Glitnir banki hf.

Consolidated Financial Statements 2007

Glitnir banki hf.
Kirkjusandur
155 Reykjavík

Reg. no. 550500-3530

Contents

Endorsement and Statement by the Board of Directors and the CEO

The profit from the Glitnir Banki's (the Bank) operations for the year 2007 amounted to ISK 27,651 million, which corresponds to a 19.3% return on equity. The Board of Directors proposes to pay a dividend of ISK 0.37 per share or ISK 5,506 million in the year 2008, and the remaining profit be allocated as indicated in the financial statements. Equity, according to the consolidated balance sheet, amounted to ISK 169,969 million at year end. The Bank's capital adequacy ratio, calculated according to the Act on Financial Undertakings, was 11.2%. Under Icelandic law the minimum requirement is 8.0%.

The Bank's total assets amounted to ISK 2,948,910 million at year end. Furthermore, the Bank held ISK 936,010 million under management for its clients.

Outstanding number of shares was 14,730 million at the year end and was increased by 616 million during the year. The Bank delivered 172 million shares to shareholders as dividend and 444 million shares to shareholders of FIM Group in relation to the takeover of FIM Group. Those shares were issued at ISK 24.8 per share.

In the first quarter of 2007 the Bank acquired the Finnish asset management company FIM Group Oy (now Glitnir Oy). Glitnir Oy is consolidated from 1 April 2007.

At 31 December 2007 the Bank's shareholders numbered 11,020 as compared to 11,323 at the beginning of the year. One shareholder owned more than 10.0% of the shares in the Bank. FL Group hf. and related parties owned 31.97%.

The consolidated financial statement of the year is made in accordance with the International financial reporting standards (IFRS), which have been approved by the European Union. Additional disclosure requirements for consolidated financial statements of firms that have listed stocks are also uphold.

To the best of our knowledge, the consolidated financial statement provides a truthful/clear picture of the operating profit in 2007, as well as its assets, liabilities and financial status on the 31st of December 2007, including the change in the cash flow in 2007.

Additionally, it is our opinion that this consolidated financial statement and the endorsement made by the Board of Directors and the CEO represent an accurate overview of the consortium's development, current status and main risk factors.

The Board of Directors and the CEO of Glitnir Banki hf. hereby confirm the Bank's consolidated financial statements for the year 2007 by means of their signatures.

Reykjavík, 31 January 2008.

Board of Directors:

Þorsteinn M. Jónsson, Chairman
Björn Ingi Sveinsson
Eiríkur S. Jóhannsson
Gunnar Karl Guðmundsson
Jón Sigurðsson
Kristinn Þ. Geirsson
Pétur Guðmundarson

Chief Executive Officer:

Lárus Welding

Independent Auditors' Report

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

We have audited the accompanying consolidated financial statements of Glitnir banki hf and its subsidiaries (the Group) which comprise the consolidated balance sheet as of 31 December 2007 and the consolidated income statement, consolidated statement of changes in equity and consolidated statement of cash flow for the year then ended and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements
Management is responsible for the preparation and fair presentation of these 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 judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, 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 2007, 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, 31 January 2008.

PricewaterhouseCoopers hf.

Sigurður B. Arnþórsson

Kristinn F. Kristinsson

Amounts are in ISK million

Consolidated Income Statement for the year 2007

	Notes	2007	2006
Interest income		187.576	119.115
Interest expense		(148.494)	(82.031)
Net interest income	10	39.082	37.084
Fee and commission income		44.059	30.307
Fee and commission expense		(6.415)	(3.848)
Net fee and commission income	11	37.644	26.459
Net financial income	12-14	4.155	8.503
Other net operating income	15	4.214	555
Net operating income		85.095	72.601
Administrative expenses	16-20	(48.144)	(27.301)
Net impairment losses on financial assets	35	(5.516)	(4.759)
Net gains on non-current assets classified as held for sale	21	2.523	4.244
Share of (loss) profit of associates	38	(54)	1.470
Profit before income tax		33.904	46.255
Income tax	22,54	(6.253)	(8.024)
Profit for the year		27.651	38.231
Attributable to:			
Equity holders of Glitnir banki hf.		26.680	37.360
Minority interest		971	871
Profit for the year		27.651	38.231
Basic earnings per share	23	1,86	2,68
Diluted earnings per share	23	1,85	2,66

The notes on pages 9 to 69 are an integral part of these consolidated financial statements

Amounts are in ISK million

Consolidated Balance Sheet as at 31 December 2007

	Notes	31.12.2007	31.12.2006
Assets			
Cash and balances with central banks	24	55.500	20.417
Derivatives	26-29	118.706	72.603
Bonds and debt instruments	30	278.960	231.675
Shares and equity instruments	31	105.581	108.846
Loans to banks	32	278.469	177.010
Loans to customers	33	1.974.907	1.596.184
Investments in associates	37-38,40	2.820	4.379
Investment property	42	5.539	0
Property and equipment	43	4.202	3.296
Intangible assets	44	46.955	18.310
Deferred tax assets	53-55	1.269	264
Non-current assets held for sale	3	476	409
Other assets	45	75.526	12.947
Total Assets		2.948.910	2.246.340
Liabilities			
Short positions	46	15.023	4.877
Derivatives	26-29	77.497	60.721
Deposits from central banks	47	4.653	36.045
Deposits from banks	47	50.524	42.532
Deposits from customers	48-49	725.349	438.272
Debt issued and other borrowed funds	50	1.746.199	1.377.787
Subordinated loans	51	101.669	108.998
Post-employment obligations	52	425	529
Current tax liabilities	53-55	4.362	7.526
Deferred tax liabilities	53-55	5.641	3.121
Other liabilities	56	47.599	19.813
Total Liabilities		2.778.941	2.100.221
Equity			
Share capital	57	14.730	14.161
Share premium		58.329	51.847
Other reserves	58	9.456	7.504
Retained earnings		86.686	71.066
Total equity attributable to the equity holders of Glitnir banki hf.		169.201	144.578
Minority interest		768	1.541
Total Equity	59	169.969	146.119
Total Liabilities and Equity		2.948.910	2.246.340

The notes on pages 9 to 69 are an integral part of these consolidated financial statements

Amounts are in ISK million

Consolidated Statement of Changes in Equity for the year 2007

	Attributable to equity holders of Glitnir banki hf.					Minority interest	Total equity
	Share capital	Share premium	Other reserves	Retained earnings	Total		
Equity at 1.1.2006	13.112	32.888	(465)	39.002	84.537		84.537
Translation differences for foreign operations			10.958		10.958		10.958
Net loss on hedges of net investments in foreign operations			(4.462)		(4.462)		(4.462)
Net change in fair value 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	7.357	0	7.357	(6)	7.351
Profit for the year				37.360	37.360	871	38.231
Total recognised income and expense for the year			7.357	37.360	44.717	865	45.582
Dividends paid				(5.296)	(5.296)		(5.296)
Issued new shares	1.130	19.752			20.882		20.882
Change in minority interest					0	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	7.504	71.066	144.578	1.541	146.119
Translation differences for foreign operations			534		534	21	555
Net loss on hedges of net investments in foreign operations			(89)		(89)		(89)
Net change in fair value of financial assets available-for-sale			(340)		(340)		(340)
Income tax on equity items			77		77		77
Net income recognised directly in equity			182		182	21	203
Profit for the year				26.680	26.680	971	27.651
Total recognised income and expense for the year	0	0	182	26.680	26.862	992	27.854
Dividends paid				(9.403)	(9.403)		(9.403)
Issued new shares	616	14.661			15.277		15.277
Change in minority interest				(1.657)	(1.657)	(1.765)	(3.422)
Purchased and sold own shares	(47)	(8.179)			(8.226)		(8.226)
Accrued stock options			1.770		1.770		1.770
Equity as at 31.12.2007	14.730	58.329	9.456	86.686	169.201	768	169.969

The notes on pages 9 to 69 are an integral part of these consolidated financial statements

Amounts are in ISK million

Consolidated Statement of Cash Flows for the year 2007

	Notes	2007	2006
Cash flows from operating activities:			
Profit for the year		27.651	38.231
Adjustments to reconcile profit for the year to cash flow used in operating activities:			
Non-cash items included in profit for the year and other adjustments		3.180	29.423
Changes in operating assets and liabilities:			
Required reserves with central banks		(245)	(1.238)
Loans and receivables		(338.452)	(188.917)
Trading assets		(57.314)	(35.094)
Financial assets designated at fair value through profit or loss		(71.209)	9.968
Financial assets available for sale		(13.858)	0
Deposits		241.798	101.204
Debt issued and other borrowed funds		355.282	188.080
Trading financial liabilities		33.531	22.937
Financial liabilities designated at fair value through profit or loss		35.009	0
Derivatives used for hedging		(12.256)	3.266
Post-employment obligations		(104)	99
Other operating assets and liabilities		(40.498)	(20.089)
Net cash provided by operating activities		162.515	147.870
Cash flows from investing activities:			
Investments in associates		1.560	9.344
Investments in subsidiaries, net of cash acquired		(27.374)	(6.476)
Property and equipment		(581)	(875)
Investment property		(1.815)	0
Net cash (used in) provided by from investing activities		(28.210)	1.993
Cash flows from financing activities:			
Subordinated loans		(7.329)	44.401
Issued new shares		15.277	20.882
Purchase of treasury shares		(8.226)	(873)
Dividends paid		(9.403)	(5.296)
Net cash (used in) provided by financing activities		(9.681)	59.114
Net increase in cash and cash equivalents		124.624	208.977
Translation difference on cash and cash equivalents		555	536
Cash and cash equivalents at the beginning of the year		304.648	95.135
Cash and cash equivalents at year-end		429.827	304.648
Reconciliation of cash and cash equivalents:			
Cash in hand	24	1.180	1.044
Cash balances with central banks	24	51.624	14.967
Treasury bills		0	1.954
Money market loans	32	192.918	87.467
Bank accounts	32	63.360	33.590
Other loans	32	22.191	55.953
Financial assets designated at fair value through profit and loss		98.554	109.673
		429.827	304.648

The notes on pages 9 to 69 are an integral part of these consolidated financial statements

Notes to the Consolidated Financial Statements

1. General information

Glitnir banki hf. is a company incorporated and domiciled in Iceland. The consolidated financial statements for the year 2007 comprise Glitnir banki hf. (the parent) and its subsidiaries (together referred to as "the Bank"). The Bank provides a wide range of financial services, including retail banking, corporate banking, brokerage services, investment management and asset based financing. The Bank operates worldwide with its home market being in Iceland and Norway.

The consolidated financial statements are presented in Icelandic krona (ISK), which is the functional currency of Glitnir banki hf. Except as indicated, the amounts presented have been rounded to the nearest million.

The consolidated financial statements have been approved for issue by the Board of Directors of Glitnir banki hf. on 31 January 2008.

2. Basis of preparation

2.1 Statement of compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union.

Information about the application of new Standards and Interpretation is disclosed in notes 3.28 and 3.29

2.2 Basis of measurement

The consolidated financial statements are prepared on the historical cost basis, except for the following assets and liabilities, which are measured at fair value: derivatives, short positions, bonds and debt instruments, shares and equity instruments, loans to customers designated at fair value through profit or loss, debt issued and designated at fair value through profit or loss, and investment property. The carrying amounts of recognised assets and liabilities that are hedged items in fair value hedges, and otherwise carried at cost, are adjusted to record changes in fair value attributable to the risks that are being hedged.

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.

2.3 Significant accounting judgements and estimates

The preparation of the consolidated financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of accounting policies and 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 most significant accounting judgements and estimates are as follows:

a) Determination of fair value

As disclosed in note 3.5, 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.

Notes to the Consolidated Financial Statements

b) *Impairment losses on loans and receivables*

As disclosed in note 3.24, 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 quarterly 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.

c) *Classification of financial assets and financial liabilities*

The Bank’s accounting policies provide scope for assets and liabilities to be designated on inception into different accounting categories in certain circumstances. In classifying financial assets as “held for trading”, the Bank has determined that it meets the description of financial assets held for trading set out in note 3.3. In designating financial assets or liabilities at fair value through profit or loss, the Bank has determined that it has met one of the criteria for this designation set out in note 3.3. Details of the Bank’s classification of financial assets and liabilities are given in note 8 and 9.

d) *Qualifying hedge relationships*

In designating financial instruments as qualifying hedge relationships, the Group has determined that it expects the hedge to be highly effective over the life of the hedging instrument.

e) *Income taxes*

The Bank is subject to income taxes in numerous jurisdictions. Significant estimates are required in determining the worldwide provision for income taxes. There are many transactions and calculations for which the ultimate tax determination is uncertain during the ordinary course of business. The Bank recognises liabilities for anticipated tax audit issues based on estimates of whether additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the income tax and deferred tax provisions in the period in which such determination is made.

3. Significant accounting policies

3.1 The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements, and have been applied consistently by Banks entities.

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.

Notes to the Consolidated Financial Statements

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) *Minority interests*

Minority interests represent the portion of profit or loss and net assets not owned, directly or indirectly, by the Bank and are presented separately in the income statement and within equity in the consolidated balance sheet, separately from the equity attributable to equity holders of Glitnir banki hf. The Bank accounts for transactions with minority interests as transactions with parties external to the Bank. Disposals to minority interests result in gains and losses for the Bank that is recorded in the income statement. Purchases from minority interests result in goodwill, being the difference between any consideration paid and the relevant share acquired of the carrying value of net assets of the subsidiary. If the cost of acquisition is less than the fair value of the net assets acquired, the difference is recognised immediately as income in the income statement.

c) *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.

Investments in associates are accounted for using the equity method and are initially recognised at cost. The investments include goodwill identified on acquisition, net of any accumulated impairment losses. The carrying amount of the investments 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 carrying amount of that associate 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 the associate. If the associate subsequently reports profits, the Bank resumes recognising its share of profits only after its share of 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 3.13.

Investments in associates held by the venture capital organisation of the Bank are not accounted for using the equity method 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 3.3.

d) *Jointly controlled entities*

Jointly controlled entities are those entities over whose activities the Bank has joint control, established by contractual agreement and requiring unanimous consent of ventures for strategic financial and operating decisions. The Bank recognises its interest in jointly controlled entities using the proportionate consolidation method of accounting whereby the Bank’s share of each of the assets, liabilities, income and expenses of the jointly controlled entities is combined line by line with similar items in the Bank’s consolidated financial statements. The Bank determines its share of the profits and net assets of jointly controlled entities based on the substance of the contractual agreements between the Bank and the other ventures.

Notes to the Consolidated Financial Statements

e) *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 and jointly controlled entities are eliminated to the extent of the Bank's interest in them. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

3.2 Foreign currencies

a) *Foreign currency transactions*
Items included in the financial statements of each of the Bank's entities are measured using the functional currency of the respective entity. 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 retranslated into functional currencies at the foreign exchange rate ruling at that date. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are retranslated at foreign exchange rates ruling at the dates the fair value was determined. Foreign exchange differences arising on retranslation are recognised in the income statement in "Net financial income", except for differences arising on financial instruments designated as hedging instruments of net investments in foreign operations (see note 29).

b) *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 (ISK), 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 the translation reserve in equity. When a foreign operation is disposed of, in part or in full, the relevant amount in the translation reserve is transferred from equity and recognised in the income statement as part of the gain or loss on sale.

3.3 Financial assets

For the purpose of measurement, the Bank classifies its financial assets in the following categories: financial assets held for trading, financial assets designated at fair value through profit or loss, loans and receivables, and available-for-sale financial assets. Management determines the classification of financial assets at initial recognition.

a) *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 and debt instruments, shares and equity instruments, and derivatives with positive fair value which are not designated as hedging instruments.

Financial assets held for trading are initially recognised and subsequently measured at fair value in the balance sheet with transaction costs taken directly to profit or loss. Changes in fair value are recognised in the income statement in "Net financial income", except for interest earned, which is recognised as "Interest income" on an accrual basis.

b) *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 through 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.

Notes to the Consolidated Financial Statements

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
- debt and equity 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 initially recognised and subsequently measured at fair value in the balance sheet with transaction costs taken directly to profit or loss. Changes in fair value are recognised in the income statement in "Net financial income", except for interest earned, which is recognised as "Interest income" on an accrual basis.

c) *Loans and receivables*

Loans and receivables are non-derivative financial instruments with fixed or determinable payments that are not quoted in an active market and that the Bank does not intend to sell immediately or in the near term, other than those that the Bank designates upon initial recognition as financial assets at fair value through profit or loss. Loans and receivables include loans originated by the Bank to other banks and to its customers, participations in loans from other lenders and purchased loans.

