8,703	7,632	(87)	843
Steinvirki ehf.	Iceland	100%	162	6	18	14
Glitnir Real Estate Fund I slhf.	Iceland	59%	1,823	1,253	(6)	(3)
11 other wholly owned subsidiaries		100%	947	474	399	178
Total			855,959	777,197	17,835	8,101

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Notes to the Consolidated Financial Statements

Related party disclosures

63. The Bank has a related party relationship with its subsidiaries, the board of directors of the parent company, the managing directors of the Bank, the managing directors of the largest subsidiaries, close family members of individuals referred to herein and entities with significant influence as the largest shareholders of the Bank. The balances with related parties at year end are as follows:

	2006	2005
Loans to the CEO and managing directors	5,726	3,239
Loans to members of the board and companies related to members of the board	37,217	22,982
Shares in Sjóvá-Almennar tryggingar hf., company related to a member of the board	0	5,932
Loans to associated companies	13,325	12,555

Loans granted to the CEO and managing directors, in the amount of ISK 5,685 million, were in relation of purchase of shares in the Bank. Terms of transactions with related parties are determined on an arms-length basis. No provisions have been recognised in respect of loans given to related parties.

Property and equipment

64. Property and equipment are specified as follows:

	Real estate	Fixtures, equipment & vehicles	Total
Book value as at 1.1.2005	1,389	1,228	2,617
Additions during the year	207	872	1,079
Net acquistion through business combinations	584	101	685
Depreciation during the year	(11)	(421)	(432)
Disposals during the year	(9)	(28)	(37)
Transferred due to sale of subsidiary	(1,395)	(506)	(1,901)
Foreign exchange translation differences	(22)	(2)	(24)
Book value 31.12.2005	743	1,244	1,987
Book value 1.1.2006	743	1,244	1,987
Additions during the year	188	637	825
Net acquistion through business combinations	392	453	845
Depreciation during the year	(16)	(519)	(535)
Disposals during the year	0	(41)	(41)
Transferred due to sale of subsidiary	0	0	0
Foreign exchange translation differences	152	63	215
Book value 31.12.2006	1,459	1,837	3,296
Total value as at 31.12.2005	960	3,377	4,337
Accumulated depreciation as at 31.12.2005	(217)	(2,133)	(2,350)
Book value 31.12.2005	743	1,244	1,987
Total value as at 31.12.2006	1,752	5,477	7,229
Accumulated depreciation as at 31.12.2006	(293)	(3,640)	(3,933)
Book value 31.12.2006	1,459	1,837	3,296
Insurance value of buildings as at 31.12.2006			1,781
Insurance value of fixtures, equipment and vehicles as at 31.12.2006			2,618

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Intangible assets

65. Goodwill is allocated to the Bank's cash-generating units (CGU) in keeping with the main emphasis of monitoring and managing activites. With regard to this, goodwill has been distributed between CGU according to its origin. As part of the apportioning of the Bank's goodwill, the recoverable amount is measured by value in use. Each CGU is assessed on its own, in which expectations for return on equity, payout ratio, equity and yield are the main variables in the assessment of each CGU. An independent operating budget acts as the bases for results for the five year of the scheme and after that it is based on long-term yield of comparable units. Return objectives are different within each CGU. A sensitivity analysis of budgets and key premises revealed that a significant deviation from the budget or a breakdown must take place in order to affect an impairment of the goodwill in the Bank's balance sheet.

The allocation of the goodwill for each CGU is as follows:

	31.12.2006	31.12.2005
BNbank ASA	12,642	10,314
Glitnir Securities AS	655	0
Glitnir Kapitalforvaltning AS	91	0
Union Group AS	1,567	0
Glitnir AB	2,002	0
Kreditkort hf.	466	0
Other cash generating units	523	237
Total goodwill 31.12.2006	17,946	10,551

Intangible assets are specified as follows:

	Goodwill	Software	Total
Intangible assets as at 1.1.2005	11,552	314	11,866
Additions during the year	11,663	193	11,856
Acquistion through business combinations	0	131	131
Disposals during the year	0	(314)	(314)
Transferred due to sale of subsidiary	(12,302)	0	(12,302)
Impairment	(80)	0	(80)
Amortization during the year	0	(49)	(49)
Foreign exchange translation differences	(282)	(2)	(284)
Intangible assets at 31.12.2005	10,551	273	10,824
Additions during the year	4,498	129	4,627
Acquistion through business combinations	299	23	322
Amortization during the year	0	(127)	(127)
Foreign exchange translation differences	2,598	66	2,664
Intangible assets as at 31.12.2006	17,946	364	18,310

Deposits from credit institutions and central banks

66. Deposits from credit institutions and central banks are specified as follows:

	31.12.2006	31.12.2005
Repurchase agreements with central banks	36,045	17,801
Deposits from credit institutions	42,531	12,855
Deposits from credit institutions and central banks	78,576	30,656

