KAUPTHING BANK

Consolidated Financial Statements
for the year 2007

Kaupthing Bank hf.
Borgartún 19
105 Reykjavík
Iceland

Reg. no. 560882-0419

Contents

Endorsement and Statement by the Board of Directors and the CEO

Operations in 2007

The Consolidated Financial Statements of Kaupthing Bank hf. for the year ended 31 December 2007 include the Financial Statements of Kaupthing Bank hf. and its subsidiaries, together referred to as "the Bank".

Net earnings, according to the Consolidated Income Statement, amounted to ISK 71,191 million for the year ended 31 December 2007. The Board of Directors proposes a payment of dividend, ISK 20 per share or ISK 14,810 million, which is 21% of net earnings for the year. Total Equity, according to the Consolidated Balance Sheet, amounted to ISK 356,431 million at the end of the year, including share capital amounting to ISK 7,371 million. The equity ratio of the Bank, calculated according to the Act on Financial Undertakings, was 11.8%. This ratio may not be lower than 8.0%.

At the end of year 2007 the Bank's shareholders numbered 32,264 compared to 31,730 at the beginning of the year. At the end of the year, one shareholder held more than 10.0% of the shares in the Bank, Exista B.V., which owned 23.26% of the shares.

In April the Bank sold all shares in the wholly owned subsidiary Eik fasteignafélag hf. The Bank generated a profit before taxes of ISK 4,262 million on this transaction, which was booked in the second quarter of 2007.

In August 2007 the Bank entered into an agreement to purchase the entire share capital of NIBC N.V. for EUR 2,985 million. On 29 January 2008 the Bank came to an agreement with the Sellers that both parties relinquish from their prior agreement.

In December the Bank sold its operation in the Faroe Islands.

In May the Bank increased its holding in the Norwegian insurance and financial services company Storebrand ASA to 20% of the company's outstanding shares.

Share Capital and Articles of Association

The share capital of the Bank amounted to ISK 7,405 million at year-end. The Bank owns treasury shares with nominal value of ISK 34 million. The share capital is divided into shares of ISK 10 each with equal rights within a single class of shares listed on the Iceland Stock Exchange (OMX Iceland) and Stockholm Stock Exchange (OMX Sweden). The Board of Directors has the right to increase the share capital of the Bank by the nominal value of ISK 1,500 million with sale of new shares. Shareholders have waived the pre-emptive rights to these shares. The Board of Directors will decide the sale price and sale rules. The Board of Directors has the right to purchase up to 10% of the nominal value of the shares of the Bank, provided that the purchase price in not more than 20% higher or 20% lower than the last quoted price in the Iceland Stock Exchange or Stockholm Stock Exchange.

Share option agreements have been concluded with employees of the Bank, which enables them to purchase shares in the Bank at the exercise price of ISK 51 to ISK 1,224 over a period of 3 to 6 years, given that they are employeed by the Bank during that time. Further information on the share option program is in note 116.

In the course of the Bank's normal business it has entered into agreements with employees which may be affected by the event of a take-over or termination without cause. The Board of Directors considers none of these to be of material importance to the Bank's operation.

Endorsement and Statement by the Board of Directors and the CEO

The Bank's Board of Directors comprises nine members elected at the Annual General Meeting. Those persons willing to stand for election shall give formal notice thereof in writing to the Bank's Board at least full seven days before the beginning of the meeting. The Bank's Articles of Association can only be amended with the approval of 2/3 of casted votes in a legal shareholders' meeting, provided that the notification calling the meeting thoroughly informs on such amendment and what the amendment consists in.

Statement by the Board of Directors and the CEO

The Annual Consolidated Financial Statements for the year ended 31. December 2007 have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU and additional Icelandic disclosure requirements for consolidated financial statements of listed companies.

According to our best knowledge it is our opinion that the Annual Consolidated Financial Statements give a true and fair view of the consolidated financial performance of the Bank for the financial year 2007, its assets, liabilities and consolidated financial position as at 31 December 2007 and its consolidated cash flows for the financial year 2007.

Further, in our opinion the Consolidated Financial Statements and the Endorsement of the Board of Directors and the CEO gives a fair view of the development and performance of the Bank's operations and its position and describes the principal risks and uncertainties faced by the Bank.

The Board of Directors and the CEO have today discussed the Annual Consolidated Financial Statements of Kaupthing Bank hf. for the year 2007 and confirm them by means of their signatures. The Board of Directors and the CEO recommend that the Consolidated Financial Statements will be approved at the Annual General Meeting of Kaupthing Bank hf.

Reykjavík, 30 January 2008

Board of Directors

Sigurdur Einarsson
Chairman

Antonios P. Yerolemou

Bjarnfredur H. Ólafsson

Gunnar Páll Pálsson

Niels de Coninck-Smith

Ásgeir Thoroddsen

Brynja Halldórsdóttir

Hjörleifur Thór Jakobsson

Tommy Persson

CEO

Hreidar Már Sigurdsson

Independent Auditors' Report

To the Board of Directors and Shareholders of Kaupthing Bank hf.