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, less allowance for impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees and costs that are an integral part of the effective interest rate. Accrued interest is included in the carrying amount of the loans and receivables in the balance sheet.

Gains and losses on loans and receivables are recognised in the income statement in 'Interest revenue' and 'Interest expense' when the loans and receivables are derecognised and in 'Currency exchange difference' when the the loans and receivables are remeasured for foreign exchange differences. The losses arising from impairment are recognised in the income statement in "Net impairment losses on financial assets".

d) *Financial assets available-for-sale*

Financial assets available-for-sale are non-derivative investments which the Bank designates as such or are not classified as loans and receivables, financial assets held for trading or financial assets designated at fair value through profit or loss. Financial assets available-for-sale consist of debt instruments held by the Bank for long-term investment purposes.

Financial assets available-for-sale are initially recognised at fair value plus transaction costs, and subsequently are carried at fair value. Changes in fair value are initially recognised directly in equity, net of income taxes. The cumulative changes in fair value recognised in equity are transferred to the income statement in "Net financial income" when the financial assets are derecognised or impaired. Gains and losses on derecognition are determined using the average cost method.

Interest earned on financial assets classified as available-for-sale is recognised in income statement in "Interest income" using the effective interest method. Foreign exchange gains and losses on monetary financial assets classified as available-for-sale are recognised in income statement in "Net financial income". Dividends on available-for-sale equity instruments are recognised in income statement in "Net financial income" when the Bank’s right to receive payment is established. The losses arising from impairment of financial assets classified as available-for-sale are recognised in income statement in "Net impairment losses on financial assets".

Notes to the Consolidated Financial Statements

3.4 Financial liabilities

For the purpose of measurement, the Bank classifies its financial liabilities in the following categories: financial liabilities held for trading, financial liabilities designated at fair value through profit or loss, and financial liabilities measured at amortised cost. Management determines the classification of financial liabilities at initial recognition.

a) *Financial liabilities held for trading*

Financial liabilities held for trading are financial liabilities incurred principally for the purpose of generating profits from short-term price fluctuations or from dealer’s margin. Financial liabilities held for trading consist of short position in equity and bond instruments, and derivatives with negative fair value which are not classified as financial guarantees or are not designated as hedging instruments.

Financial liabilities held for trading are initially recognised and subsequently measured at fair value in the balance sheet with transaction costs taken directly to profit or loss. Changes in fair value are recognised in the income statement in "Net financial income", except for interest incurred, which is recognised as "Interest expense" on an accrual basis.

b) *Financial liabilities designated at fair value through profit or loss*

The Bank classifies certain financial liabilities upon their initial recognition as financial liabilities at fair value through 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.

Liabilities classified according to the above-mentioned conditions consist of:
- fixed rate deposits and fixed interest rate debt issued by the Bank whose fixed interest has been swapped into floating by entering into corresponding interest rate swaps, and
- structured notes which are managed and evaluated on a fair value basis.

Financial liabilities designated at fair value through profit or loss are initially recognised and subsequently measured at fair value in the balance sheet with transaction costs taken directly to profit or loss. Changes in fair value are recognised in the income statement in "Net financial income", except for interest incurred, which is recognised as "Interest expense" on an accrual basis.

c) *Financial liabilities measured at amortised cost*

Financial liabilities measured at amortised cost are non-derivative financial liabilities which are not classified as financial liabilities held for trading or financial liabilities designated at fair value through profit or loss. Financial liabilities measured at amortised cost include deposits, debt issued and other borrowed funds and subordinated loans.

Financial liabilities measured at amortised cost are recognised initially at fair value net of transaction costs incurred, and subsequently are carried at amortised cost using the effective interest method. Amortised cost is calculated by taking into account any discount or premium on the issue and fees and costs that are an integral part of the effective interest rate. Accrued interest is included in the carrying amount of the liabilities in the balance sheet.

Notes to the Consolidated Financial Statements

3.5 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, in which case the inputs 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 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 the difference between the transaction price and fair value in the income statement in "Net financial income" on initial recognition of the financial instrument. In cases where use is made of data which is not from observable markets, the difference between the transaction price and the value produced by the valuation technique, if any, is recognised in the income statement in "Net financial income", depending upon individual facts and circumstances of each transaction and not later than when the data becomes observable.

Notes to the Consolidated Financial Statements

3.6 Recognition and derecognition of financial assets and financial liabilities

The Bank uses trade date accounting to recognise purchases and sales of financial assets, 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.

The Bank derecognises financial assets when the contractual rights to the cash flows from the financial assets expire or when the Bank transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Any interest in transferred financial assets that is created or retained by the Bank is recognised as a separate asset or liability.

The Bank recognises financial liabilities held for trading and financial liabilities designated at fair value through profit or loss on the trade date at which the Bank becomes a party to the contractual provisions of the financial instrument. The Bank recognises financial liabilities measured at amortised cost on the date when they are originated. The Bank derecognises a financial liability when its contractual obligations are discharged or cancelled or expire.

The Bank enters into transactions whereby it transfers assets recognised on its balance sheet, but retains either all risks and rewards of the transferred assets or a portion of them. If all or substantially all risks and rewards are retained, then the transferred assets are not derecognised from the balance sheet. Transfers of assets with retention of all or substantially all risks and rewards include, for example, repurchase transactions and securities lending.

The Bank does not derecognise from the balance sheet securities which the Bank sells under agreements to repurchase at a specified future date ("repos") at a fixed price or at the sale price plus a lender’s return. The Bank recognises the cash received as a liability on its balance sheet. The difference between the sale and repurchase prices is recognised as interest expense over the life of the agreement using the effective rate method. Conversly, the Bank does not recognise securities purchased under agreements to resell at a specified future date ("reverse repos") at a fixed price or at the sale price plus a lender’s return. The Bank recognises the cash paid as a receivable on its balance sheet. The difference between the purchase and resale prices is recognised as interest income over the life of the agreement using the effective rate method.

Securities lending and borrowing transactions are usually collateralised by securities or cash. The transfer of securities to counterparties is only reflected on the balance sheet if the risks and rewards of ownership are also transferred. Cash advanced or received as collateral is recorded as an asset or liability. Securities borrowed are not recognised on the balance sheet, unless the Bank sells them to third parties, in which case the Bank's obligation to return the securities is recorded as "Short positions" in the balance sheet.

3.7 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.

3.8 Derivative financial instruments and hedge accounting

The Bank uses derivatives for trading purposes and to hedge its exposure to market price risk, currency risk and interest rate risk. Derivatives which do not classify as equity instruments of the Bank are classified as financial assets or financial liabilities, measured at fair value and presented in the balance sheet as assets or liabilities, depending on whether their fair value at the balance sheet date is positive (assets) or negative (liabilities).

Derivatives embedded in other contractual arrangements are accounted for 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.

Notes to the Consolidated Financial Statements

The method of recognising changes in fair value of derivatives depends on whether the derivatives are designated as hedging instruments, and if so, the nature of the item being hedged, as described below. Derivatives which the Bank does not designate or are not effective hedging instruments are classified as financial asset or financial liabilities held for trading and are accounted for in accordance with note 3.3(a) and 3.4(a) above.

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 applies 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. Therefore, derivatives which the Bank designates and are effective hedging instruments are accounted for in accordance with the rules applicable to hedge accounting.

Where hedge accounting is applied the Bank documents, at the inception of the hedge, the relationship between hedged items and hedging instruments, as well as the Bank's risk management objective and strategy for undertaking the hedges. The Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

The Bank assesses the effectiveness of the hedge both at the inception of the hedge and each time the Bank prepares its annual or interim financial statements. 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 gains or losses on hedging instruments 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 could affect profit or loss.

Changes in fair value of hedged assets or liabilities that are attributable to the risks being hedged are recognised as part of the carrying amounts of the assets or liabilities in the balance sheet. The changes in fair value of hedged assets or liabilities are recognised in income statetment, together with changes in fair value of derivatives and are included in "Net financial income" line item in the income statement. Accrued interest on hedging instruments is presented as an adjustment to interest recognised in income statement from the hedged assets or liabilities.

If the derivative expires or is sold, terminated, or exercised, or where it no longer meets the criteria for fair value hedge accounting, or the designation is revoked, hedge accounting is discontinued. In this case, any adjustment to the carrying amount of hedged assets or liabilities for which the effective interest method is used is amortised to profit or loss over the period to maturity. If the hedged assets or liabilities are derecognised, the unamortised fair value adjustment is recognised immediately in the income statement.

b) *Net investment hedges*

Hedges of net investments in foreign operations seek to eliminate the currency exposure on the carrying amount of the Bank's net investments in foreign subsidiaries and associates in the consolidated financial statements.

The exchange differences arising from the translation of net investments in foreign subsidiaries and associates into the presentation currency are recognised directly in the translation reserve in equity. The effective portion of the gains or losses on hedging insturments are also recognised directly in the translation reserve in equity, net of related income tax. Any ineffective portion of changes in the fair value of hedging instruments is recognised immediately in income statement in "Net financial income" along with any portion of changes in the fair value of hedging instruments that are excluded from the assessment of hedge effectiveness. The amounts recognised in equity are transferred to income statement upon disposals of hedged foreign subsidiaries and associates.

Notes to the Consolidated Financial Statements

3.9 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.

3.10 Investment property

The Bank holds certain properties as investments to earn rental income, for capital appreciation or both. Investment property is measured initially at cost, including transaction costs. Subsequently, investment property is measured at fair value, which reflects market conditions at the balance sheet date. Changes in the fair values are included in the income statement in "Other net operating income".

3.11 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.

Notes to the Consolidated Financial Statements

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.

3.12 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 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.

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 anually and whenever there is an indication that goodwill may be impaired. Other intangible assets are amortised from the date they are available for use.

3.13 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.

Notes to the Consolidated Financial Statements

3.14 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%.

3.15 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.

3.16 Financial guarantees

Financial guaranteee are contracts that require the Bank to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payments when due, in accordance with the terms of a debt instrument.

Financial guarantees are recognised in the financial statements when they are issued and are included within "Other liabilities" in the balance sheet. Financial guarantees are initially measured at fair value, being the premium received. Subsequently, the Bank’s liability under each guarantee is measured at the higher of the amortised premium and the best estimate of the expenditure required to settle any financial obligation arising as a result of the guarantee at the balance sheet date. The estimates are determined based on experience of similar transactions and history of past losses, supplemented by the judgement of management.

Any increase in the liability relating to financial guarantees is recognised in income statement in "Other net operating income". The premium received is recognised in income statement in "Net fees and commission income" on a straight line basis over the life of each guarantee.

3.17 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.

3.18 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 58. 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.

Notes to the Consolidated Financial Statements

3.19 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) *Dividends 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.

3.20 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, and are used by the Bank in the management of its short-term commitments.

3.21 Interest income and expense

For all financial assets and financial liabilities measured at amortised cost and for debt instruments classified as financial assets available-for-sale (see notes 3.3 and 3.4), interest income and expense is recognised in the income statement using the effective interest method. For all financial assets and financial liabilities held for trading and for all financial assets and liabilities designated at fair value through profit or loss (see notes 3.3 and 3.4), interest income and expense is recognised in the income statement on an accrual basis.

The effective interest 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 a shorter period, when appropriate, 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.

The effective interest rate is established on initial recognition of financial assets and financial liabilities and their carrying amount is subsequently adjusted if the Bank revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original effective interest rate (i.e. the effective interest rate established at initial recognition) and the change in carrying amount is recorded as interest income or expense. For floating rate instruments interest income or expense is generally recognised based on the current market rate plus or minus amortisation or accretion of the discount or premium based on the original effective interest rate. Interest on impaired financial assets is calculated by applying the original effective interest rate of the financial asset to the carrying amount as reduced by any allowance for impairment.

Interest income and expense include gains and losses on derecognition of loans and receivables and financial liabilities measured at amortised cost.

Notes to the Consolidated Financial Statements

3.22 Fee and commission income and expense

Fees and commissions are generally recognised on an accrual basis when the service has been provided.

Loan commitment fees for loans that are likely to be drawn down are deferred and recognised as an adjustment to the effective interest rate on the loan. When a loan commitment is not expected to result in the draw-down of a loan, loan commitment fees are recognised on a straight-line basis over the commitment period. Loan syndication fees are recognised as revenue when the syndication has been completed and the Bank has retained no part of the loan package for itself or has retained a part at the same effective interest rate as the other participants.

Commission and fees arising from negotiating, or participating in the negotiation of, a transaction for a third party – such as the arrangement of the acquisition of shares or other securities or the purchase or sale of businesses – are recognised on completion of the underlying transaction. Portfolio and other management advisory and service fees are recognised based on the applicable service contracts, usually on a time-apportionate basis. Asset management fees related to investment funds are recognised rateably over the period in which the service is provided. The same principle is applied for wealth management, financial planning and custody services that are continuously provided over an extended period of time. Performance linked fees or fee components are recognised when the performance criteria are fulfilled.

3.23 Net financial income

Net financial income consists of net gains on financial instruments held for trading, net gains on financial instruments designated at fair value through profit or loss, fair value adjustments in hedge accounting and net foreign exchange gains.

a) *Net gains on financial instruments held for trading*

Net gains on financial instruments held for trading comprise gains and losses related to financial assets and financial liabilities held for trading, and includes all realised and unrealised fair value changes, except for interest (which is included in "Interest income" and "Interest expense") and foreign exchange gains and losses (which are included in "Net foreign exchange gains" as described below). Dividend income from financial assets held for trading is recognised in the income statement when the Bank's right to receive payment is established.

Gains and losses arising from changes in the fair value of derivatives that are classified as held for trading and which are economic hedges of financial assets or financial liabilities designated at fair value through profit or loss are included in "Net gains on financial instruments designated at fair value through profit or loss".

b) *Net gains on financial instruments designated at fair value through profit or loss*

Net gains on financial instruments designated at fair value through profit or loss comprise gains and losses related to financial assets and financial liabilities designated at fair value through profit or loss, and includes all realised and unrealised fair value changes, except for interest (which is included in "Interest income" and "Interest expense") and foreign exchange gains and losses (which are included in "Net foreign exchange gains" as described below). Dividend income from financial assets designated at fair value through profit or loss is recognised in the income statement when the Bank's right to receive payment is established.

Net gains on financial instruments designated at fair value through profit or loss include also gains and losses arising from changes in the fair value of derivatives that are classified as held for trading and which are economic hedges of financial assets or financial liabilities designated at fair value through profit or loss.

c) *Fair value adjustments in hedge accounting*

Fair value adjustments in hedge accounting comprises gains and losses arising from the entire change in fair value of hedging instruments in fair value hedges and gains and losses on hedged items attributable to the risks being hedged (see note 28).

d) *Net foreign exchange gains*

Net foreign exchange gains comprise all foreign exchange differences arising on the settlement of foreign currency monetary assets and liabilities and on translating foreign currency monetary assets and liabilities at rates different from those at which they were translated on initial recognition during the period or in previous financial statements, except for differences arising on financial instruments designated as hedging instruments of net investments in foreign operations (see note 29).

Notes to the Consolidated Financial Statements

Net foreign exchange gains also include foreign exchange differences arising on translating non-monetary assets and liabilities which are measured at fair value in foreign currencies and whose other gains and losses are also recognised in profit or loss.

3.24 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 Bank uses to determine that there is objective evidence of an impairment loss include:

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.

Notes to the Consolidated Financial Statements

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.

Loan write-offs

When a loan is uncollectible, it is written off against the related provision for loan impairment. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined.

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.

f) *Renegotiated loans*

Where possible, the Bank seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated, the loan is no longer considered past due. Management continuously reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment.

3.25 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 carry forward 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

3.26 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.

3.27 Segment reporting

A business segment is a group of assets and operations engaged in providing products or services that are subject to risk and return that are different from those of other business segments. The Bank is organised into six main business segments: Retail banking, Corporate banking, Investment banking, Markets, Investment management and Treasury. A geographical segment is engaged in providing products or services within a particular economic environment that are subject to risks and returns different from those of segments operating in other economic environments. The Bank is organised into four geographical segments: Iceland, Nordics, Europe and International.