Amounts are in ISK millions

Other deposits

67. Other deposits (than deposits from credit institutions) are specified by type as follows:

	31.12.2006	31.12.2005
Demand deposits	259,156	195,805
Time deposits	179,116	108,331
Other deposits total	438,272	304,136

68. Other deposits are specified by owners as follows:

	2006		**2005**	
	Amount	% of total	Amount	% of total
Central government and state-owned enterprises	11,389	3%	339	0%
Municipalities	40,497	9%	1,827	1%
Other companies	171,194	39%	173,232	57%
Individuals	215,192	49%	128,738	42%
Other deposits total	438,272	100%	304,136	100%

Borrowings

69. Specification of borrowings:

	31.12.2006	31.12.2005
Issued bonds	1,046,138	808,850
Issued bonds designated at fair value	203,776	49,654
Loans from credit institution	101,073	75,202
Other borrowings	26,800	4,088
Borrowings	1,377,787	937,794

Subordinated loans

70. Specification of subordinated loans:

	Currency	Interest	Maturity date	Book value 2006
Loans which qualify as Tier 1 capital:				
Subordinated loans - unlisted	JPY	3.6%	Perpetual	2,404
Subordinated loans - unlisted	NOK	7.1%	Perpetual	1,916
Subordinated loans - unlisted	NOK	5.8%	Perpetual	964
Subordinated loans - listed on the Iceland Stock Exchange	ISK	6.0%	Perpetual	4,204
Subordinated loans - listed on the Iceland Stock Exchange	ISK	9.5%	Perpetual	1,171
Subordinated loans - listed on the Euronext Amsterdam	EUR	8.0%	Perpetual	12,391
Subordinated loans - listed on the London Stock Exchange	USD	7.5%	Perpetual	18,676
Total Tier 1				41,726

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Loans which qualify as Tier 2 capital:	Currency	Interest	Maturity date	Book value 2006
Subordinated loans - listed on the Iceland Stock Exchange	NOK	5.0%	2010	60
Subordinated loans - listed on the Iceland Stock Exchange	ISK	7.0%	2008	219
Subordinated loans - listed on the Iceland Stock Exchange	EUR	4.3%	2008	4,741
Subordinated loans - listed on the London Stock Exchange	EUR	4.0%	2009	6,659
Subordinated loans - listed on the London Stock Exchange	EUR	6.6%	2011	673
Subordinated loans - listed on the London Stock Exchange	EUR	6.8%	2015	1,002
Subordinated loans - listed on the London Stock Exchange	EUR	6.9%	2015	503
Subordinated loans - listed on the London Stock Exchange	USD	5.8%	2015	5,411
Subordinated loans - listed on the London Stock Exchange	USD	6.7%	2016	36,343
Subordinated loans - listed on the London Stock Exchange	NOK	4.4%	2008	213
Subordinated loans - listed on the Oslo Stock Exchange	NOK	5.3%	2013	3,436
Subordinated loans - listed on the Oslo Stock Exchange	NOK	4.4%	2015	3,436
Subordinated loans - listed on the Oslo Stock Exchange	NOK	4.6%	2016	350
Subordinated loans - listed on the Oslo Stock Exchange	NOK	4.5%	2016	4,226
Total Tier 2				67,272
Total subordinated loans				108,998

Financial liabilities held for trading

71. Balances of financial liabilities held for trading:

	31.12.2006	31.12.2005
Short positions in trading securities	4,877	0
Derivatives, credit institutions	36,954	16,408
Derivatives, others	9,898	12,383
Financial liabilities held for trading	51,729	28,791

Post-employment obligations

72. Amounts recognised in the balance sheet for post-employment obligations are determined as follows:

Pension liability as at 1.1.	418	2,607
Transferred into the Group	9	359
Transferred due to sale of subsidiary	(3)	(417)
Increment during the year	142	134
Paid during the year	(104)	(2,259)
Foreign exchange translation differences	67	(6)
Pension liability at year-end	529	418

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Notes to the Consolidated Financial Statements

Specification of post-employment obligations:	31.12.2006	31.12.2005
Present value of funded obligations	1,223	864
Fair value of plan assets	(868)	(638)
	355	226
Present value of unfunded obligations	111	102
Unrecognised actuarial losses	57	87
Unrecognised prior service cost	6	3
Pension liability in the balance sheet	529	418

Tax assets and tax liabilities

73. Tax in the balance sheet:

	2006		2005	
	Assets	Liabilities	Assets	Liabilities
Short-term	0	7,526	0	1,404
Deferred tax	264	3,121	268	3,682
Tax in the balance sheet	264	10,647	268	5,086

74. Changes in the deferred tax assets and the tax liabilities during the year are as follows:

	Assets	Liabilities
Tax assets and tax liabilities 1.1.2005	456	2,334
Transferred into the Group	0	955
Transferred from the Group	0	(2,211)
Exchange difference due to foreign subsidiaries	(22)	0
Calculated income tax for 2005	(166)	4,008
Income tax payable in 2006 and correction due to 2005	0	(1,404)
Deferred tax assets and tax liabilities 31.12.2005	268	3,682
Transferred into the Group	0	45
Translation difference due to foreign subsidiaries	59	(252)
Calculated income tax for 2006	(63)	7,962
Income tax on equity items		(790)
Income tax payable in 2007 and correction due to 2006	0	(7,526)
Deferred tax assets and tax liabilities at the end of 2006	264	3,121