We have audited the accompanying Consolidated Financial Statements of Kaupthing Bank hf. and its subsidiaries (the "Bank"), which comprise the Consolidated Balance Sheet as at 31 December 2007, the Consolidated Income Statement, Consolidated Statement of Changes in Equity and Consolidated Statement of Cash Flows 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 EU. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatements, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

Our responsibility is to express an opinion on these 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 relevant ethical requirements and plan and perform the audit to obtain reasonable assurance whether the Financial Statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the Financial Statements. The procedures selected depend on 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 Bank's internal control. An audit also includes evaluating the appropriateness of accounting principles 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 Consolidated Financial Statements give a true and fair view of the consolidated financial position of Kaupthing Bank hf. as at 31 December 2007, of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU.

Reykjavík, 30 January 2008

KPMG hf.

Saemundur Valdimarsson

Reynir Stefán Gylfason

Consolidated Income Statement
for the year 2007

	Notes	2007	2006
Interest income		304,331	187,451
Interest expense		(224,218)	(135,089)
Net interest income	44	80,113	52,362
Fee and commission income		64,865	40,904
Fee and commission expense		(9,844)	(3,620)
Net fee and commission income	45	55,021	37,284
Net financial income	46-51	14,433	60,157
Share of profit of associates	73	3,459	1,194
Other operating income	52	12,792	16,219
Operating income		165,818	167,216
Salaries and related expenses	54-55	(46,647)	(33,570)
Administration expenses		(24,693)	(19,800)
Depreciation and amortisation	79	(6,550)	(5,976)
Other operating expenses		(841)	(660)
Impairment on loans	57	(6,098)	(4,857)
Impairment on other assets	57	(82)	(1,270)
Earnings before income tax		80,907	101,083
Income tax expense	58	(9,716)	(14,636)
Net earnings		71,191	86,447
Attributable to:			
Shareholders of Kaupthing Bank hf.		70,020	85,302
Minority interest		1,171	1,145
Net earnings		71,191	86,447
Earnings per share			
Basic earnings per share (ISK)	59	95.2	127.1
Diluted earnings per share (ISK)	59	93.3	123.4

The notes on pages 11 to 72 are an integral part of these Consolidated Financial Statements.

Kaupthing Bank hf. Consolidated Financial Statements 2007 6 Amounts are in ISK millions

Consolidated Balance Sheet
as at 31 December 2007

	Notes	2007	2006
Assets			
Cash and balances with central banks	60	97,959	106,961
Loans to credit institutions	61	588,441	485,334
Loans to customers	62-68	3,304,408	2,538,609
Bonds and debt instruments	69	367,350	318,264
Shares and instruments with variable income	69	160,797	159,020
Derivatives	69,96	134,856	65,454
Derivatives used for hedging	69,96	22,503	6,453
Securities used for hedging	69	159,949	115,938
Investments in associates	73	83,831	5,304
Intangible assets	74-75	66,774	68,301
Investment property	76-77	28,155	31,584
Property and equipment	78-80	32,714	30,466
Tax assets	87-90	6,899	5,834
Other assets	81	292,709	117,874
Total Assets		5,347,345	4,055,396
Liabilities			
Due to credit institutions and central banks	69	339,088	110,456
Deposits	69	1,381,457	750,658
Financial liabilities measured at fair value	69,84-86	217,945	71,264
Borrowings	82	2,615,960	2,399,939
Subordinated loans	83	267,289	216,030
Tax liabilities	87-90	22,478	23,209
Other liabilities	91-92	146,697	148,948
Total Liabilities		4,990,914	3,720,504
Equity			
Share capital		7,371	7,321
Share premium		162,221	164,028
Other reserves		(14,627)	17,220
Retained earnings		190,643	134,941
Total Shareholders' Equity	93-95	345,608	323,510
Minority interest		10,823	11,382
Total Equity		356,431	334,892
Total Liabilities and Equity		5,347,345	4,055,396

The notes on pages 11 to 72 are an integral part of these Consolidated Financial Statements.