3.28 New Standards and Interpretations effective in 2007

IFRS 7 *Financial Instruments: Disclosures* and the Amendment to IAS 1 *Presentation of Financial Statements: Capital Disclosures* became mandatory for the Bank's 2007 financial statements. The adoption of IFRS 7 and the amendment to IAS 1 impacted the type and amount of disclosures made in these financial statements, but had no impact on the reported profits or financial position of the Bank. In accordance with the transitional requirements of the standards, the Bank has provided comparative information. In connection with the initial application of IFRS 7, the Bank decided to change the presentation of financial assets and some financial liabilities in the balance sheet and the presentation of related gains and losses in the income statement.

IFRIC 7 – 10 became mandatory for the Bank's 2007 financial statements but their adoption had no impact on the Bank's 2007 financial statements.

3.29 New standards and interpretations not yet adopted

A number of new standards, amendments to standards and interpretations are not yet effective for the year ended 31 December 2007, and have not been applied in preparing these consolidated financial statements:

a) IFRS 8 *Operating Segments* introduces the "management approach" to segment reporting. IFRS 8, which becomes mandatory for the Bank's 2009 financial statements, will require the disclosure of segment information based on the internal reports regularly reviewed by the Bank's Chief Operating Decision Maker in order to assess each segment's performance and to allocate resources to them. Currently the Bank presents segment information in respect of its business and geographical segments (see note 5 and 6). The Bank has not yet determined the potential effect of IFRS 8 on the consolidated financial statements.

b) IAS 1 *Presentation of Financial Statements* (revised in 2007) replaces IAS 1 *Presentation of Financial Statements* (revised in 2003) as amended in 2005. IAS 1 (Revised 2007) sets the overall requirements for the presentation of financial statements, guidelines for their structure and minimum requirements for their content. The main change in revised IAS 1 is a requirement to present all non-owner changes in equity (changes in equity not resulting from transactions with owners in their capacity as owners) in one or two statements: either in a single statement of comprehensive income, or in an income statement plus in a statement of comprehensive income. Unlike under current IAS 1, it is not permitted to present components of comprehensive income in the statement of changes in equity. IAS 1 (revised in 2007), which becomes mandatory for the Bank's 2009 financial statements if endorsed by the EU, is expected to impact the presentation of the Bank's income statement and statement of changes in equity.

c) Revised IAS 23 *Borrowing Costs* removes the option to expense borrowing costs and requires that an entity capitalise borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. If endorsed by the EU, the revised IAS 23 will become mandatory for the Bank's 2009 financial statements and will have no effect on the Bank's accounting policies.

Notes to the Consolidated Financial Statements

d) The amendments to IFRS 2 *Share Based Payment – Vesting Conditions and Cancellations* (January 2008) clarify the definition of vesting conditions and the accounting treatment of cancellations. If endorsed by the EU, the amendments become mandatory for the Bank's 2009 financial statements, with retrospective application required. The amendments are not expected to have any effect on the consolidated financial statements of the Bank.

e) IFRS 3 *Business Combinations* (revised in 2008) and amended IAS 27 *Consolidated and Separate Financial Statements* introduce changes to the accounting for business combinations and for non-controlling (minority) interest. The most significant changes from IFRS 3 (2004) and IAS 27 (2003) are the following:

- IFRS 3 (2008) applies also to business combinations involving only mutual entities and to business combinations achieved by contract alone;
- The definition of a business combination has been revised to focus on control;
- The definition of a business has been amended;
- Transaction costs incurred by the acquirer in connection with the business combination do not form part of the business combination transaction;
- Acquisitions of additional non-controlling equity interests after the business combination are accounted for as equity transactions;
- Disposals of equity interests while retaining control are accounted for as equity transactions;
- New disclosures are required.

IFRS 3 (revised in 2008) and amended IAS 27 will become mandatory for the Bank's 2010 financial statements, if endorsed by the EU. The carrying amounts of any assets and liabilities that arose under business combinations prior to the application of IFRS 3 (revised in 2008) are not adjusted while most of the amendments to IAS 27 must be applied retrospectively. The Bank has not yet determined the potential effect of IFRS 3 (revised in 2008) and amended IAS 27 on the consolidated financial statements.

f) IFRIC 11 *IFRS 2 – Group and Treasury Share Transactions* requires a share-based payment arrangement in which an entity receives goods or services as consideration for its own equity instruments to be accounted for as an equity-settled share-based payment transaction, regardless of how the equity instruments are obtained. IFRIC 11 will become mandatory for the Bank's 2008 financial statements, with retrospective application required. IFRIC 11 is not expected to have any impact on the consolidated financial statements.

g) IFRIC 12 *Service Concession Arrangements* provides guidance on certain recognition and measurement issues that arise in accounting for public-to-private service concession arrangements. IFRIC 12, which becomes mandatory for the Bank's 2008 financial statements if endorsed by the EU, will have no effect on the consolidated financial statements.

h) IFRIC 13 *Customer Loyalty Programmes* addresses the accounting by entities that operate, or otherwise participate in, customer loyalty programmes for their customers. It relates to customer loyalty programmes under which the customer can redeem credits for awards such as free or discounted goods or services. IFRIC 13, which becomes mandatory for the Bank's 2009 financial statements if endorsed by the EU, is not expected to have a material impact on the consolidated financial statements.

i) IFRIC 14 *IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* clarifies when refunds or reductions in future contributions in relation to defined benefit assets should be regarded as available and provides guidance on the impact of minimum funding requirements (MFR) on such assets. It also addresses when a MFR might give rise to a liability. IFRIC 14 will become mandatory for the Bank's 2008 financial statements if endorsed by the EU, with retrospective application required. The Bank has not yet determined the potential effect of the interpretation on the consolidated financial statements.

Amounts are in ISK million

Notes to the Consolidated Financial Statements

Changes within the Group

4. During the year, the Bank acquired the Finnish Asset Management Company FIM Group Oy, now Glitnir Oy, Leimdörfer Holding AB, Tamm & Partners AB and Norsk Privatøkonomi ASA. The effects of the combination on the Bank's consolidated accounts are specified below. The shares were paid for in cash and in exchange for shares in the Glitnir banki hf.

Assets	FIM Group Oy (Glitnir Oy)	Leimdörfer Holding AB	Tamm & Partners AB	Norsk Privatøkonomi ASA	Total
Cash and balances with central banks				326	326
Shares and equity instruments	2.741		6		2.747
Loans to banks	1.828	423	94		2.345
Property and equipment	354	23	10	70	457
Intangible assets	28.717	2.869	252	2.451	34.289
Tax assets	165				165
Other assets	1.383	230	35	204	1.852
Total assets	35.188	3.545	397	3.051	42.181
Liabilities and minority interest					
Derivatives	436				436
Deferred Tax liability	2.866			62	2.928
Other liabilities	1.535	323	19	541	2.418
Minority interest	0	31		8	39
Total liabilities and minority interest	4.837	354	19	611	5.821
Acquisition price	30.351	3.191	378	2.440	36.360
Ownership	100%	91%	100%	98%	
Consolidated from	1.4.2007	1.7.2007	1.7.2007	1.12.2007	

During the year, the Bank reduced its share in Glitnir Property Holding AS and Glitnir Real Estate Fund I hf. The effects of the disposals on the Bank's consolidated accounts are specified below:

Assets	Glitnir Property Holding AS	Glitnir Real Est. Fund I hf.	Total
Shares and equity instruments		132	132
Loans to banks	1.663	1.029	2.692
Loans to customers		100	100
Investment in associates		178	178
Property and equipment	33		33
Investment property		1.988	1.988
Intangible assets	8.621		8.621
Other assets	2.303	111	2.414
Total assets	12.620	3.538	16.158
Liabilities and minority interest			
Debt issued and other borrowings	7.623	1.231	8.854
Current tax liability	466		466
Deferred tax liability	47		47
Other liabilities	140	885	1.025
Minority interest	2.973	796	3.769
Total liabilities and minority interest	11.249	2.912	14.161
Book value of equity at the disposal date	1.371	626	1.997
Realized gain	1.809	6	1.815
Ownership after disposal	49%	44%	
Consolidated until	1.12.2007	1.12.2007	

Amounts are in ISK million

Notes to the Consolidated Financial Statements

Geographical segments

6. 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 2007	Total assets	Total liabilities	Net operating income	Operating costs and other items
Iceland	1.693.215	1.623.001	38.588	21.412
Nordics	755.702	696.932	27.557	19.731
Europe	424.291	390.593	14.904	8.196
International	75.702	68.415	4.046	1.852
Total	2.948.910	2.778.941	85.095	51.191

At 31 December 2006	Total assets	Total liabilities	Net operating income	Operating costs and other items
Iceland	1.228.453	1.143.023	45.342	13.578
Nordics	655.397	612.574	14.691	6.801
Europe	207.224	195.674	9.294	4.698
International	155.266	148.950	3.274	1.269
Total	2.246.340	2.100.221	72.601	26.346

Quarterly Statements

7. Operations by quarters:

2007	Q4	Q3	Q2	Q1	Total
Net interest income	11.863	9.618	9.658	7.943	39.082
Other operating income	8.047	14.172	13.525	10.269	46.013
Administrative expenses	(15.642)	(11.738)	(12.127)	(8.637)	(48.144)
Impairment losses	(2.366)	(1.671)	(247)	(1.232)	(5.516)
Other income	1.904	14	478	73	2.469
Profit before income tax	3.806	10.395	11.287	8.416	33.904
Income tax	(1.320)	(1.759)	(1.766)	(1.408)	(6.253)
Profit for the period	2.486	8.636	9.521	7.008	27.651

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

Amounts are in ISK million

Notes to the Consolidated Financial Statements

Financial assets and liabilities

8. The following table describes the carrying value and fair value of financial assets and financial liabilities. For instruments that are not recognised at fair value on the balance sheet the fair value has been estimated by discounting the cash flow, taking into account interest rate risk and credit risk. It is assumed that the pricing of interest rate risk and credit risk is consistent between assets and liabilities.

At 31 December 2007	Notes	Held for trading	Designated at fair value through P&L	Loans & receivables	Available for sale	At amortised cost	Hedges	Total carrying amount	Fair value
Cash and balances with central banks	24			55.500				55.500	55.500
Derivatives	26-29	107.338					11.368	118.706	118.706
Bonds and debt instruments	30	99.712	161.707		17.541			278.960	278.960
Shares and equity instruments	31	77.516	28.001		64			105.581	105.581
Loans to banks	32			278.469				278.469	266.345
Loans to customers	33		71.245	1.903.662				1.974.907	1.912.020
Total		284.566	260.953	2.237.631	17.605	0	11.368	2.812.123	2.737.112
Short positions	46	15.023						15.023	15.023
Derivatives	26-29	70.238					7.259	77.497	77.497
Deposits from central banks	47					4.653		4.653	4.653
Deposits from banks	47					50.524		50.524	50.524
Deposits from customers	48-49		37.836			687.513		725.349	725.349
Debt issued and other borrowed funds	50		224.053			1.522.146		1.746.199	1.679.004
Subordinated liabilities	51		2.427			99.242		101.669	97.421
Total		85.261	264.316	0	0	2.364.078	7.259	2.720.914	2.649.471
At 31 December 2006									
Cash and balances with central banks	24			20.417				20.417	20.417
Derivatives	26-29	66.882					5.721	72.603	72.603
Bonds and debt instruments	30	81.197	146.732		3.746			231.675	231.675
Shares and equity instruments	31	79.171	29.675					108.846	108.846
Loans to banks	32			177.010				177.010	170.793
Loans to customers	33		24.457	1.571.727				1.596.184	1.554.752
Total		227.250	200.864	1.769.154	3.746	0	5.721	2.206.735	2.159.086
Short positions	46	4.877						4.877	4.877
Derivatives	26-29	46.851					13.870	60.721	60.721
Deposits from central banks	47					36.045		36.045	36.045
Deposits from banks	47					42.532		42.532	42.532
Deposits from customers	48-49		15.956			422.316		438.272	438.272
Debt issued and other borrowed funds	50		141.005			1.236.782		1.377.787	1.337.080
Subordinated liabilities	51		2.346			106.652		108.998	105.337
Total		51.728	159.307	0	0	1.844.327	13.870	2.069.232	2.024.864

Amounts are in ISK million

Notes to the Consolidated Financial Statements

Fair value of financial assets

9. The following table shows an analysis of financial instruments recorded at fair value, between those whose fair value is based on quoted market prices, those involving valuation techniques where all the model inputs are observable in the market, and those where the valuation techniques involves the use of non-market observable inputs.

2007	Quoted market price	Valuation techniques market observable	Valuation techniques non-market observable	Total
Financial assets				
Derivative financial instruments	158	107.180	0	107.338
Financial assets held for trading	177.228	0	0	177.228
Financial assets designated at fair value through profit or loss	4.868	239.707	16.378	260.953
Financial investments - available-for-sale	14.409	3.196	0	17.605
	196.663	350.083	16.378	563.124
Financial liabilities				
Derivative financial instruments	426	69.812	0	70.238
Financial liabilities held for trading	30	14.993	0	15.023
Financial liabilities designated at fair value through profit or loss	0	264.316	0	264.316
	456	349.121	0	349.577

2006				
Financial assets				
Derivative financial instruments	20	66.862	0	66.882
Financial assets held for trading	158.210	2.158	0	160.368
Financial assets designated at fair value through profit or loss	7.942	188.256	4.666	200.864
Financial investments - available-for-sale	4	3.742	0	3.746
	166.176	261.018	4.666	431.860
Financial liabilities				
Derivative financial instruments	0	46.851	0	46.851
Financial liabilities held for trading	0	4.877	0	4.877
Financial liabilities designated at fair value through profit or loss	0	159.307	0	159.307
	0	211.035	0	211.035

Amounts are in ISK million

Notes to the Consolidated Financial Statements

Net interest income

10. Net interest income is specified as follows:

	2007	2006
Interest income on:		
Cash and cash balances with central banks	2.343	1.183
Loans and receivables	149.901	103.292
Financial assets held for trading	28.747	10.377
Financial assets designated at fair value through profit or loss	5.892	3.786
Financial assets available-for-sale	377	435
Other assets	316	42
Total interest income	187.576	119.115
Interest expenses on:		
Deposits from credit institutions and central banks	(5.109)	(3.218)
Deposits	(34.748)	(19.508)
Borrowings	(74.816)	(51.250)
Subordinated loans	(6.899)	(4.809)
Financial liabilities held for trading	(26.466)	(3.183)
Other interest expense	(456)	(63)
Total interest expenses	(148.494)	(82.031)
Net interest income	39.082	37.084

Net fee and commission income

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

	2007	2006
Fee and commission income from:		
Asset management	9.107	3.269
Securities brokerage	11.493	6.127
Payment processing	3.953	2.892
Loans and guarantees	3.906	2.905
Foreign currency brokerage commission	5.543	4.230
Advisory	8.099	9.856
Other fees and commissions income	1.958	1.028
Total fees and commission income	44.059	30.307
Commission expenses due to:		
Inter-bank charges	(1.688)	(1.353)
Brokerage	(1.200)	(736)
Clearing and settlement	(1.221)	(526)
Other commission expenses	(2.306)	(1.233)
Total commission expenses	(6.415)	(3.848)
Net fee and commission income	37.644	26.459

Amounts are in ISK million

Notes to the Consolidated Financial Statements

Net financial income

12. Net financial income is specified as follows:

	2007	2006
Net (loss) gains on financial instruments held for trading	(879)	6.010
Net gains on financial instruments designated at fair value through profit or loss	5.202	2.097
Fair value adjustments in hedge accounting	(448)	(185)
Net foreign exchange gains	280	581
Net financial income	4.155	8.503

Net gains on financial instruments held for trading

13. Net gains on financial instruments held for trading are specified as follows:

	2007	2006
Shares and related derivatives	(361)	1.011
Dividend income on shares held for trading	435	1.323
Bonds and related derivatives	160	(1.023)
Other derivatives	(1.113)	4.699
Net (loss) gains on financial instruments held for trading	(879)	6.010

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

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

	2007	2006
Shares	7.853	2.707
Dividend income on shares designated at fair value through profit or loss	32	0
Bonds	(3.567)	138
Loans to customers and related derivatives	(1.017)	(748)
Borrowings, deposits and related derivatives	1.901	0
Net gains on financial instruments designated at fair value through profit or loss	5.202	2.097

Other net operating income

15. Other net operating income is specified as follows:

	2007	2006
Rental income	158	38
Gains on investment property	2.678	0
Realized gains on property and equipment	1.237	3
Other net operating income	141	514
Other net operating income	4.214	555

Notes to the Consolidated Financial Statements

Administrative expenses

16. Administrative expenses are specified as follows:

	2007	2006
Salaries and related expenses	27.896	15.747
Other administrative expenses	18.359	10.892
Depreciation and amortisation	1.889	662
Administrative expenses	48.144	27.301

Staff and related expenses

17. Salaries and related expenses are specified as follows:

	2007	2006
Salaries	20.527	12.074
Pension and similar expenses	2.365	1.609
Social security charges	1.771	1.140
Share based payments	2.966	756
Other	267	168
Salaries and related expenses	27.896	15.747

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

	2007	2006
Average number of employees (full year equivalents)	1.976	1.392
Positions at the end of the year	2.248	1.518

Employment Terms for the Board of Directors and the CEO

19. Employment terms for the Board of Directors and the CEO are specified as follows:

				Number of shares (million)		
2007	Salaries and fringe benefits	Bonus payments	Net gain on stock options	Call options	Put options	Ownership at year end
Lárus Welding, CEO	76			150		
Bjarni Ármannsson, former CEO	90	100	381			
Þorsteinn M. Jónsson, Chairman of the Board	9					
Einar Sveinsson, former Chairman of the Board	3					
Jón Sigurðsson	9					
Björn Ingi Sveinsson	3					
Haukur Guðjónsson	3					
Katrín Pétursdóttir	3					
Pétur Guðmundarson	3					
Skarphéðinn Berg Steinarsson	6					
Karl E. Wernersson	3					
Guðmundur Ólason	2					
Jón Snorrason	1					
Morten Bjørnsen EVP Nordic Banking Operations	14	11		15		
Guðmundur Hjaltason EVP Corporate Banking	42	15		20		
12 Other EVPs (there of five not employed at year-end)	379	231	998	159		55
Total	646	357	1.379	344	0	55

Call options held by the CEO are exercisable at a price of 26.6. They are exercisable in the years 2008-2012. Other call options held by management are exercisable in the years 2008-2010 at a price from 15.5 to 27.5.