75. The Bank's deferred tax assets and tax liabilities are attributable to the following balance sheet item:

	2006		2005	
	Assets	Liabilities	Assets	Liabilities
Leasing contracts		912		380
Shares in other companies	1	6		402
Property and equipment	2	213		172
Assets and liabilities denominated in foreign currencies		1,512		1,358
Tax loss of subsidiary carried forward	77		22	
Other items	184	478	246	1,370
Deferred tax assets and tax liabilities at the end of 2006/2005	264	3,121	268	3,682

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Other liabilities

76. Specification of other liabilities

	31.12.2006	31.12.2005
Accruals	6,595	2,819
Unsettled securities transactions	7,637	7,665
Deferred income	86	93
Other liabilities	5,495	15,253
Total	19,813	25,830

Equity

77. According to the Parent Company´s Articles of Association, the total outstanding number of shares is 14,265 million. At the end of December 2006 treasury shares were 104 million. One vote is attached to each share. In January 2006 the Bank issued 1,000 million new shares at ISK 18.6 per share. Also, 130 million new shares were issued through a payment of dividends in the form of shares.

78. Other reserves are specified as follows:

	Revaluation of fixed assets	Fair value change in AFS fin. assets	Accrued cost of stock options	Translation reserve	Total
Other reserves as at 1.1.2005	149	139	0	(1)	287
Translation differences				(1,357)	(1,357)
Net loss on hedge of net investment in foreign operations				915	915
Fair value changes of financial assets available-for-sale		(18)			(18)
Income tax on equity items		3		(198)	(195)
Accrued cost of stock options			52		52
Transferred due to sale of subsidiary	(149)				(149)
Other reserves as at 31.12.2005	0	124	52	(641)	(465)
Translation differences				10,187	10,187
Net loss on hedge of net investment in foreign operations				(4,462)	(4,462)
Fair value changes of financial assets available-for-sale		70			70
Income tax on equity items		(13)		804	791
Accrued cost of stock options			612		612
Other reserves as at 31.12.2006	0	181	664	5,888	6,733

Amounts are in ISK millions

Capital adequacy ratio

79. The capital adequacy ratio (CAD) is determined as follows:

	2006	2005
Shareholders' equity	144,578	84,537
Minority interest	1,541	0
Total shareholders' equity	146,119	84,537
Intangible assets	(18,310)	(10,824)
Core capital	127,809	73,713
Hybrid core capital	41,725	19,577
Tier 1 capital	169,534	93,290
Subordinated loans, excluding hybrid core capital	66,794	27,456
Deductions	(1,070)	(1,317)
Capital base	235,258	119,429
Risk-weighted assets		
Not included in trading portfolio	1,519,288	918,270
With market risk in trading portfolio	45,012	28,158
Total risk weighted assets	1,564,300	946,428
Core capital ratio	8.2%	7.8%
Tier 1 capital ratio	10.8%	9.9%
Capital adequacy ratio	15.0%	12.6%

Obligations

80. Specification of obligations:

	31.12.2006	31.12.2005
Guarantees granted to customers	79,583	19,788
Unused overdrafts	40,858	26,166

Operating lease commitments

81. Future non-cancellable minimum operating lease payments are due as follows:

Up to 1 year	411	354
1-5 years	1,417	1,268
Later than 5 years	4,472	4,255
	6,300	5,877

Amounts are in ISK millions

Assets under management and in custody

82. Balance of assets under management and custody assets:

	31.12.2006	31.12.2005
Assets under management	490,321	344,975
Custody assets	697,735	415,662

Pledged assets

83. Assets have been pledged as security in respect of the following liabilities and contingent liabilities:

Repurchase agreements with central banks	36,045	17,801

Stock options

84. All open stock options are listed in the tables below in millions of shares:

Stock options oustanding at 1.1.2005	45
Exercised during the year	(23)
New options issued	160
Stock options oustanding at 31.12.2005	**182**
Exercised during the year	(10)
Terminated during the year	(5)
New options issued	275
Stock options oustanding at 31.12.2006	**442**

	Millions of shares	Exercise price
Exercisable options	15	3.47
Exercisable options	3	3.10
Options exercisable in 2006 to 2008	11	10.65
Options exercisable in 2007	7	13.90
Options exercisable in 2007	141	15.50
Options exercisable in 2008	2	16.50
Options exercisable in 2008	3	13.95
Options exercisable in 2008	199	18.10
Options exercisable in 2008	1	18.50
Options exercisable in 2008	50	18.96
Options exercisable in 2008	10	19.80
Stock options outstanding at 31.12.2006	442	