Amounts are in ISK millions

Consolidated Statement of Changes in Equity
for the year 2007

	Share capital and share premium	Other reserves	Retained earnings	Total Share-holders' equity	Minority interest	Total equity
2007						
Equity 1 January 2007	171,349	17,220	134,941	323,510	11,382	334,892
Translation difference		(31,866)		(31,866)	(358)	(32,224)
Fair value changes in financial assets available-for-sale		19		19		19
Net loss recognised directly in equity		(31,847)		(31,847)	(358)	(32,205)
Net earnings according to the Income Statement			70,020	70,020	1,171	71,191
Total recognised earnings for the year		(31,847)	70,020	38,173	813	38,986
Dividends paid to shareholders, ISK 14 per share			(10,272)	(10,272)		(10,272)
Purchases and sales of treasury stock	(3,995)			(3,995)		(3,995)
Exercised stock options	716			716		716
Stock option expense	1,522			1,522		1,522
Restating the initial investments in shares			(5,111)	(5,111)		(5,111)
Other changes			1,065	1,065	(1,372)	(307)
Equity 31 December 2007	169,592	(14,627)	190,643	345,608	10,823	356,431
2006						
Equity 1 January 2006	121,244	(1,540)	74,479	194,183	8,329	202,512
Translation difference		18,289		18,289	2,176	20,465
Fair value changes in financial assets available-for-sale		(9)		(9)		(9)
Deferred pension reserve		480		480		480
Net earnings recognised directly in equity		18,760		18,760	2,176	20,936
Net earnings according to the Income Statement			85,302	85,302	1,145	86,447
Total recognised earnings for the year		18,760	85,302	104,062	3,321	107,383
Dividends paid to shareholders, ISK 37.6 per share			(24,814)	(24,814)		(24,814)
Issued new share capital	55,558			55,558		55,558
Purchases and sales of treasury stock	(6,024)			(6,024)		(6,024)
Exercised stock options	571			571		571
Other changes			(26)	(26)	(268)	(294)
Equity 31 December 2006	171,349	17,220	134,941	323,510	11,382	334,892

The notes on pages 11 to 72 are an integral part of these Consolidated Financial Statements.

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Consolidated Statement of Cash Flows
for the year 2007

	2007	2006
Cash flows from operating activities:		
Earnings before tax income	80,906	101,083
Adjustments to reconcile net earnings to cash flow (used in) from operating activities:		
Non-cash items included in net earnings and other adjustments	(28,057)	1,481
Changes in operating assets and liabilities	49,421	(144,389)
Income taxes paid	(10,154)	(8,115)
Net cash from (used in) operating activities	92,116	(49,940)
Cash flows from investing activities:		
Investment in associated companies	(26,329)	(5,400)
Proceeds from sale of associated companies	512	20,266
Dividend received from subsidiaries	149	4,103
Purchase of intangible assets	(2,654)	(1,810)
Proceeds from sale of intangible assets	77	0
Purchase of investment property	(10,293)	(3,475)
Proceeds from sale of investment property	13,473	5,367
Purchase of property and equipment	(12,453)	(13,818)
Proceeds from sale of property and equipment	2,283	3,283
Payment for acquisition of subsidiaries, less cash acquired	(3,320)	0
Proceeds from sale of subsidiaries, net of cash disposed	7,808	0
Other changes	(3,312)	221
Net cash (used in) from investing activities	(34,059)	8,737
Cash flows from financing activities:		
Subordinated loan capital issued	51,666	111,336
Subordinated loan capital repaid	(407)	(2,601)
Purchases of own shares to meet share awards and share option awards	(3,995)	(5,800)
Proceeds from the issue of shares	0	55,558
Dividends paid	(10,272)	(24,814)
Net cash from financing activities	36,992	133,679
Net increase in cash and cash equivalents	95,049	92,476
Cash and cash equivalents at beginning of the year	202,789	81,758
Effect of exchange rate changes on cash held	(9,279)	28,555
Cash and cash equivalents at year-end	288,559	202,789

The notes on pages 11 to 72 are an integral part of these Consolidated Financial Statements.

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Consolidated Statement of Cash Flows
for the year 2007 - notes

Non-cash items in the Income Statement and other adjustments:	2007	2006
Impairment on loans	6,743	4,857
Depreciation and amortisation	6,551	5,976
Impairment on intangible assets	82	1,270
Share of profit of associates	(3,459)	(1,194)
Investment property, fair value change	219	(96)
Net gain on disposal of investment property	0	(3,020)
Indexation and exchange rate difference	(30,884)	2,689
Net gain on disposal on property and equipment	(845)	(303)
Net gain on a disposal of subsidiaries	(5,962)	(8,398)
Share based payment expenses	1,522	571
Changes in other non cash items	(2,024)	(871)
	(28,057)	1,481

Changes in operating assets and liabilities:		
Loans	(769,465)	(1,253,947)
Financial assets measured at fair value	(207,671)	(51,150)
Derivatives used for hedging	(15,980)	(2,016)
Financial assets available for sale	(1)	3
Tax assets	1,136	(3,060)
Other assets	(176,239)	(82,894)
Deposits	862,168	301,998
Borrowings	216,958	834,270
Financial liabilities, measured at fair value	147,362	10,872
Provisions	(4,647)	1,378
Tax liabilities	11	(1,788)
Other liabilities	2,428	101,945
	56,060	(144,389)

Cash and cash equivalents at year-end:		
Cash in hand and demand deposits	97,959	95,828
Due from credit institutions	197,240	106,961
Cash and cash equivalents at year-end	295,199	202,789

The notes on pages 11 to 72 are an integral part of these Consolidated Financial Statements.