Ownership at year-end consists of shares owned by the employees and financially related parties.

Notes to the Consolidated Financial Statements

In addition to the above, Lárus Welding received a sign-on payment amounting ISK 300 million in 2007.

			Number of shares (million)		
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				
Guðmundur Ólason	2				50
Jón Sigurðsson	1				
Jón Snorrason	2				
Karl Emil Wernersson	3				13
Skarphéðinn Berg Steinarsson	2				
Other board members	3				2
Frank Ove Reite, EVP of Markets and Com. Banking Norway	50	44	38		
Haukur Oddsson, EVP of Com. Banking Iceland	53		20		48
Four other EVPs on the executive board	189		70		155
Total	460	120	143	0	889

Auditors' Fees

20. Auditors' fees are specified as follows:

	2007	2006
Audit of the annual accounts	78	72
Audit and review of interim accounts	68	41
Other services	218	68
Auditors' fees	364	182
Thereof remuneration to others than the auditors of the parent company	267	91

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

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

	2007	2006
Net profit (loss) from sale of foreclosed mortgages	462	(6)
Net profit from sale of subsidiaries and associates	2.061	4.159
Other	0	91
Net gains on non-current assets classified as held for sale	2.523	4.244

Amounts are in ISK million

Notes to the Consolidated Financial Statements

Effective income tax rate

22. The corporate income tax rate in Iceland is 18.0% whereas the effective income tax rate in the Bank's income statement is 18.4%. The difference is specified as follows:

	2007		2006	
Profit before tax	33.904		46.255	
18.0% income tax calculated on the profit of the year	6.103	18,0%	8.326	18,0%
Effect of tax rates in foreign jurisdictions	1.932	5,7%	831	1,8%
Dividends received, exempt from tax	(210)	(0,6%)	(405)	(0,9%)
Acquisition price of subsidiaries reduced by gain on sale of shares	(1.808)	(5,3%)	(1.311)	(2,8%)
Correction in accordance with ruling on prior years' taxable income	0	0,0%	589	1,3%
Other differences	236	0,7%	(6)	(0,0%)
Income tax according to income statement	6.253	18,4%	8.024	17,3%

Earnings per Share

23. 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.

	2007	2006
Net profit of the equity holders of the parent, according to the financial statements	26.680	37.360
Average outstanding shares:		
Outstanding shares according to the financial statements at the beginning of the year, millions	14.161	13.112
Issuance of new shares, millions	199	824
Average outstanding shares, millions	14.360	13.936
Earnings per share, ISK	1,86	2,68
Adjustment for share options	62	128
Average outstanding shares for the calculation of diluted earnings per share	14.422	14.064
Diluted Earnings per share, ISK	1,85	2,66

Cash and balances with central banks

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

	31.12.2007	31.12.2006
Cash in hand	1.180	1.044
Balances with central banks other than mandatory reverse deposits	51.624	14.967
Treasury bills	0	1.954
Included in cash and cash equivalents	52.804	17.965
Mandatory reverse deposits with central banks	2.696	2.452
Total	55.500	20.417

Mandatory reserve deposits are not available for use in the Bank's day-to-day operations. Cash on hand and balances with central banks and mandatory reserve deposits are non-interest-bearing. Other money-market placements are floating-rate assets.

Amounts are in ISK million

Notes to the Consolidated Financial Statements

Pledged assets

25. Financial assets that may be repledged or resold by counterparties at year-end 2007:

Government bonds	5.365
Banks	44.081
Corporate bonds	130.565
Equities	13.389
Total	193.400

Financial assets that have been pledged as collateral for liabilities (including amounts reflected above)	198.238

These transactions are conducted under terms that are usual and customary to standard lending, and securities borrowing and lending activities, as well as requirements determined by exchanges where the bank acts as an intermediary. The bonds are held as collateral for liabilities to the Central Banks.

Derivatives financial instruments

26. Derivatives held for trading:	Assets 2007	Liabilities 2007	Notional amount 2007	Assets 2006	Liabilities 2006	Notional amount 2006
Interest rate swap	12.179	22.129	832.462	4.709	15.165	608.771
Cross currency interest rate swaps	19.122	20.992	991.383	20.297	8.133	473.043
Forward rate agreements	1	8	34.326	17	0	30.350
Interest rate future	158	34	112.794	20	0	91.204
Caps & Floors	24	23	21.269	0	0	0
Equity forwards	16.027	3.057	12.028	1.926	2.718	28.871
Equity futures	0	0	121	0	0	0
Equity swaps	3.023	9	8.298	569	1.119	13.493
Equity options	1.234	967	5.197	7.331	7.359	40.957
FX forward	2.811	2.690	179.989	1.492	2.039	255.790
FX swaps	23.143	10.474	742.928	17.143	6.435	808.773
FX options	2.446	1.764	308.562	2.950	2.010	135.341
Bond forwards	5.451	145	55.287	914	83	32.875
Bond swaps	2.244	0	10.422	0	0	0
Total return swaps	7.216	158	119	2.741	150	10.005
Equity linked options	12.259	7.788	38.280	6.773	1.641	32.526
Total	107.338	70.238	3.353.465	66.882	46.852	2.561.999

Amounts are in ISK million

Notes to the Consolidated Financial Statements

27. Derivatives to which hedge accounting is applied:

	Assets 2007	Liabilities 2007	Notional amount 2007	Assets 2006	Liabilities 2006	Notional amount 2006
Derivatives held as fair value hedges:						
Interest rate swap	11.089	3.824	357.080	5.226	10.912	335.626
Currency swaps	279	3.435	14.804	495	2.957	24.754
Total	11.368	7.259	371.884	5.721	13.869	360.380
Total derivatives	118.706	77.497	3.725.349	72.603	60.721	2.922.379

Fair value hedges

28. Fair value hedges are used by the Bank to protect it against changes in the fair value of financial liabilities due to movements in interest rates. The financial instruments hedged for interest rate risk are debt issued and other borrowed funds as well as subordinated debt. The Bank uses interest rate swaps to hedge interest rate risk.

In the year 2007 the Bank recognised a gain of ISK 6,353 million representing the gain on the hedging instruments. The total loss on hedged items attributable to the hedged risk amounted to ISK 6,801 million.

Hedge of net investment in foreign operations

29. The Bank has partly hedged its investments in its foreign subsidiaries against exposure to foreign exchange risk on these investments. Gains or losses on the hedging instruments are transferred to equity to offset any gains or losses on translation of the net investment in the subsidiaries. Details of the hedges are presented in the table below:

Line item in balance sheet	Currency	Amount in currency	ISK equivalent	Type of hedging instrument
Derivatives	NOK	1.079	12.346	Interest rate swaps
Debt issued and other borrowed funds	NOK	65	744	Bond issue
Derivatives	SEK	180	1.743	Interest rate swaps
Derivatives	EUR	2	182	Interest rate swaps
			15.015	

Bonds and debt instruments

30. Specification of bonds and debt instruments:

	31.12.2007	31.12.2006
Listed	168.594	128.448
Unlisted	110.366	103.227
Total	278.960	231.675

Amounts are in ISK million

Notes to the Consolidated Financial Statements

Shares and equity instruments

31. Specification of shares and equity instruments:

	31.12.2007	31.12.2006
Listed	78.358	77.460
Unlisted	27.223	31.386
Total	105.581	108.846

Loans

32. Loans to banks:

Money market loans	192.918	87.467
Bank accounts	63.360	33.590
Other loans	22.191	55.953
Loans to banks	278.469	177.010

33. Loans to customers:

Loans and advances to customers at fair value through profit or loss	71.245	24.458
Loans and advances to customers at amortised cost	1.903.662	1.571.726
Loans to customers	1.974.907	1.596.184

34. Loans to customers at amortised cost:

	2007			2006		
	Gross amount	Impairment allowance	Carrying amount	Gross amount	Impairment allowance	Carrying amount
Loans to individuals:						
Overdrafts and credit cards	19.169	(565)	18.604	15.589	(276)	15.313
Term loans	70.036	(1.418)	68.618	49.715	(887)	48.828
Residential mortgages	295.182	(585)	294.597	295.373	(511)	294.862
Leasing	17.081	(176)	16.905	11.053	(129)	10.924
Other	33.835	(78)	33.757	32.642	(145)	32.497
Loans to corporate entities:						
Large corporate customers	778.388	(7.763)	770.625	515.553	(6.409)	509.144
SMEs	578.294	(2.870)	575.424	537.739	(2.911)	534.828
VSEs	76.330	(860)	75.470	64.457	(1.126)	63.331
Other	34.142	(56)	34.086	39.828	(68)	39.760
Central government and state-owned enterprises	12.740	0	12.740	18.651	0	18.651
Loans to municipalities	2.836	0	2.836	3.588	0	3.588
Total	1.918.033	(14.371)	1.903.662	1.584.188	(12.462)	1.571.726

Amounts are in ISK million

Notes to the Consolidated Financial Statements

35. **Specific allowances for impairment:**

	2007	2006
Balance at 1 January	5.205	3.520
Transferred into the group	0	167
Transferred from the group	0	(38)
Charge to income statement	4.757	3.162
Recoveries	94	109
Effect of foreign currency movements	(167)	296
Write-offs	(3.534)	(2.010)
Balance at 31 December	6.355	5.206
Collective allowances for impairment		
Balance at 1 January	7.257	5.671
Transferred from the group	0	(12)
Charge to income statement	759	1.597
Balance at 31 December	8.016	7.256
Total allowances for impairment	14.371	12.462
Total impairment charge	5.516	4.759

Financial assets held for trading

36. Specification of financial assets held for trading:

	31.12.2007 According to balance sheet	Against derivative contracts	Net position	**31.12.2006** According to balance sheet	Against derivative contracts	Net position
Bonds	99.712	(97.196)	2.516	81.197	(77.373)	3.824
Shares	77.516	(67.143)	10.373	79.171	(67.074)	12.097
	177.228	(164.339)	12.889	160.368	(144.447)	15.921
Carrying amount of derivatives	107.338			66.882		
Total	284.566	(164.339)	12.889	227.250	(144.447)	15.921

Investments in associates

37. Changes in investments in associates:

	2007	2006
Investments in associates at the beginning of the year	4.379	8.081
Purchases of shares in associates	1.549	3.863
Sales of shares in associates	(2.067)	(8.020)
Transfers	(986)	(1.019)
Share of results	(54)	1.470
Dividends paid	(39)	(157)
Foreign exchange translation differences	38	161
Investments in associates at year-end	2.820	4.379

Amounts are in ISK million

Notes to the Consolidated Financial Statements

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

	Ownership at year-end	Book value 31.12.2007	Share of results 2007	Book value 31.12.2006	Share of results 2006
Eignarhaldsfélagið Fasteign hf.	41,3%	2.258	103	731	77
Reiknistofa Bankanna	23,5%	383	0	345	0
Other		179	(157)	3.303	1.393
Total		2.820	(54)	4.379	1.470

Investment in subsidiaries

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

	Location	Ownership
BN bank ASA	Norway	100%
Glitnir Bank ASA	Norway	100%
Glitnir Factoring AS	Norway	100%
Glitnir Securities ASA	Norway	100%
Glitnir Marine Finance AS	Norway	51%
Glitnir Norway AS	Norway	100%
Glitnir AB	Sweden	100%
Glitnir Luxembourg SA	Luxembourg	100%
Glitnir Oy	Finland	100%
Kreditkort hf.	Iceland	55%
Borgun hf.	Iceland	55%
Glitnir sjóðir hf.	Iceland	100%
Glitnir eignarhaldsfélag ehf.	Iceland	100%
Rivulus ehf.	Iceland	100%
Lómur ehf.	Iceland	100%
20 other wholly owned subsidiaries		100%

Interest in joint venture

40. The Bank has a 67% interest in a joint venture, Drumlin JV INC, a company managing liquid funds for the Bank. Pretax profit related to the investment amounted to ISK 2,070 million in 2007.

Related party disclosures

41. The Bank has a related party relationship with its subsidiaries, the board of directors of the parent company, the executive vice presidents of the Bank, 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:

	2007	2006
Loans to the CEO and managing directors	1.832	5.726
Loans to large shareholders and members of the board	38.904	37.217
Loans to associated companies	16.890	13.325

No provisions have been recognised in respect of loans given to related parties. For salary terms of management see note 19.

Amounts are in ISK million

Notes to the Consolidated Financial Statements

Investment property

42. Investment property is specified as follows:

	2007
Additions during the year	4.111
Disposals during the year	(1.987)
Revaluation during the year	3.415
Investment property 31.12.2007	5.539

The Bank's Investment property was valued at 31 December 2007 by independent professionally qualified evaluator which have experience in the location and category of the Investment property being valued.