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Notes to the Consolidated Financial Statements

General information

1. Reporting entity

Kaupthing Bank hf., the Parent Company, is a company incorporated and domiciled in Iceland. The address of Kaupthing Bank's registered office is Borgartún 19, Reykjavik. The Consolidated Financial Statements for the year 2007 comprise Kaupthing Bank hf. and its subsidiaries (together referred to as "the Bank"). The Bank offers integrated financial services to companies, institutional investors and individuals. These services include corporate banking, investment banking, retail banking, capital markets services, asset management and comprehensive wealth management for private banking clients.

2. Basis of preparation

a) *Statement of compliance*
The Consolidated Financial Statements have been prepared in accordance with International Financial Reporting Standards (IFRs) as adopted by the EU.

The Financial Statements were approved and authorised for issue by the Board of Directors of Kaupthing Bank hf. on 30 January 2008.

b) *Basis of measurement*
The Consolidated Financial Statements are prepared on the historical cost basis except for the following:

- Derivative financial instruments are measured at fair value
- Financial instruments held for trading are measured at fair value
- Financial instruments designated at fair value through profit and loss are measured at fair value
- Financial instruments classified as available-for-sale are measured at fair value
- Investment properties are measured at fair value

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

c) *Functional and presentation currency*
The Consolidated Financial Statements are presented in Icelandic krona (ISK), which is the Parent Company´s functional currency. Except as indicated, financial information presented in ISK has been rounded to the nearest million.

d) *Use of estimates and judgements*
The preparation of the Financial Statements in conformity with IFRS requires management to make judgements, estimates and assumptions. These judgements, estimates and assumptions affect the application of accounting policies and the reported amounts of assets and liabilities as well as income and expenses in the Financial Statement presented. Actual results may differ from the estimates and the assumption made.

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 and in any future periods affected.

Judgements made by management in the application of IFRS that have significant effect on the Financial Statements and estimates with a significant risk of material adjustment within the next financial year are discussed in note 38.

Significant accounting policies

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 Bank entities.

3. Basis of consolidation

a) *Subsidiaries*
Subsidiaries are entities controlled by the Bank. Control exists when the Bank has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Control usually exists when the Bank holds more than the 50% of the voting power of the subsidiary. In assessing control, potential voting rights that are currently exercisable or convertible 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.

3. cont.

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 value, 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 combination 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 net identifiable 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 directly in the Income Statement.

b) *Special purpose entities*

Special purpose entities are entities that are created to accomplish a narrow and well-defined objective such as the securitisation of particular assets, or the execution of a specific borrowing or lending transaction. The Financial Statements of special purpose entities are included in the Bank's Consolidated Financial Statements where the substance of the relationship is that the Bank controls the special purpose entity.

c) *Funds management*

The Bank manages and administers assets held in unit trusts and other investment vehicles on behalf of investors. The Financial Statements of these entities are not included in these Consolidated Financial Statements except when the Bank controls the entity. Information about the Bank's funds management and securitisation activities is set out in note 71.

d) *Transactions eliminated on consolidation*

Intragroup balances, unrealised income and expenses arising from intragroup transactions, are eliminated in preparing the Consolidated Financial Statements. Unrealised gains arising from transactions with associated entities are eliminated to the extent of the Bank's interest in the entity. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

4. Associates

Associates are those entities over which the Bank has significant influence, i.e. the power to participate in the financial and operating policy decisions of the associates but 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. Investments in associates are initially recognised at cost. The carrying amount of investments in associates includes goodwill and accumulated impairment loss.

Investments in associates held as venture capital in Investment Banking are not accounted for on an equity basis but 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.

The Consolidated Financial Statements include the Bank's share of the total recognised income and expenses of associates on an equity accounted investees, 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 equity accounted associate, the Bank's carrying amount is reduced to nil and recognition of further losses is discontinued except to the extent that the Bank has incurred legal or constructive obligations or made payments on behalf of the associate. If the associate subsequently reports profits, the investor resumes recognising its share of those profits only after its share of the profits equals the share of losses not recognised.

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 as non-current assets held for sale.

5. Foreign currency

a) *Functional currencies*

Items included in the Financial Statements of each of the Bank's entities are measured using the functional currency of the respective entity.

b) *Foreign currency transactions*

Transactions in foreign currencies are translated to the respective functional currencies of Bank entities at exchange rates at the dates of transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated to the functional currency at the exchange rate at that date. The foreign currency gain or loss on monetary items is the difference between amortised cost in the functional currency at the beginning of the period, adjusted for effective interest and payments during the period, and the amortised cost in foreign currency translated at the exchange rate at the end of the period. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated to the functional currency at the exchange rate at the date that the fair value was determined. Foreign currency differences arising on retranslation are recognised in profit or loss, except for differences arising on the retranslation of available-for-sale equity instruments or financial instruments designated as a hedge of the net investment in a foreign operation which are recognised directly in equity.