Property and equipment

43. Property and equipment are specified as follows:

	Real estate	Fixtures, equipment & vehicles	Total
Book value as at 1.1.2006	743	1.244	1.987
Additions during the year	188	637	825
Net acquisition through business combinations	392	453	845
Depreciation during the year	(16)	(519)	(535)
Disposals during the year	0	(41)	(41)
Foreign exchange translation differences	152	63	215
Book value 31.12.2006	1.459	1.837	3.296
Additions during the year	19	1.815	1.834
Net acquisition through business combinations	0	416	416
Depreciation during the year	(25)	(887)	(912)
Disposals during the year	(425)	(9)	(434)
Transferred due to sale of subsidiary	0	(33)	(33)
Foreign exchange translation differences	(18)	53	35
Book value 31.12.2007	1.010	3.192	4.202
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
Total value as at 31.12.2007	1.270	7.395	8.665
Accumulated depreciation as at 31.12.2007	(260)	(4.203)	(4.463)
Book value 31.12.2007	1.010	3.192	4.202

Official real estate value of buildings and leased land	1.069
Insurance value of buildings as at 31.12.2007	1.214
Insurance value of fixtures, equipment and vehicles as at 31.12.2007	1.934

Amounts are in ISK million

Notes to the Consolidated Financial Statements

Intangible assets

44. Goodwill is allocated to the Bank's cash-generating units (CGU) in keeping with the main emphasis of monitoring and managing activities. 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:

	31.12.2007	31.12.2006
BNbank ASA	12.630	12.642
Glitnir Oy	21.855	0
Glitnir Securities AS	1.317	746
Union Group AS	0	1.567
Glitnir AB	448	2.002
Kreditkort hf.	186	0
Borgun hf.	280	466
Glitnir Privatøkonomi ASA	2.451	0
Parent company - Markets	359	0
Parent company - Investment Banking	179	0
Parent company - Corporate Banking	359	0
Other cash-generating units	451	523
Total goodwill 31.12.2007	40.515	17.946

Intangible assets are specified as follows:

	Goodwill	Software	Brands & other	Total
Intangible assets as at 1.1.2006	10.551	273		10.824
Additions during the year	4.498	129		4.627
Acquisition through business combinations	299	23		322
Amortization during the year	0	(127)		(127)
Foreign exchange translation differences	2.598	66		2.664
Intangible assets at 31.12.2006	17.946	364	0	18.310
Acquisition through business combinations	27.688		6.601	34.289
Other additions during the year		149	69	218
Buyout of minority shareholders	2.764			2.764
Disposals during the year	(8.621)			(8.621)
Amortization during the year		(141)	(836)	(977)
Foreign exchange translation differences	738	(3)	237	972
Intangible assets as at 31.12.2007	40.515	369	6.071	46.955

Amounts are in ISK million

Notes to the Consolidated Financial Statements

Other assets

45. Other assets are specified as follows:

	31.12.2007	31.12.2006
Other receivables	70.906	11.633
Accruals	830	208
Other assets	3.790	1.106
Other assets	75.526	12.947

Short positions

46. Balances of short positions:

	31.12.2007	31.12.2006
Short positions in listed bonds	15.023	4.877
Short positions	15.023	4.877

Deposits from central banks and banks

47. Deposits from central banks and banks are specified as follows:

Repurchase agreements with central banks	4.653	36.045
Deposits from banks	50.524	42.532
Deposits from central banks and banks	55.177	78.577

Deposits from customers

48. Deposits from customers are specified by type as follows:

Demand deposits	350.227	259.156
Time deposits	375.122	179.116
Other deposits total	725.349	438.272

49. Deposits from customers are specified by owners as follows:

	2007		**2006**	
	Amount	% of total	Amount	% of total
Central government and state-owned enterprises	15.531	2%	11.389	3%
Municipalities	95.237	13%	40.497	9%
Other companies	311.690	43%	171.194	39%
Individuals	302.891	42%	215.192	49%
Other deposits total	725.349	100%	438.272	100%

Amounts are in ISK million

Notes to the Consolidated Financial Statements

Debt issued and other borrowed funds

50. Specification of debt issued and other borrowed funds:

	31.12.2007	31.12.2006
Issued bonds	967.672	976.701
Loans from banks	380.158	101.073
Other debt securities	8.375	26.800
Hedged borrowings	389.994	273.213
Total	1.746.199	1.377.787

Subordinated loans

51. Specification of subordinated loans:

At 31 December 2007	Currency	Interest	Maturity date	Book value 2007
Loans which qualify as Tier 1 capital:				
Subordinated loans - unlisted	JPY	3,6%	Perpetual	2.226
Subordinated loans - unlisted	NOK	7,1%	Perpetual	2.113
Subordinated loans - unlisted	NOK	8,0%	Perpetual	961
Subordinated loans - listed on the Iceland Stock Exchange	ISK	6,0%	Perpetual	4.450
Subordinated loans - listed on the Iceland Stock Exchange	ISK	9,5%	Perpetual	1.238
Subordinated loans - listed on the Euronext Amsterdam	EUR	8,0%	Perpetual	11.836
Subordinated loans - listed on the London Stock Exchange	USD	7,5%	Perpetual	16.592
Total Tier 1				39.416

	Currency	Interest	Maturity date	Book value 2007
Loans which qualify as Tier 2 capital:				
Subordinated loans - listed on the Iceland Stock Exchange	NOK	5,0%	2010	59
Subordinated loans - listed on the Iceland Stock Exchange	ISK	7,0%	2008	233
Subordinated loans - listed on the Iceland Stock Exchange	EUR	4,3%	2013	4.535
Subordinated loans - listed on the London Stock Exchange	EUR	4,0%	2014	6.323
Subordinated loans - listed on the London Stock Exchange	EUR	6,6%	2011	627
Subordinated loans - listed on the London Stock Exchange	EUR	6,8%	2015	946
Subordinated loans - listed on the London Stock Exchange	EUR	6,9%	2015	478
Subordinated loans - listed on the London Stock Exchange	USD	5,8%	2015	4.848
Subordinated loans - listed on the London Stock Exchange	USD	6,7%	2016	32.757
Subordinated loans - listed on the Oslo Stock Exchange	NOK	7,5%	2008	3.441
Subordinated loans - listed on the Oslo Stock Exchange	NOK	6,6%	2010	3.441
Subordinated loans - listed on the Oslo Stock Exchange	NOK	4,6%	2011	341
Subordinated loans - listed on the Oslo Stock Exchange	NOK	6,7%	2011	4.224
Total Tier 2				62.253
Total subordinated loans				101.669

Amounts are in ISK million

Notes to the Consolidated Financial Statements

At 31 December 2006	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

	Currency	Interest	Maturity date	Book value 2006
Loans which qualify as Tier 2 capital:				
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 Oslo 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%	2015	4.226
Total Tier 2				67.272
Total subordinated loans				108.998

Post-employment obligations

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

	2007	2006
Pension liability as at 1.1.	529	418
Transferred into the Group	0	9
Transferred due to sale of subsidiary	0	(3)
Increment during the year	(63)	142
Paid during the year	(41)	(104)
Foreign exchange translation differences	0	67
Pension liability at year-end	425	529

Amounts are in ISK million

Notes to the Consolidated Financial Statements

Specification of post-employment obligations:	31.12.2007	31.12.2006
Present value of funded obligations	1.485	1.223
Fair value of plan assets	(1.009)	(868)
	476	355
Present value of unfunded obligations	235	111
Unrecognised actuarial losses	(339)	57
Unrecognised prior service cost	53	6
Pension liability in the balance sheet	425	529

Tax assets and tax liabilities

53. Tax in the balance sheet:

	2007		2006	
	Assets	Liabilities	Assets	Liabilities
Current tax	0	4.362	0	7.526
Deferred tax	1.269	5.641	264	3.121
Tax in the balance sheet	1.269	10.003	264	10.647

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

	Assets	Liabilities
Tax assets and tax liabilities 1.1.2006	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	0	(790)
Income tax payable in 2007 and correction due to 2006	0	(7.526)
Deferred tax assets and tax liabilities 31.12.2006	264	3.121
Transferred from the Group	0	466
Transferred into the Group	238	1.782
Translation difference due to foreign subsidiaries	9	244
Calculated income tax for 2007	627	6.880
Income tax on equity items	131	(682)
Income tax paid 2007	0	(1.808)
Income tax payable in 2008 and correction due to 2007	0	(4.362)
Deferred tax assets and tax liabilities at the end of 2007	1.269	5.641

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

	2007		2006	
	Assets	Liabilities	Assets	Liabilities
Leasing contracts	0	2.906	0	912
Shares in other companies	0	(556)	1	6
Property and equipment	(89)	(956)	2	213
Assets and liabilities denominated in foreign currencies	299	2.850	0	1.512
Other intangible assets	131	1.382	0	0
Tax loss of subsidiary carried forward	244	0	77	0
Other items	684	15	184	478
Deferred tax assets and tax liabilities at the end of 2007	1.269	5.641	264	3.121

Amounts are in ISK million

Notes to the Consolidated Financial Statements

Other liabilities

56. Specification of other liabilities:

	31.12.2007	31.12.2006
Accruals	17.312	6.595
Deferred income	593	86
Other liabilities	29.694	13.132
Total	47.599	19.813

Equity

57. According to the Parent Company's Articles of Association, the total number of shares is 14,881 million. At the end of December 2007 treasury shares were 151 million. One vote is attached to each share. In 2007 the Bank issued 616 million new shares at ISK 24.8 per share. Of these, 172 million shares were paid as dividend to shareholders and 444 million shares were delivered to shareholders of FIM Group in exchange for their shares in FIM Group (now Glitnir Oy).

58. Other reserves are specified as follows:

	Fair value change in AFS fin. assets	Accrued cost of stock options	Translation reserve	Total
Other reserves as at 1.1.2006	124	52	(641)	(465)
Translation differences			10.958	10.958
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	181	664	6.659	7.504
Translation differences			534	534
Net loss on hedge of net investment in foreign operations			(89)	(89)
Fair value changes of financial assets available-for-sale	(340)			(340)
Income tax on equity items	61		16	77
Accrued cost of stock options		1.770		1.770
Other reserves as at 31.12.2007	(98)	2.434	7.120	9.456

Amounts are in ISK million

Notes to the Consolidated Financial Statements

Capital adequacy ratio

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

	2007	2006
Shareholders' equity	169.201	144.578
Minority interest	768	1.541
Total shareholders' equity	169.969	146.119
Intangible assets	(45.574)	(18.310)
Core capital	124.395	127.809
Hybrid core capital	39.564	41.725
Tier 1 capital	163.959	169.534
Subordinated loans, excluding hybrid core capital	61.617	66.794
Deductions	0	(1.070)
Capital base	225.576	235.258
Risk-weighted assets		
Not included in trading portfolio	1.929.818	1.519.288
With market risk in trading portfolio	87.652	45.012
Total risk weighted assets	2.017.470	1.564.300
Core capital ratio	6,2%	8,2%
Tier 1 capital ratio	8,1%	10,8%
Capital adequacy ratio	11,2%	15,0%

Obligations

60. Specification of obligations:

	31.12.2007	31.12.2006
Guarantees granted to customers	44.932	42.826
Committed undrawn lines of credit	42.404	14.179
Unused overdrafts	44.005	40.858

Operating lease commitments

61. Future non-cancellable minimum operating lease payments, where the Group is the lessee are due as follows:

Up to 1 year	731	411
1-5 years	1.890	1.417
Later than 5 years	4.659	4.472
	7.280	6.300

Notes to the Consolidated Financial Statements

Assets under management and in custody

62. Balance of assets under management and custody assets:

	31.12.2007	31.12.2006
Assets under management	936.010	490.321
Custody assets	1.317.827	697.735

Stock options and stock options equivalents

63. All open stock options and stock option equivalents are listed in the tables below in millions of shares:

Outstanding at 1.1.2006	182
Exercised during the year	(10)
Terminated during the year	(5)
New issues	275
Stock options and stock option equivalents outstanding at 31.12.2006	**442**
Exercised during the year	(180)
Terminated during the year	(118)
New issues	889
Stock options and stock option equivalents outstanding at 31.12.2007	**1.033**

	Millions of shares	Exercise price
Exercisable	3	2,44
Exercisable	94	15,50
Exercisable in 2008	179	16.5-19.8
Exercisable in 2009-2012	757	23.0-27.5
Stock options and stock option equivalents outstanding at 31.12.2007	1.033	

Certain employees have been granted the right to receive stock options after certain time on the basis of share price when the agreements were entered into. The accounting treatment of these agreements, referred to as stock option equivalents, is principally the same as for ordinary stock options.

Other issues

64. In 2006 the Icelandic tax authorities ruled that the Bank shall pay additional tax of ISK 589 million (including penalties) in relation to the merger with Framtak fjárfestingabanki hf. in 2004. The ruling has been appealed before Icelandic courts but the entire amount was charged to the income statement in 2006.

Amounts are in ISK million

Notes to the Consolidated Financial Statements

Business segments

5. 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. Transactions between the business segments are on normal commercial terms and conditions. Internal charges and transfer pricing adjustments have been reflected in the performance of each business. Revenue sharing agreements are used to allocated external customer revenue to a business segment on a reasonable basis.

The Bank is organised into six main business segments:

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

b) Corporate Banking: Incorporates Glitnir's international operations, homemarket corporate customers and leveraged finance.

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

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

e) Investment Management: Comprises private banking in Iceland and Luxembourg as well as assets management in Iceland, Norway and Finland.

f) Treasury: Incorporates funding and interbank function.

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 at the beginning of the year 2007 into the business segments described above. Comparative amounts in the schedules below have been reclassified to reflect the new structure.

The year 2007

Operations	Retail Banking	Corporate Banking	Investment Banking	Markets	Investment Management	Treasury other & eliminations	Total
Net interest income	13.521	23.198	(562)	2.914	797	(786)	39.082
Net fee income	4.408	2.919	6.230	17.182	8.551	(1.646)	37.644
Net financial income	892	1.427	5.187	(140)	(65)	(3.146)	4.155
Other net operating income	3	11	423	105	6	3.666	4.214
Administrative exp.	(12.831)	(10.812)	(3.230)	(12.890)	(7.641)	(740)	(48.144)
Impairment	(1.067)	(4.316)	(7)	5	(136)	5	(5.516)
Other income	35	307	56			2.071	2.469
Profit before tax	4.961	12.734	8.097	7.176	1.512	(576)	33.904
Net segment revenue from external customers	21.128	68.756	12.597	21.493	10.845	(49.724)	85.095
Net segment revenue from other segments	(2.304)	(41.201)	(1.319)	(1.432)	(1.556)	47.812	0

Amounts are in ISK million

Notes to the Consolidated Financial Statements

At 31 December 2007

Segment assets	Retail Banking	Corporate Banking	Investment Banking	Markets	Investment Management	Treasury and other	Eliminations	Total
Loans and cash	572.238	1.324.002	6.829	18.977	38.643	1.561.629	(1.213.442)	2.308.876
Other financial assets	31.225	41.015	39.582	26.108	165	384.363	(19.211)	503.247
Other assets	3.631	4.762	1.958	21.159	5.783	187.467	(87.973)	136.787
Total assets	607.094	1.369.779	48.369	66.244	44.591	2.133.459	(1.320.626)	2.948.910
Segment liabilities								
Deposits, borrowings and subordinated loans	564.411	1.230.888	36.886	17.331	34.656	1.881.188	(1.136.966)	2.628.394
Other liabilities	14.827	22.775	1.350	31.861	1.392	89.954	(11.612)	150.547
Total liabilities	579.238	1.253.663	38.236	49.192	36.048	1.971.142	(1.148.578)	2.778.941

The year 2006

Operations	Retail Banking	Corporate Banking	Investment Banking	Markets	Investment Management	Treasury other & eliminations	Total
Net interest income	12.974	19.961	(370)	3.078	785	656	37.084
Net fee income	3.057	2.989	6.161	11.978	3.061	(787)	26.459
Net financial income	(136)	(18)	2.335	1.339	(27)	5.010	8.503
Other net operating income	209	89	0	209	14	34	555
Administrative exp.	(9.334)	(6.705)	(1.764)	(6.228)	(2.191)	(1.079)	(27.301)
Impairment	(1.970)	(2.729)	(25)	(7)	5	(33)	(4.759)
Other income	97	18	0	1.295	0	4.304	5.714
Profit before tax	4.897	13.605	6.337	11.664	1.647	8.105	46.255
Net segment revenue from external customers	57.878	73.013	12.125	20.374	13.816	(104.605)	72.601
Net segment revenue from other segments	(41.774)	(49.992)	(3.999)	(3.770)	(9.983)	109.518	0

At 31 December 2006

Segment assets	Retail Banking	Corporate Banking	Investment Banking	Markets	Investment Management	Treasury & other	Eliminations	Total
Loans and cash	511.932	1.107.602	6.652	85.414	24.283	1.424.113	(1.366.385)	1.793.611
Other financial assets	20.598	58.475	28.626	8.581	105	323.940	(27.201)	413.124
Other assets	2.417	2.666	374	776	425	62.304	(29.357)	39.605
Total assets	534.947	1.168.743	35.652	94.771	24.812	1.810.357	(1.422.943)	2.246.340
Segment liabilities								
Deposits, borrowings and subordinated loans	655.472	1.088.280	28.456	67.155	20.854	1.551.525	(1.408.108)	2.003.634
Other liabilities	2.714	6.934	786	7.471	1.983	77.630	(931)	96.587
Total liabilities	658.186	1.095.214	29.242	74.626	22.837	1.629.155	(1.409.039)	2.100.221

Notes to the Consolidated Financial Statements

Risk management

65. Glitnir is exposed to various risks through its use of financial instruments. The Board of Directors determines the Bank's risk management policy and defines the acceptable levels of risk, sets targets regarding risk management and monitoring of major risk factors, including credit risk, liquidity risk, market risk and operational risk.

The ultimate responsibility for monitoring, managing and reporting on each risk factor lies with the parent company. Each of the subsidiaries has a risk management function that manages its respective risk in line with Glitnir risk management policy and reports to the centralised risk management unit.

Decisions on credit exposures and risk limits are based on a committee structure. The risk committee sets guidelines and rules on credit and market risk evaluation. Credit and market risk management and supervision are further delegated by the risk committee to sub-committees: the credit committees, risk model committee and market risk committee.

Asset and liability management is supervised by the asset and liability committee (ALCO) and operational risk is supervised by the operational risk committee.