5. cont.

c) *Foreign operations*
The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on acquisition, are translated to Icelandic krona, at exchange rates at the reporting date. The income and expenses of foreign operations are translated to Icelandic krona at average exchange rates approximating the exchange rates current at the dates of the transactions.

Foreign exchange differences arising on translation are recognised directly in equity. Since 1 January 2004, the Bank's date of transition to IFRSs, such differences have been recognised in the Translation reserve. When a foreign operation is disposed of, in part or in full, the relevant amount in the Translation reserve is transferred to the Income Statement.

d) *Hedges of net investment in foreign operations*
See accounting policy 10d.

6. Income and Expense

a) *Interest income and expense*
Interest income and expense are recognised in the Income Statement using the effective interest method. The effective interest rate is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial asset or liability (or, where appropriate, a shorter period) to the carrying amount of the financial asset or liability. The effective interest rate is established on initial recognition of the financial asset and liability and is not revised subsequently.

The calculation of the effective interest rate includes all fees and points paid or received, transaction costs, and discounts or premiums that are an integral part of the effective interest rate. Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or liability.

Interest income and expense presented in the income statement include:
- Interest on financial assets and liabilities at amortised cost on an effective interest rate basis,
- Unwinding of the discount on impaired financial assets,
- Interest on trading assets and liabilities on an accrual basis,
- Interest on financial assets and financial liabilities designated at fair value through profit or loss on an accrual basis,
- Interest on derivatives designated as hedging instruments on an accrual basis.

b) *Fee and commission income and expense*
The Bank provides various services to its clients and earns income there from, such as income from Investment Banking, Corporate Banking, Capital Markets, Asset Management and Retail Banking. Fees earned from services that are provided over a certain period of time are recognised as the services are provided. Fees earned from transaction-type services are recognised when the service has been completed. Fees that are performance-linked are recognised when the performance criteria are fulfilled. Fees and commission income and expenses that are integral to the effective interest rate on a financial asset or liability are included in the measurement of the effective interest rate.

c) *Net financial income*
Net financial income comprises Dividend income, Net gain on financial assets and liabilities at fair value through profit and loss, Net foreign exchange gain and Net gain on financial assets and liabilities not at fair value.

i) *Dividend income* is recognised when the right to receive income is established. Usually this is the ex-dividend date for equity securities.

ii) *Net gain on financial assets and liabilities at fair value through profit and loss* comprises *Net gain on trading portfolio*, *Net gain on assets and liabilities designated at fair value through profit and loss* and *Fair value adjustments on hedge accounting*.

Net gain on trading portfolio
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).

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".

6. cont.

Net gain on assets and liabilities designated at fair value through profit and 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).

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.

iii) *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 5).

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.

iv) *Net gain on financial assets and liabilities not at fair value through profit or loss* relates to derecognition of certain financial assets and liabilities and comprises Net realised gain on loans and finance leases, Net realised gain on available-for-sale assets, Net realised gain on financial liabilities measured as amortised cost, and other net realised gain. It does not include either unrealised foreign exchange gains or interest income and expense which are included in other line items.

d) *Lease payments*
Payments made under operating leases are recognised in profit or loss on a straight-line basis over the term of the lease. Lease incentives received are recognised as an integral part of the total lease expense, over the term of the lease.

Minimum lease payments made under finance leases are apportioned between the finance expense and the reduction of the outstanding liability. The finance expense is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of liability. Contingent lease payments are accounted for by revising the minimum lease payments over the remaining term of the lease when the lease adjustment is confirmed.

e) *Income tax*
Income tax 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 year, using tax rates enacted or substantially enacted at the reporting 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 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 deferred tax asset is only offset against income tax liability 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 reviewed at each reporting date and reduced to the extent that it is no longer probable that the related tax benefit will be realised.

7. Impairment of financial assets

At each reporting date the Bank assesses whether there is objective evidence that financial assets not carried at fair value through profit or loss are impaired. Financial assets are impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the assets, and that the loss event has an impact on the future cash flows on the asset that can be estimated reliably.

An impairment loss is recognised whenever the carrying amount of a financial asset exceeds its recoverable amount. Impairment losses are recognised as described below.

7. cont.

a) *Impairment on loans*

The Bank recognises losses for impaired loans when there is objective evidence that impairment of a loan or portfolio of loans has occurred. This is done on a consistent basis in accordance with the Bank's guidelines.

There are two basic methods of calculating impairment losses, those calculated on individual loans and those losses assessed on a collective basis. Losses expected as a result of future events, no matter how likely, are not recognised.

Objective evidence of impairment includes observable data about the following loss events:

i) Significant financial difficulty of the borrower;

ii) A breach of contract, such as a default on instalments or on interest or principal payments;

iii) The Bank granting to the borrower, for economic or legal reasons relating to the borrower’s financial difficulty, a refinancing concession, that the lender would not otherwise consider;

iv) It becomes probable that the borrower will enter bankruptcy or undergo other financial reorganisation;

v) The disappearance of an active market for that financial asset because of financial difficulties; or

vi) Observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of loans since the initial recognition of those assets, even if the decrease cannot yet be identified with the individual financial assets in the group, including:

- Adverse changes in the payment status of borrowers in the group; or
- General national or local economic conditions connected with the assets in the group.

Individually assessed loans

Impairment losses on individually assessed accounts are determined by an evaluation of the exposures on a case-by-case basis. The Bank assesses at each reporting date whether there is any objective evidence that a loan is impaired. This procedure is applied to all accounts that are considered individually significant. In determining such impairment losses on individually assessed accounts, the following factors are considered:

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

Impairment loss is calculated by comparing the present value of the expected future cash flows, discounted at the original effective interest rate of the loan, with its current carrying value and the amount of any loss is charged in the Income Statement. The carrying amount of impaired loans is reduced through the use of an allowance account. In the case of a loan at variable interest rates, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract.

Collectively assessed loans

Where loans have been individually assessed and no evidence of loss has been identified, these loans are grouped together on the basis of similar credit risk characteristics for the purpose of calculating a collective impairment loss. This loss covers loans that are impaired at the reporting date but which will not be individually identified as such until some time in the future. The estimated collective impairment loss is recognised through the use of an allowance account.

The collective impairment loss is determined after taking into account:

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

The estimated period between a losses occurring and its identification is determined for each identified portfolio.

7. cont.

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

Loan write-offs

Loans are normally written off, either partially or in full, when there is no realistic prospect of recovery of these amounts and, for collateralised loans, when the proceeds from the realisation of security have been received.

Reversals of impairment

If, in a subsequent period, the amount of an impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed. The amount of any reversal is recognised in the Income Statement.

Assets acquired in exchange for loans

Non-financial assets acquired in exchange for loans in order to achieve an orderly realisation are recorded as assets held for sale and reported in the Balance Sheet. The asset acquired is recorded at the lower of its fair value less costs to sell and the carrying amount of the loan, net of impairment allowance amounts, at the date of exchange. No depreciation is provided in respect of assets held for sale. Any subsequent write-down of the acquired asset to fair value less costs to sell is recorded as an impairment loss and included in the Income Statement. Any subsequent increase in the fair value less costs to sell, to the extent this does not exceed the cumulative impairment loss, is recognised in the Income Statement.

b) *Impairment of 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. Impairment losses are subsequently reversed if the reasons for the impairment loss charged no longer apply.

c) *Calculation of recoverable amount*

The recoverable amount of the Bank's investments in financial assets carried at amortised cost is calculated as the present value of estimated future cash flows, discounted at the original effective interest rate, i.e. the effective interest rate computed at initial recognition of these financial assets.

d) *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 an equity instrument classified as available-for-sale is not reversed through profit or loss. If the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in the Income Statement, the impairment loss shall be reversed, with the amount of the reversal recognised in the Income Statement.

However, any subsequent recovery in the fair value of an impaired available-for-sale equity security is recognised directly in equity. Changes in impairment provisions attributable to time value are reflected as a component of interest income.

e) *Impairment on investments in associates*

After applying the equity method to account for investments in associates, the Bank determines whether it is necessary to recognise any impairment loss with respect to its net investments in associates. The Bank first determines whether there is any objective evidence that a net investments in an associate is impaired in the same way as for available-for-sale equity instruments (see 7.b above). If such evidence exists, the Bank then tests the entire carrying amount of the investment for impairment, by comparing its recoverable amount, which is the higher of value in use and fair value less costs to sell, with its carrying amount. The recoverable amount of an investment in an associate is assessed for each associate, unless the associate does not generate cash inflows from continuing use that are largely independent of those from other assets of the Bank. The excess of the carrying amount over the recoverable amount is recognised in income statement as an impairment loss. Impairment losses are subsequently reversed through Income Statement if the reasons for the impairment loss no longer apply.

8. Impairment of non-financial assets

The carrying amounts of the Bank's non-financial assets, other than investment property and deferred tax assets, are reviewed at each reporting date to determine, whether there is any indication of impairment. If any such indication exists then the asset's recoverable amount is estimated. The recoverable amount of goodwill is estimated at each reporting date.

An impairment loss is recognised if the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. A cash-generating unit is the smallest identifiable asset group that generates cash flows that are largely independent of other assets and groups. Impairment losses are recognised in profit or loss. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill associated to the units and then to reduce the carrying amount of the other assets in the unit (group of units) on a pro rata basis.