The compliance function is responsible for ensuring that the processes and the business conducted within the Bank are in accordance with external laws and regulations and internal directives and instructions.

Group internal audit conducts independent evaluations and provides assurance of the internal control and risk management for its appropriateness, effectiveness and its compliance with the Bank's directives. The chief audit executive (CAE) is appointed by the Board and accordingly has an independent position in Glitnir's organisational chart. The CAE is responsible for internal audit within the Bank.

Credit risk

66. Credit risk is the primary risk factor in the Bank's operations. Credit risk is the risk of financial loss if a customer or counterparty to a financial instrument fails to meet its contractual obligations. Credit risk arises principally from the Bank‘s loans and advances to customers and other banks. There is also credit risk in the Bank‘s investment activities that bring debt securities to the Bank‘s asset portfolio and through derivates exposures primarily related to activities in Treasury.

The Credit risk control function is responsible for monitoring and reporting on the Bank's credit risk.

The Bank has policies and procedures dedicated to accepting, measuring, monitoring and controlling the credit risk arising from all activities. The Bank manages, limits and controls concentrations of credit risk wherever they are identified – in particular, to individual counterparties and groups, and to industries and countries. The Bank structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to industry segments. Such risks are monitored on a continuous basis and subject to an annual or more frequent review. A thorough analysis of the counterparty's financial standing, analysis of past and estimated future cash flows as well as the borrower's general ability to repay its obligations, forms the basis for all credit decisions.

The Bank employs a range of policies and practices to mitigate credit risk. The most traditional of these is the taking of security for funds advances, which is common practice. The principal collateral types for loans and advances are:

- Mortgages over residential properties;
- Charges over business assets such as premises, inventory and accounts receivable;
- Charges over financial instruments such as debt securities and equities.

When applicable, other credit risk mitigants are employed such as master netting agreements.

The Bank monitors effectiveness of credit mitigants or hedges by reviewing value of collateral and other credit mitigants systematically and when and where deemed necessary. To the same effect the Bank monitors closely the economic situation and estimates effect of different economic indicators on it's portfolio. As for Icelandic mortgages, the Bank monitors the development of loan-to-values in the portfolio by applying a housing index when calculating loan-to-values at regular intervals. It should be noted here that due to steep increase in house prices in Iceland since the Bank entered the Icelandic mortgage market in 2004, the Bank is in a favourable position with regards to loan-to-values in its Icelandic mortgage portfolio.

The objective of the Bank's credit risk management is to achieve an appropriate balance between risk and return and to minimise potential adverse effects of credit risk on the Bank's financial performance.

Notes to the Consolidated Financial Statements

Credit organisation
The Board of Directors issues the Bank's credit risk policy and is the ultimate authority regarding credit risk. The Board issues credit authorisation limits for credit committees within the Bank which consist of a risk committee and regional credit committees.

Risk committee members are appointed by the CEO and members of regional credit committees are appointed by the chairman of the Risk committee. Regional credit committees report to the Risk committee and the Risk committee reports to the Board of Directors.

The Bank‘s credit management organisation is aligned with the Bank‘s geographical buiness regions. Credit management is accountable for the credit risk of each defined region and takes an active part in the region‘s credit decision making process. Responsibility for credit risk and daily monitoring functions resides within each business unit but Credit management is accountable for the proper credit risk monitoring of each portfolio and for the enforcement of best practices within the respective region. Each region's head of credit management reports to the respective head of business region.

Within Group head office, a specialised unit, Credit risk control is mandated to monitor and report on the Bank's credit risk on consolidated level. It monitors the credit decision process quality, impaired loans process quality and conducts business unit and Credit management reviews in relation to credit risk monitoring and reporting. Credit risk control specifically monitors large exposures and concentrations in loan portfolio as well as exposures that have been placed on credit watch list.

The Credit management functions and the Credit risk control unit were established in Q2 2007. Prior to the new setup, the now seperate funtions of Credit management and Credit risk control were executed in one unit. As a part of the Bank's efforts in aligning itself with Basel II and in accordance with guidelines from the Committee of European Banking Supervisors, the new setup was implemented to strengthen the Bank's control and monitoring of credit risk.

Credit risk measurements
The Internal Ratings-Based (IRB) compliant risk assessment models used by the Bank are divided into three types: scoring models, rating models, and simulation models. The scoring models are statistical models that assign a rating to an obligor without the need for human judgement. The rating models consist both of a financial part, that uses information from a company's annual statements, and a qualitative part, that takes expert judgement into account. Simulation models directly simulate the cash flow of the underlying transaction taking information about market factors and their uncertainty into account. The output from the risk assessment models is either a probability of default (PD) or a risk class, which is subsequently mapped to a PD value using historic default data.

The bank currently has the following risk assessment models in use for the estimation of PDs:
• Corporate PD Model (rating model)
• Retail PD Models (scoring models)
• Very Small Entities (VSE) PD Model (scoring model)
• Leverage Finance PD Model (rating model)
• Corporate IPRE Model (simulation model, used by subsidiary in Norway)

Credit risk assessment is conducted as a part of every transaction where credit risk arises. In most cases, the models listed above are used but when the models do not apply, the Bank uses various methods to assess the inherent credit risk in a transaction e.g. borrower external rating, pier comparison, market position etc.

The purpose of credit risk assessment within the Bank is to:
• Assess the customers' credit quality and quantify the risk inherent in lending decisions
• Assess customers' repayment capacity
• Improve the quality of the Bank's loan portfolios
• Estimate input parameters for the loan pricing model

Credit risk control is responsible for the validation and calibration of the Bank's risk assessment models.

In accordance with model output, counterparties are assigned a risk class from 1 to 9, where risk class 1 reflects the lowest probability of default and risk class 9 reflects the highest probability of default. The table below compares the Bank's risk classes to the PD classes issued by S&P:

Risk Class	1	2	3	4	5	6	7	8	9	10
S & P	≥AA-	A	BBB+/ BBB	BBB-	BB+	BB/BB-	B+/B	B-	CCC/C	D

Amounts are in ISK million

Notes to the Consolidated Financial Statements

The assessment of an obligor's credit quality by these models is an integral part of the Bank's credit process and a prerequisite for credit approval.

The model outputs also form an integral part of the capital requirement calculation process at Glitnir. Each obligor of the retail and corporate Basel II asset classes is assigned a PD, and each facility is assigned an estimate of loss given default (LGD). The PD and LGD estimates are then used to calculate the regulatory capital requirement, and the expected loss (EL) for exposures.

For debt securities and other bills, ratings by external rating agencies such as Standard & Poor's or their equivalents are used by the Bank for managing of the credit risk exposures.

Impairments

Individually assessed impairment allowances are determined by an evaluation of incurred loss at balance-sheet date on a case-by-case basis. The assessment encompasses collateral held (including re-confirmation of its enforceability) and the anticipated receipts for that individual account. Each business unit reviews its credit portfolio on a quarterly basis and evaluates the need for allowances for impairment.

The Bank writes off a loan (and any related allowances for impairment losses) when every legal recourse has been fully explored resulting in a determination that the loans are uncollectible. This determination is reached after considering information such as the occurrence of significant changes in the borrower financial position such that the borrower can no longer pay the obligation, or that proceeds from collateral will not be sufficient to pay back the entire exposure.

Large Exposures:

Large exposures are exposures that exceed 10% of the Bank's CAD equity. The regulatory limit for aggregated large exposures is 800%, but the Bank's internal limit is 200%. According to the Bank's internal limits, no single exposure may exceed 20% of the Bank's CAD equity. The regulatory limit for the parent company is 25%. In 2007, neither the internal limit and therefore nor the regulatory limit for the parent company, were breached at any time. Each subsidiary is subject to local regulatory limits regarding large exposures.

Credit exposure

67. The following table presents the maximum exposure to credit risk of on-balance sheet and off-balance sheet financial instruments, before taking account of any collateral held or other credit enhancements.

	Maximum exposure	
	31.12.2007	31.12.2006
Loans to banks:		
Money market loans	192.918	87.467
Bank accounts	63.360	33.590
Other loans	22.191	55.953
Loans to customers:		
Loans to individuals:		
Overdrafts and credit cards	18.604	15.313
Term loans	68.618	48.828
Residential mortgages	294.597	294.862
Leasing	16.905	10.924
Other	33.757	32.497
Loans to corporate entities:		
Large corporate customers	770.625	509.144
SMEs	575.424	534.828
VSEs	75.470	63.331
Other	34.086	39.760
Loans to central government and state-owned enterprises	12.740	18.651
Loans to municipalities	2.836	3.588
Loans at fair value through profit and loss	71.245	24.458
Bonds and debt instruments:		
Central governments	40.561	72.338
Local governments	4.668	4.060
Corporates	233.731	155.277
Derivatives	118.706	72.603
Other assets	24.145	13.934
Financial guarantees	8.661	7.045
Loan commitments	42.403	14.179
Total	2.726.253	2.112.631

Amounts are in ISK million

Notes to the Consolidated Financial Statements

68. Past due but not impaired loans are loans where contractual interest or principal payments are past due but the Bank believes that impairment is not appropriate on the basis of the level of security or collateral available and / or the stage of collection of amounts owed to the Bank. Past due loans are reported as the total loan and not only the payment or sum of payments that are past due.

Loans and other financial assets are summarised as follows:

	Neither past due nor impaired	Past due but not impaired	Impaired	Gross	Less: allowance for impairm.	Net carrying amount
At 31 December 2007						
Loans to banks	274.025	4.444	0	278.469		278.469
Loans to individuals	405.070	27.595	2.638	435.303	(2.822)	432.481
Loans to corporate entities	1.365.751	93.661	7.742	1.467.154	(11.549)	1.455.605
Loans to central government and state-owned enterprises	12.278	462	0	12.740	0	12.740
Loans to municipalities	2.782	54	0	2.836	0	2.836
Loans at fair value through profit and loss	69.976	1.269	0	71.245	0	71.245
Other financial assets	24.145	0	0	24.145	0	24.145
Total	2.154.027	127.485	10.380	2.291.892	(14.371)	2.277.521

	Neither past due nor impaired	Past due but not impaired	Impaired	Gross	Less: allowance for impairm.	Net carrying amount
At 31 December 2006						
Loans to banks	173.838	3.172	0	177.010	0	177.010
Loans to individuals	383.171	19.961	1.240	404.372	(1.948)	402.424
Loans to corporate entities	1.050.334	99.914	7.329	1.157.577	(10.514)	1.147.063
Loans to central government and state-owned enterprises	18.622	29	0	18.651	0	18.651
Loans to municipalities	3.584	4	0	3.588	0	3.588
Loans at fair value through profit and loss	22.225	2.233	0	24.458	0	24.458
Other financial assets	13.960	0	0	13.960	0	13.960
Total	1.665.734	125.313	8.569	1.799.616	(12.462)	1.787.154

69. The Bank groups loans and other assets into risk groups aligned with the banks internal risk class system discussed above. Following information is based on the risk grouping.

	2007	2006
Risk group 1: 1-3	13%	14%
Risk group 2: 4-6	57%	59%
Risk group 3: 7-9	14%	12%
Risk group 4: 10 (Default)	0%	1%
Risk group 5	16%	14%
Total	100%	100%

Assets in risk group 5 (IRB risk class not assigned) are generally of good credit quality and principally fall into the following categories:
• Loans to Icelandic banks, municipalities, state-owned enterprises that do not have a registered external rating
• Loans to individuals in Norway other than mortgages in BNbank
• Liquidity portfolio in Norway (Norwegian banks, municipality bonds, government bonds etc.)
• Loans to corporate entities where IRB models are not applicable
• Loans to corporate entities with pending risk classification

Amounts are in ISK million

Notes to the Consolidated Financial Statements

	Risk group 1: 1-3	Risk group 2: 4-6	Risk group 3: 7-9	Risk group 4: 10 (Default)	Risk group 5:	Total
At 31 December 2007						
Loans to banks	152.008	71.900	1.249	0	48.868	274.025
Loans to individuals	19.529	203.742	104.311	1.752	75.736	405.070
Loans to corporate entities	81.017	914.250	195.288	1.125	174.071	1.365.751
Loans to central government and state-owned enterprises	0	0	0	0	12.278	12.278
Loans to municipalities	0	0	0	0	2.782	2.782
Loans at fair value through profit and loss	18.063	45.330	1.268	628	4.687	69.976
Other financial assets	26	0	0	0	24.119	24.145
Total	270.643	1.235.222	302.116	3.505	342.541	2.154.027
At 31 December 2006						
Loans to banks	91.157	43.575	1.178	0	37.928	173.838
Loans to individuals	16.495	246.763	75.913	1.891	42.109	383.171
Loans to corporate entities	115.392	688.551	121.682	10.085	114.624	1.050.334
Loans to central government and state-owned enterprises	0	0	0	0	18.622	18.622
Loans to municipalities	0	0	0	0	3.584	3.584
Loans at fair value through profit and loss	3.842	7.002	309	113	10.959	22.225
Other financial assets	0	0	0	0	13.960	13.960
Total	226.886	985.891	199.082	12.089	241.786	1.665.734

70. Gross amount of loans by class to customers that were past due but not impaired were as follows:

At 31 December 2007	Past due up to 30 days	Past due 30-60 days	Past due 60-90 days	Over 90 days	Total	Fair value of coll-atteral
Individuals (retail customers)	12.651	9.655	2.429	2.860	27.595	77.198
Corporate entities:						
Large corporate customers	54.516	7.140	2.227	178	64.061	45.696
SME's	7.742	3.132	5.439	2.142	18.455	51.194
VSE's	6.806	1.002	1.141	910	9.859	14.922
Other	0	1.286	0	0	1.286	0
Loans to central government and state-owned enterprises	462	0	0	0	462	296
Loans to municipalities	54	0	0	0	54	780
Loans at fair value through P&L	0	1.269	0	0	1.269	666
Total	82.231	23.484	11.236	6.090	123.041	190.752

Amounts are in ISK million

Notes to the Consolidated Financial Statements

71. The breakdown of the gross amount of individually impaired loans and advances by class, along with the fair value of related collateral held by the entity as security, are as follows:

At 31 December 2007	Individuals	Corporate entities	Total
Individually impaired loans	2.638	7.742	10.380
Fair value of collateral	2.005	1.829	3.834
At 31 December 2006			
Individually impaired loans	1.240	7.329	8.569
Fair value of collateral	880	5.634	6.514

72. Restructuring activity is designed to manage customer relationships, maximise collection opportunities and, if possible, avoid foreclosure or repossession. Such activities include extended payment arrangements, approved external debt management plans, deferring foreclosure, modification, loan rewrites and/or deferral of payments pending a change in circumstances. Loans with renegotiated terms are loans that have been restructured due to deterioration in the borrower´s financial position and where the Bank has made concessions that it would not otherwise consider. Following table details loans which have been renegotiated during the period that would otherwise be past due or impaired if they had not been renegotiated.

	2007	2006
Loans to individuals:		
Term loans	1.371	1.792
Residential mortgages	1.008	792
Loans to corporate entities	15.195	20.699
Total	17.574	23.283

73. Following tables detail credit quality of bonds and debt instruments assessed by reference to the Bank's credit grading system, as described above. The following information is based on that system:

At 31 December 2007	Central govern- ments	Local govern- ments	Corporates	Total
Risk group 1: 1-3	40.257	333	154.090	194.680
Risk group 2 : 4-6	0	0	60.104	60.104
Risk group 3 : 7-9	0	0	2.302	2.302
Risk group 4 : 10 (Default)	0	0	0	0
Risk group 5	304	4.335	17.235	21.874
Total	40.561	4.668	233.731	278.960
At 31 December 2006				
Risk group 1: 1-3	72.048	624	121.102	193.774
Risk group 2 : 4-6	0	0	11.387	11.387
Risk group 3 : 7-9	0	0	6.335	6.335
Risk group 4 : 10 (Default)	0	0	0	0
Risk group 5	290	3.436	16.453	20.179
Total	72.338	4.060	155.277	231.675

Amounts are in ISK million

Notes to the Consolidated Financial Statements

74. The following table breaks down the entities credit exposure at their carrying amounts as categorised by geographical region. For this table, the Bank has allocated exposures to regions based on the country of domicile of the Bank's counterparties.