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less cost to sell. 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.

An impairment loss in respect of goodwill is not reversed. In respect of other assets, impairment losses recognised in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. 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.

9. Derivatives

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

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

Derivatives are recognised at fair value. Fair value changes are recognised in the Income Statement, except in the case of derivatives that are designated and are effective hedging instruments, whose fair value changes are recognised in accordance with the accounting policies in note 10. Changes in fair values of derivatives are split into interest income, foreign exchange differences and other gains and losses. Interest income is recognised on accrual basis. Derivatives with positive fair values are recognised as Derivatives and derivatives with negative fair values are recognised as Financial liabilities measured at fair value.

Embedded derivatives

Derivatives may be embedded in another contractual arrangement (a "host contract"). The Bank accounts for embedded derivatives separately from the host contract when the host contract is not itself carried at fair value through profit or loss, and the characteristics of the embedded derivatives are not clearly and closely related to the host contract. Separated embedded derivatives are accounted for depending on their classification, and are presented in the Balance Sheet together with the host contract.

The fair value of derivatives is determined in accordance with the accounting policy presented in note 13.

10. Hedging

Due to the Bank’s risk positions and funding structure, its risk management policies require that the Bank should minimise its exposure to changes in foreign currency rates and manage interest rate risk, credit risk and market price risk exposure within certain guidelines (see also separate section on risk management). The Bank uses both derivative and securities to manage the potential earnings impact of these risks. Securities comprise bonds and other debt instruments as well as shares and other equity instruments.

Several types of derivatives are used for this purpose, including interest rate swaps, currency swaps, options, financial futures, forward contracts and other derivatives. The purpose of the Bank’s hedging activities is to protect the Bank from the risk that the net cash inflows will be adversely affected by changes in interest or exchange rates, credit ratings or market prices. The Bank enters into transactions to ensure that it is economically hedged in accordance with risk management policies. For qualifying hedge relationships, the Bank uses hedge accounting.

Each qualifying hedge relationship is evidenced and driven by management’s approach to risk management and the decision to hedge the particular risk. Where hedge accounting is applied the Bank assesses, both at the inception of the hedge and each time the Bank prepares its annual or interim Financial Statements, whether the derivatives used as hedges are highly effective in offsetting the changes in value or cash flows associated with the hedged items. A hedge is normally regarded as highly effective if the changes in fair value or cash flows of the hedged item are expected to almost fully offset the changes in fair value or cash flows of the hedging instrument. Actual effectiveness results must be within a range of 80 to 125 percent on a cumulative basis. The designation and effectiveness measurement follows the methodologies that management has in place for risk identification and measurement. The ineffective portion of any gain or loss on a hedging instrument is recognised in the Income Statement.

10. cont.

The Bank's risk management activities concentrate on hedging the Bank's net exposure based on its asset and liability positions. Therefore the Bank monitors its interest rate risk exposures by reviewing the net asset or liability gaps within repricing bands. For hedge accounting purposes, the Bank designates the benchmark interest rate exposure of a portion of the underlying gross exposure as the hedged item and the hedge relationship is viewed at a micro level, considering only the relationship between the hedged item and the hedging instrument.

Where the Bank hedges a portfolio of loans in respect of interest rate risk it groups the loans into homogenous layers, each with specific maturities.

The Bank designates hedge relationships only for fair value hedge accounting and net investments in foreign operations.

The treatment of changes in fair value depends on their classification into the following categories:

a) *Fair value hedges*
Fair value hedges seek to eliminate risks of changes in the fair value of a recognised asset or liability or firm commitment that will give rise to a gain or loss that will be recognised in the Income Statement.

When a derivative hedges the changes in fair value of recognised assets or liabilities or an identified portion of such assets or liabilities, any gain or loss on the hedging instrument is recognised in the Income Statement. The hedged items are also stated at fair value in respect of the risk being hedged, with any gain or loss being recognised in the Income Statement. The gains and losses on the hedging instruments and hedge items, are presented together in the Income Statement as part of Net financial income except for the changes in fair values of derivatives used as hedging instruments that relate to interest income (see note 9). Fair value changes of derivatives used as hedging instruments are included in Net interest income.

If the derivative expires or is sold, terminated or exercised, it no longer meets the criteria for fair value hedge accounting, or the designation is revoked, hedge accounting is discontinued. Any adjustment up to that point, to a hedged item for which the effective interest method is used, is amortised to profit or loss as part of the recalculated effective interest rate of the item over its remaining life.

b) *Other non-trading derivatives*
When a derivative is not held for trading, and is not designated in a qualifying hedge relationship, all changes in its fair value are recognised immediately in profit or loss as a component of Net financial income and Net interest income.

c) *Hedges of net investments in foreign operations*

Hedges of net investments in foreign operations seek to eliminate the exposure to foreign currency risks of the net investments.