	Iceland	Norway	United Kingdom	Denmark	Germany	Sweden	Finland	USA	Other countries	Total
Loans to banks:										
Money market loans	90,986	2	8	91,977		5,944	305	2,173	1,523	192,918
Bank accounts	371	5,504	33,417		99	89	8,662	3,675	11,543	63,360
Other loans	17,013	5,178								22,191
Loans to customers:										
Loans to individuals:										
Overdrafts and creditcards	18,372		2				28	194	8	18,604
Term loans	26,302	39,994	10		11	14	17		2,270	68,618
Residential mortgages	112,918	171,709	42		46	60	72		9,750	294,597
Leasing	16,905									16,905
Other	181	31,889			19	9	1,484		175	33,757
Loans to corporate entities:										
Large corporate customers	522,587	39,844	69,283		10,985	42,333	7,382	16	78,195	770,625
SMEs	152,223	318,207	384		53,457	0	10,269		40,884	575,424
VSE	31,795	28,381	2,080		1,917	4,130	2,491	636	4,040	75,470
Other	2,547	30,876					663			34,086
Loans to central government and state-owned enterprises	12,740									12,740
Loans to municipalities	2,795	41								2,836
Loans at fair value through profit and loss	513	70,732								71,245
Bonds and debt instruments:	118,386	35,268	5,873		4,244	192	5,640	7,550	101,807	278,960
Derivatives	568	106,524	20		361	1	0	2,635	8,597	118,706
Other assets	143	14,178	28		153	34	1,393	7,446	770	24,145
As at 31 December 2007	1,127,345	898,327	111,147	91,977	71,292	52,806	38,406	24,325	259,562	2,675,187

75. The following table breaks down the entities credit exposure at their carrying amounts as categorised by industry sectors of the Bank's counterparties.

	Central government and state owned enterprices	Munici-palities	Agri-culture	Fishing industries	Commerce	Industry & contractors	Real estate	Services	Individuals	Off-shore vessels	Finacial institutions	Other	Total
Loans to banks:													
Money market loans											192.918		192.918
Bank accounts											63.360		63.360
Other loans											22.191		22.191
Loans to customers:													
Loans to individuals:													
Overdrafts and credit cards								2.063	16.541				18.604
Term loans					57	101	412	294	67.754				68.618
Residential mortgages									294.597				294.597
Leasing									16.905				16.905
Other					228	984	3.175	3.478	25.892				33.757
Loans to corporate entities:													
Large corporate customers			436	85.339	29.928	101.825	44.542	485.705		22.831	19		770.625
SMEs			2.422	49.577	21.352	41.548	308.927	108.686	11.748	26.589		4.575	575.424
VSE			2.071	8.375	9.997	2.975	27.436	20.448		1.218		2.950	75.470
Other					527	49	29.955	2.743	111			701	34.086
Loans at fair value through profit and loss									71.245				71.245
Loans to central government and state-owned enterprises	12.740												12.740
Loans to municipalities		2.836											2.836
Bonds and debt instruments:	35.506	7.516			156	554	235	95.164		185	139.297	347	278.960
Derivatives	113.880			57		266		924	63	3.417		99	118.706
Other assets	561				11	3.593		2.876	13.594		1.903	1.607	24.145
As at 31 December 2007	162.687	10.352	4.929	143.348	62.256	151.895	414.682	722.381	518.450	54.240	419.688	10.279	2.675.187

76. The bank obtained assets by taking possession of collateral held as security, as follows:

	2007	2006
Residential property	133	58
Industrial property	218	256
Financial guarantees	2.476	609
Equipment	127	91
Other assets	310	237
Total	3.264	1.251

Notes to the Consolidated Financial Statements

Liquidity Risk

77. Liquidity risk is the risk that the Bank will encounter difficulty in meeting contractual payment obligations associated with its financial liabilities, or will only be able to do so substantially above the prevailing market cost of funds. The risk mainly arises from mismatches in the timing of cash flows.

Funding
To limit liquidity risk, the Bank actively diversifies its funding sources with respect to types of funding instruments, maturities, markets accessed and counterparties. Mismatches in the timing of cash flows are monitored closely to ensure that all foreseeable funding commitments and refinancing needs are met when due. Committed back-up facilities and other back-up sources are in place to be able to meet unforeseen liquidity disruptions and regular liquidity stress testing is conducted to assess the liquidity position under stressed scenarios.

The subsidiaries are largely self sufficient in their funding, through their deposit base and by bond issuance in local markets. Majority of the Bank's international funding is however done by the parent company.

In Iceland, the Bank's main source of funding is customer deposits. Apart from the domestic bond market, other funding sources are driven by off balance sheet activities and issuance of structured notes.

In Norway, deposits are a core funding source along with frequent issuance of bonds in the Norwegian bond market.

The majority of the Bank's assets are denominated in foreign currencies and as such a majority of the Bank's funding is executed in foreign currencies. The Bank has several diverse international funding programs in place and has been successful in broadening its foreign deposit base through various initiatives.

The Group treasury unit is responsible for co-ordination of funding for the group in line with the Bank's liquidity and funding strategy.

Liquidity Risk management
The ALM & capital management unit is responsible for measuring, monitoring and reporting on the Bank's liquidity position. Risk management functions within each operating unit track their respective liquidity positions on daily basis and report to the parent company at least on monthly basis. The Bank's treasury functions are responsible for the day-to-day liquidity management.

Both the parent company and its subsidiaries are subject to external regulatory liquidity requirements that differ between countries. For the parent company, this entails keeping a minimum coverage ratio between the cash flow of assets and liabilities, as defined by the Central bank of Iceland, for given time buckets. At the end of 2007, both the parent company and all its subsidiaries were in compliance with external liquidity requirements.

The Bank's internal liquidity policy is stricter than the external liquidity requirements. It assumes that immediately available funds cover all financial liabilities expected to mature for the following six months. In addition, all financial liabilities expected to mature within the following 12 months must be covered with immediately available funds and other liquid assets. This policy is applicable on group level.

Immediately available funds (IAF) include cash; money market deposits with banks; highly liquid bonds held specifically as liquidity back-up and can either be sold or used as collateral for secure borrowing; committed credit facilities; and loans and that can either be securitised or used as collateral for secure borrowing. Other liquid assets include loans and securities that can be liquidated within one year but where the liquidation time is expected to exceed six months. The table below details the Bank's IAF at the end of 2007 and for comparison at the end of 2006.

Amounts are in ISK million

Notes to the Consolidated Financial Statements

Liquidity position

	31.12.2007	31.12.2006
Cash in hand	1.180	1.044
Cash balances with central banks	51.624	14.967
Treasury bills	0	1.954
Money market loans	192.918	87.467
Bank accounts	63.360	33.590
Other loans	22.191	55.953
Liquid debt securities	98.554	109.673
Cash and cash equivalents	429.827	304.648
Unused securities eligible as collateral for secure borrowing	44.414	17.030
Regulatory liquidity reserves	25.277	22.274
Committed credit facilities	88.920	113.532
Immediatly liquidity	588.438	457.484

When determining the expected maturity of liabilities the Bank generally assumes that the counterparty will require repayment at the first possible date. An exception is made in the case of deposits where expected maturities are based on historical stability of the deposit base. All unrecognised loan commitments are expected to be met at the first possible execution date. For long-term liabilities, the maturity profile is based on the contractual instalment structure.

Generally, customer deposits have remained stable and are viewed as a long-term funding source, with only a small part expected to mature within one year. Institutional time deposits are treated more conservatively although, based on historical development, a large part of the institutional deposit base is expected to be extended at maturity. All corporate time deposits are assumed to be withdrawn at maturity.

Analysis of derivative instruments is based on net cash flows when managing liquidity on consolidated basis. However, when managing liquidity down to individual currencies, the total expected cash flow of derivative instruments per each currency is monitored separately.

The following table shows the Bank’s contractual maturity profile on 31 December 2007, including both on and off balance sheet items. The analysis is based on the period remaining until the contractual maturity according to the requirements under IFRS7 and thus differing from the Bank's internal measures. These figures are based on undiscounted cash flows and do not include future interest payments.

The cash flows are based on the assumption is that the counterparty will in all cases require repayment at the first possible date. Hence, most customer deposits fall into the first time bucket. For long-term liabilities, the maturity profile is based on the contractual instalment structure.

Amounts are in ISK million

Notes to the Consolidated Financial Statements

Maturity analysis 31 December, 2007

On balance sheet financial liabilities - contractual undiscounted cashflows	Up to 1 month	1-3 months	3-6 months	6-12 months	1-2 years	2-5 years	Over 5 years	Total
Short positions	15.023	0	0	0	0	0	0	15.023
Derivatives (balance sheet amount)	77.497	0	0	0	0	0	0	77.497
Deposits from banks and central banks	47.954	6	281	836	1.288	4.442	370	55.177
Deposits from customers	592.825	65.869	30.934	23.133	7.048	2.543	2.997	725.349
Debt issued and other borrowed funds	219.705	196.015	89.595	182.902	275.040	719.467	63.475	1.746.199
Subordinated liabilities	46	161	113	5.069	7.051	46.074	43.155	101.669
Total financial liabilities	953.050	262.051	120.923	211.940	290.427	772.526	109.997	2.720.914
Other liabilities and equity								
Other liabilities	18.584	1.161	425	2.591	0	0	35.266	58.027
Equity							169.969	169.969
Total liabilities and equity	971.634	263.212	121.348	214.531	290.427	772.526	315.232	2.948.910
Total assets	530.637	135.061	91.882	267.643	232.597	510.258	1.180.834	2.948.910
Total maturity gap on 31 December, 2007	(440.997)	(128.151)	(29.466)	53.112	(57.830)	(262.268)	865.602	0
Total maturity gap on 31 December, 2006	(185.353)	(60.943)	(50.036)	(36.875)	(89.675)	(291.346)	714.228	0

Cash-flow from derivative instruments - contractual undiscounted cashflows	Up to 1 month	1-3 months	3-6 months	6-12 months	1-2 years	2-5 years	Over 5 years	Total
Derivatives settled on net basis								
- net outflow	9.964	0	7.855	14.788	13.158	15.865	0	61.629
- net inflow	0	49.713	0	0	0	0	6.296	56.009
Derivatives settled on gross basis								
- outflow	18.682	34.053	63.275	175.068	589.273	497.302	497.302	1.874.955
- inflow	23.060	33.341	64.255	173.088	588.105	493.702	493.702	1.869.253
	(5.585)	49.001	(6.875)	(16.768)	(14.326)	(19.465)	2.696	(11.322)

Notes to the Consolidated Financial Statements

Market risk

78. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return on risk.

Market risk is the risk that changes in market prices, such as foreign exchange rates, interest rates, credit spreads and equity prices, will affect the fair value or future cash flows of the Bank's financial instruments. The Bank separates exposures to market risk into trading book and banking book.

The Bank's primary sources of market risk in the trading book are equities, debt instruments, foreign currency positions and derivatives. Shares and equity instruments are held for trading and market making. Bonds and debt instruments are held for trading and market making and consist of fixed income securities such as government bonds and swap contracts. The Bank also holds trading positions in derivatives whose value changes in response to changes in market prices. All financial assets and liabilities in the trading book are recognized at fair value and all resulting changes are immediately reflected in the income statement.

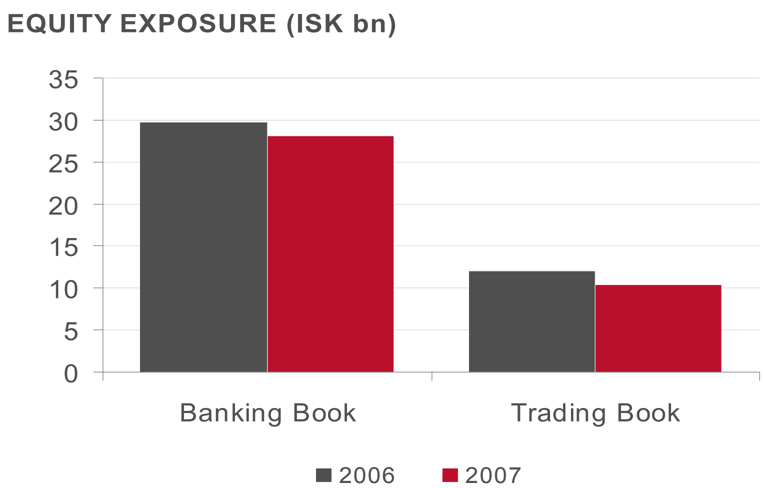
Primary sources of market risk in the banking book are equities, loans, deposits, debt issued and other borrowed funds and subordinated loans. They are evaluated periodically using latest market prices and financials. Any resulting loss is recorded in the income statement. Market risk from equity investment activities in the banking book os managed by the market risk unit. Market risk from other instruments in the banking book, including currency and interest rate risk, is managed within the Bank's asset and liability framework (see following chapters on interest rate risk in the banking book and currency risk).

Market risk management
The market risk unit is responsible for monitoring the Bank's exposure towards market risk in the trading book and the Bank's equity exposure in the banking book and reporting of consolidated risk figures to management . The market risk unit ensures that the Bank's exposure to risk is in line with the bank's policies and risk profile as determined by The Board of Directors. Subsidiaries with market risk exposure have local risk management units to monitor and manage the risk on a day-to-day basis, ensure limit compliance and report to the parent.

The Bank's market risk limits are set by the Market risk committee and consist of conventional risk measures such as market value and sensitivity measures. Limits are set for portfolios, products and risk types. Portfolios including options contracts are also subject to limits on price sensitivities of the options (e.g. greeks). Concentration risk is managed by using concentration limits on securities, currencies and duration time buckets. For trading positions the Bank uses a daily Value-at-Risk (VaR) method to measure market risk in individual portfolios as well as the Bank's overall risk exposure. In addition, the Bank uses stress tests to model the financial impact of a variety of exceptional market scenarios.

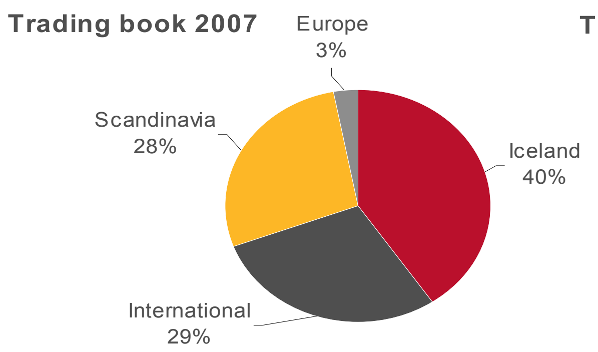
Investments in shares and equity instruments
The Bank's equity exposure arises from proprietary trading and investment activities. Limits on both aggregated market value and maximum exposure in single security are aimed at reducing the concentration risk in the Bank's portfolios.

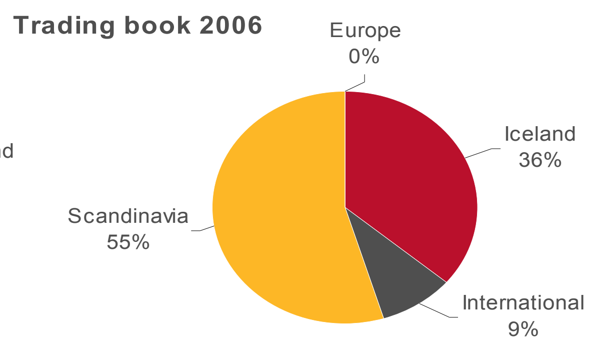
The banking book consists mainly of unlisted shares whereas the trading book consists mainly of listed shares. The Bank's overall exposure and listed versus unlisted equity composition in the trading and banking book has not changed significantly between 2006 and 2007.



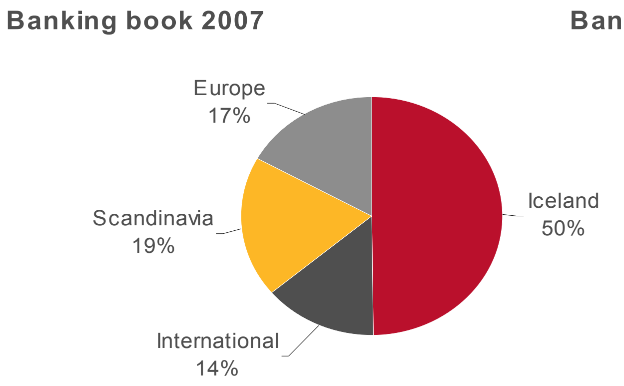
Notes to the Consolidated Financial Statements

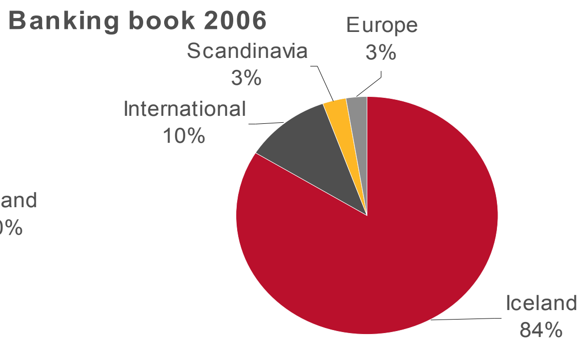
Diversification in both trading and banking book has improved in 2007, reflecting the internationalization of the Bank's operations. As can be seen from the accompanying charts, the trading book exposures in the Nordic have been replaced with a significant portion of international positions.





In the banking book a significantly larger portion of investments in 2007 have taken place outside of Iceland.





Other trading positions

The fixed income trading unit invests in government bonds and the Housing Financing Fund (HFF). Government bonds are non-indexed with duration up to five years. HFF bonds are linked to the consumer price index (CPI) in Iceland and have duration around ten years. Sensitivity measures are used to manage the risk arising from these exposures.

Trading positions in foreign currency are subject to absolute value limits on total positions and in single currency.

In addition, the Market Risk unit monitors and manages the bank's investments in derivatives with market risk exposure, including swaps, equity OTC options and FX OTC options. Sensitivity measures, such as the delta of the options, as well as the market values of underlying and hedging securities are monitored and subject to limits.

Value at risk

79. The VaR of the Group's trading book is the estimated loss that will arise on the trading book over a specified period of time (holding period) from an adverse market movement with a specified probability (confidence level). A historical VaR method is used based on the previous 250 days using end of day exposures. Reporting is based on a probability level of 99% and a one-day holding period. Back testing is used to assess the effectiveness of the VaR model.

The VaR model's output is driven by the exposures of the bank's positions and the volatility of the market. VaR measurements have some limitations. These include that the model does not reflect losses that exceed the confidence level, the model does not reflect exposures that arise intra-day, the 1-day holding period assumes that it is possible to hedge or dispose of positions within that period and historical data may not always cover all possible scenarios.

Amounts are in ISK million

Notes to the Consolidated Financial Statements

The VaR model is used to support the existing limit structure already in place and to give an overall view of the Bank's overall risk exposure.

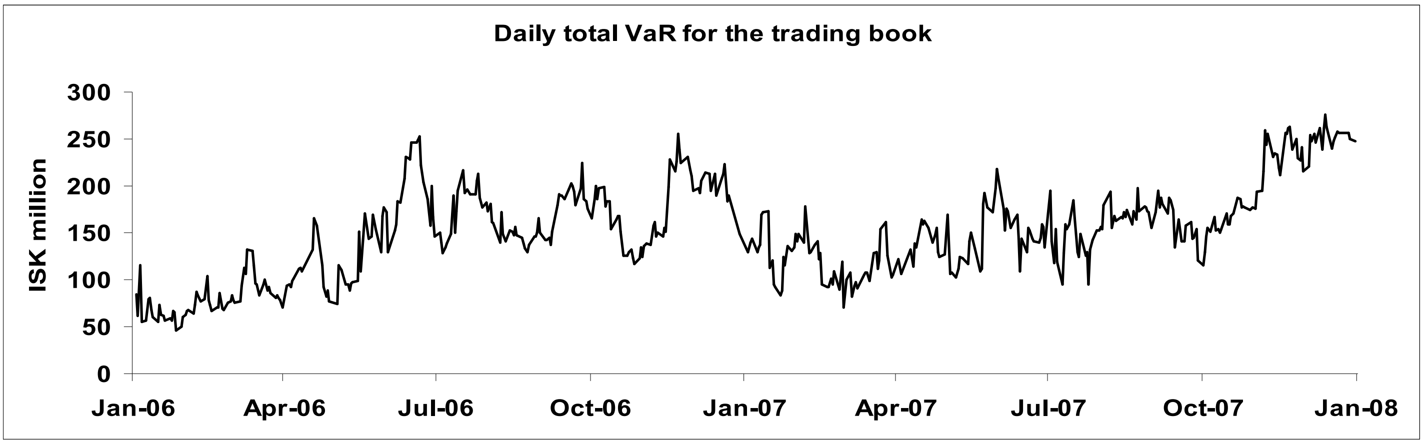
In 2007 a new VaR model was implemented. Main improvements are that unlisted equity positions are now included in the calculations on the trading book and diversification effect is displayed.

The table below summarizes the Group's VaR measures for 2007, with comparative figures for 2006 calculated by the new model.

Value at Risk

	12 months to 31 December 2007				12 months to 31 December 2006			
	Average	High	Low	End of year	Average	High	Low	End of year
Risk type								
Equity risk	228	390	101	353	197	352	54	230
Interest rate risk	45	96	28	55	32	59	12	34
Currency risk	136	327	4	146	79	239	15	125
Diversification gain	(184)	(313)	(76)	(205)	(108)	(246)	(40)	(179)
Group VaR	225	389	99	349	200	360	65	210

Increased volatility in the market directly affects the VaR while equity exposure by market value is similar at the end of year 2007 and 2006, the VaR is considerably higher for 2007.



Amounts are in ISK million

Notes to the Consolidated Financial Statements

Interest rate risk in the banking book

80. Interest rate risk in the banking book arises from the Bank’s core banking activities. The main source of this type of interest rate risk the risk of loss from fluctuations in future cash flows or fair values of financial instruments as market interest rates change over time, reflecting the fact that the Bank’s assets and liabilities are of different maturities and are priced off different interest rates.

Management of interest rate risk in the banking book
The ALM & capital management unit is responsible for measuring, monitoring and reporting on the Bank’s interest rate risk in the banking book.

The Bank manages its assets and liabilities with respect to interest terms and any mismatch thereof is subject to limits and reported to ALCO. It is the Bank’s policy to minimise foreign currency interest rate risk in the banking book. Financial assets and financial liabilities with fixed terms are hedged with interest rate swaps or other derivatives and hedge accounting is applied when possible in order to minimise the impact on the Bank’s income statement. Interest rate exposures in ISK are not hedged to the same extent and the Bank has banking book exposure to ISK interest rate movements.

Sensitivity analysis
The management of interest rate risk against interest repricing gap limits is supplemented by monitoring the sensitivity of the Bank’s financial assets and financial liabilities. Standard scenarios include a 100 basis point parallel shift in all yield curves.

At the end of 2007, a 100 basis point shift in yield curves would result in a loss of ISK 7 billion, or 3% of the Bank’s CAD equity.

The sensitivity towards interest movements is within the limits set by the Icelandic Financial Supervisory Authority (FME) of 20% of CAD equity. The consolidated interest rate risk position of the Bank is reported to the FME quarterly.

The table below shows the Bank's interest repricing gaps in individual currencies at the end of 2007.

Interest repricing gap at 31 December 2007 - categorised by currency	ISK	NOK	SEK	EUR	USD	GBP	CHF	JPY	Other	Total
0-1 year	(201,024)	37,554	2,156	25,695	(6,303)	(6,402)	(1,580)	(259)	1,255	(148,906)
1-5 years	92,676	624	0	12,274	4,804	6,603	2,167	668	725	120,541
5-10 years	12,414	50	0	(752)	(1,861)	(200)	0	0	10	9,661
10-20 years	13,259	0	0	44	0	292	0	0	0	13,595
> 20 years	5,038	0	0	0	0	(11)	0	82	0	5,109
	(77,637)	38,228	2,156	37,261	(3,360)	282	587	491	1,990	

Amounts are in ISK million

Notes to the Consolidated Financial Statements

Currency risk

81. Currency risk arises when financial instruments are not denominated in the reporting currency and can both affect the Bank's income and balance sheet.

Management of currency risk
A large part of the Bank's financial assets and financial liabilities is denominated in foreign currencies. Any mismatch between assets and liabilities in each currency is monitored closely and managed within strict limits. Trading positions in foreign currency are managed within the market risk unit and reported to Market risk committee. Other currency positions are related to the Bank's capital management and managed within the ALM and capital management unit and reported to ALCO. These are described further in the chapter on capital management.

The table below summarizes the Bank's exposure to currency risk at December 31, 2007 and the comparable net figures for the December 31, 2006. In addition, the currency exposures at the end of 2007 are supplemented by the respective interest rate gaps, based on the earlier of interest reset date or repricing date.

On balance sheet financial items - categorised by currency	ISK	NOK	SEK	EUR	USD	GBP	CHF	JPY	Other	Total
Assets										
Cash and balances with banks	43.517	8.632	29	2.987	117	62	36	13	107	55.500
Derivatives	106.836	11.413	0	426	30	0	0	0	1	118.706
Bonds and debt instruments	125.043	33.268	1	93.438	21.342	5.696	0	0	172	278.960
Shares and equity instruments	45.331	14.441	8.056	11.303	9.689	5.211	0	0	11.550	105.581
Loans to banks	23.736	6.391	9.752	76.905	119.576	38.442	1.077	523	2.067	278.469
Loans to customers	459.238	642.948	43.651	329.068	129.232	98.900	117.549	79.652	74.669	1.974.907
Other assets	70.084	22.394	3.924	39.878	435	1	3	7	61	136.787
Total financial assets	873.785	739.487	65.413	554.005	280.421	148.312	118.665	80.195	88.627	2.948.910
Liabilities										
Short positions	14.993	0	0	30	0	0	0	0	0	15.023
Derivatives	63.065	14.428	0	4	0	0	0	0	0	77.497
Deposits from banks and central banks ...	15.022	709	513	10.298	21.218	241	658	957	5.561	55.177
Deposits from customers	222.104	250.926	10.646	55.877	24.195	150.942	867	292	9.500	725.349
Debt issued and other borrowed funds ...	28.557	235.357	10.679	839.378	413.851	69.077	60.370	12.491	76.439	1.746.199
Subordinated loans	5.744	14.517	0	26.915	51.697	0	0	2.796	0	101.669
Other liabilities	43.922	9.698	2.706	88	1.147	10	0	0	456	58.027
Equity	169.969	0	0	0	0	0	0	0	0	169.969
Total financial liabilities	563.376	525.635	24.544	932.590	512.108	220.270	61.895	16.536	91.956	2.948.910
Net on balance sheet currency gap	310.409	213.852	40.869	(378.585)	(231.687)	(71.958)	56.770	63.659	(3.329)	
Offsetting derivatives										
Net derivative currency gap	(388.046)	(175.624)	(38.713)	415.847	228.327	72.240	(56.182)	(63.168)	5.320	
Net currency gap 31 December, 2007	(77.637)	38.228	2.156	37.262	(3.360)	282	588	491	1.991	
Net currency gap 31 December, 2006	(36.305)	22.478	2.256	3.106	4.315	1.038	(886)	499	3.499	

The Bank is subject to limits set by the Central bank of Iceland regarding the maximum open currency position, both with respect to individual currencies and the net open position. The currency balance of the parent company is reported daily to the Central bank of Iceland.

Exposure towards inflation

82. The Bank is exposed to Icelandic inflation since Consumer Price Indexed (CPI) indexed assets exceed CPI indexed 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. Mismatch in CPI indexed assets and liabilities is reported to ALCO. On 31 December 2007, the CPI gap amounted to ISK 141 billion compared to ISK 127 billion on 31 December 2006.

Notes to the Consolidated Financial Statements

Capital management

83. Financial institutions are required to hold a minimum capital base, regulatory capital, to meet unexpected losses in the operations. The Bank's regulatory capital is managed in two tiers and subject to certain limits regarding its composition.

Tier 1 capital:
Qualifying as Tier 1 capital is share capital, share premium account, retained earnings, translation reserve, hybrid debt securities that fulfil the requirements set by the Icelandic Financial Supervisory authority and minority interest after deductions for goodwill and intangible assets.

Tier 2 capital:
Qualifying as Tier 2 capital are subordinated liabilities that fulfil the requirements set by the Icelandic Financial Supervisory authority, collective impairment allowances and the element of the fair value reserve relating to unrealised gains on equity instruments, less statutory deductions relating to investments in other financial companies and other regulatory items.

Capitalisation targets
The Bank's capitalisation targets aim to maintain a strong capital base that supports its credit ratings and maintains investors' confidence while at the same time taking into account the Bank's targets for return on shareholders' capital. This ensures that the risk profile is linked with other financial targets, such as the Bank's growth rate, profit and dividend policy. The Bank's Board of Directors sets the capitalisation targets based on recommendations from ALCO. These targets, along with other financial targets, are reviewed at least annually. Current capitalisation targets assume a minimum total capital ratio of 11% and a Tier 1 ratio of 8%.

Capital management and measurement
Allocation of economic capital, across business units and individual positions, is a key element in the Bank's operations, pricing and performance measurement. ALCO is responsible for capital allocation mechanisms and methodologies, which are reviewed at least annually.

Capital is allocated to individual positions based on the Bank's risk classification system, the type of exposure and the Bank's target capitalisation. Each business unit is capitalised according to its exposure and risk profile, and return on allocated capital is calculated for each unit as a risk-adjusted performance measure.

BASEL II
The Bank has submitted an application to the Icelandic Financial Supervisory Authority to become an internal rating based (IRB) bank as defined under the new Basel II rules. From 1 January 2008, the Bank will use the IRB approach to determine capital requirements for the parent company and expects to roll out the use of IRB models for this purpose at subsidiary level in stages throughout 2008. The table below shows estimates for the RWA based on the balance sheet at 31 December 2007 under the Basel II rules using the Bank's IRB models. The table also shows capital composition and capital ratios of Glitnir at 31 December 2006 and 2007 based on the Basel I rules.

Amounts are in ISK million

Notes to the Consolidated Financial Statements

	2006 Basel I	2007 Basel I	2007 Basel II (unaudited)
Tier 1 capital			
Ordinary share capital	14.161	14.730	14.730
Share premium	51.847	58.329	58.330
Retained earnings	71.066	86.686	86.686
Other reserves	7.504	9.456	9.456
Minority interest	1.541	768	768
Hybrid debt securities	41.725	39.564	39.564
Less intangible assets	18.310	45.574	45.574
Total Tier 1 capital	169.534	163.959	163.960
Tier 2 capital			
Qualifying subordinated liabilities	66.794	61.617	61.617
Less statutory deductions	1.070	0	0
Total regulatory capital	235.258	225.576	225.577
Risk weighted assets			
- due to credit risk	1.519.288	1.929.818	1.818.929
- due to market risk	45.012	87.652	87.652
- due to operational risk			120.693
Total risk weighted assets	1.564.300	2.017.470	2.027.274
Capital ratios			
Tier 1 ratio	10,8%	8,1%	8,1%
Total capital adequacy ratio	15,0%	11,2%	11,1%

Internal capital adequacy assessment process (ICAAP)

As required under the second pillar of the Basel II rules, the Bank has in place a process for assessing its capital adequacy (Internal Capital Adequacy Assessment Process, ICAAP). This includes extensive stress testing of the Bank's capital ratios. The ICAAP aims to ensure that all material risks that the Bank is exposed to are adequately identified and assessed and that adequate capital is held in relation to the Bank's risk profile. The Bank submitted its first annual ICAAP report to the Icelandic Financial Supervisory Authority in December 2007.

Sensitivity of capital ratios towards foreign currency fluctuations

Since the Bank's assets are largely foreign currency denominated while the equity Bank's is in ISK, the Bank's capital ratios are sensitive to fluctuations in the exchange rate. To reduce this sensitivity, the Bank holds long positions in EUR, NOK and SEK against its holding in foreign subsidiaries.

Operational risk

84. Operational risk has now become a part of the basis for calculating capital requirements of financial institutions. This is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. the Bank has implemented an operational risk management framework which satisfies the requirements for the Standardized Approach under the Basel II Accord with respect to assessment, monitoring and control of operational risk. Under this framework, operational risk management will be carried out in a consistent manner across all business units in the Bank with the primary responsibility for the assessment and managing of operational risk residing with each business unit. The Bank expects to fulfil the said requirements in the year 2008.

An Operational risk committee has been established in the Bank, reporting to the Executive Board. In addition to the operational risk defined above related to capital requirements calculations, this committee is also responsible for risk to information systems, to reputation, to business continuation and to other operational risks in the Bank. The Bank's operational risk policy is based on four principles:

• accept no unnecessary risk
• make risk management decisions at the appropriate level
• accept risk when the benefits out the costs
• reduce the impact of operational risk

The operational risk function is responsible for measuring, monitoring and reporting on the Bank's operational risk.