Exchange differences arising from the translation of the net investment in foreign operations and of related hedges are taken to Translation reserve in equity. The portion of the gain or loss on an instrument used to hedge a net investment in a foreign operation that is determined to be an effective hedge is recognised directly in equity. The ineffective portion is recognised immediately in Net financial income. They are recycled and recognised in Net financial income upon disposal of the operation. In respect of all foreign operations, any differences that have arisen before 1 January 2004, the date of transition to IFRS, are presented as retained earnings in the equity statement.

11. Cash and cash equivalents

Cash and cash equivalents in the Consolidated Statement of Cash Flows consist of cash, demand deposits with the central banks and demand deposits with other credit institutions.

12. Loans

Loans 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. Loans include loans provided by the Bank to credit institutions and to its customers, participation in loans from other lenders and purchased loans.

When the Bank is the lessor in a lease agreement that transfers substantially all of the risks and rewards incidental to ownership of an asset to the lessee, the arrangement is presented within loans.

When the Bank purchases a financial asset and simultaneously enters into an agreement to resell the asset (or a substantially similar asset) at a fixed price on a future date reverse repo or stock borrowing, the arrangement is accounted for as a loan, and the underlying asset is not recognised in the Bank's Financial Statements.

Loans are initially measured at fair value plus incremental direct transaction costs, and subsequently measured at their amortised cost using the effective interest method, except when the Bank chooses to carry the loans at fair value through profit or loss as described in accounting policy 13 b). Accrued interest is included in the carrying amount of the loans.

13. Financial assets measured at fair value through profit and loss.

a) *Trading assets*
Trading assets are financial instruments acquired principally for the purpose of generating profits from short-term price fluctuations or from a dealer's margin.

b) *Financial assets designated at fair value through profit or loss*
The Bank classifies certain financial assets upon their initial recognition as financial assets held at fair value with fair value changes recognised in the Income Statement as Net financial income if doing so results in more relevant information because:

i) the assets are managed, evaluated and reported internally on a fair value basis;
ii) the designation eliminates or significantly reduces an accounting mismatch which would otherwise arise; or
iii) the assets contain an embedded derivative that significantly modifies the cash flows that would otherwise be required under the contract.

The assets classified according to the above-mentioned conditions consist of:
i) fixed interest rate loans originated by the Bank whose fixed interest has been changed into floating by entering into corresponding interest rate swaps;
ii) equity and debt instruments which are acquired by the Bank with a view to profiting from their total return and which are managed and evaluated on a fair value basis, including equity instruments held by the venture capital organisation of the Bank which give the Bank significant influence over the issuer but not control;
iii) structured products that contain embedded derivatives; and
iv) mortgage loans originated by the Bank's subsidiary in Denmark. These are financial assets that are granted by the Bank by providing money directly to a debtor. They are initially recorded at fair value, which is the cash given to originate the loan and are subsequently measured at fair value. The fair value of mortgage loans is based on the fair value of the underlying mortgage bonds.

Interest and dividend income that arises from these assets are included in Interest income and Net financial income, respectively. Interest income on debt instruments is recognised on an accrual basis.

14. Financial assets available-for-sale

Financial assets available-for-sale consists of unlisted equity instruments held for long time investment purposes.

Financial assets available-for-sale are recognised at fair value. Unrealised gains or losses on available-for-sale investments are recognised in equity, net of income taxes, until such investments are disposed of or until they are determined to be impaired. On disposal of an available-for-sale investment, the accumulated unrealised gain or loss included in equity is transferred to the Income Statement and recognised in Net gain on financial assets and liabilities not at fair value through profit or loss. Gains and losses on disposal are determined using the average cost method.

Dividend income on available-for-sale financial assets is included in Dividend income in the Income Statement. Exchange rate differences arising on equity instruments are recognised in equity.

15. Determination of fair value

The determination of fair value of financial assets and financial liabilities that are quoted in an active market is based on quoted prices. 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 net present value techniques, the discounted cash flow method, comparison to similar instruments for which market observable prices exist, and valuation models. The Bank uses widely recognised valuation models for determining the fair value of common and more simpler financial instruments like options and interest rate and currency swaps. For these financial instruments, inputs into models are market observable.

For more complex instruments, the Bank uses proprietary models, which usually are developed from recognised valuation models. Some or all of the inputs into these models may not be market observable, and are derived from market prices or rates or are estimated based on assumptions. When entering into a transaction, the financial instrument is recognised initially at the transaction price, which is the best indicator of fair value, although the value obtained from the valuation model may differ from the transaction price. This initial difference, usually an increase, in fair value indicated by valuation techniques is recognised in income depending upon the individual facts and circumstances of each transaction and not later than when the market data becomes observable.

The value produced by a model or other valuation technique is adjusted to allow for a number of factors as appropriate, because valuation 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.

16. Recognition and derecognition of financial assets and financial liabilities

Purchases and sales of financial assets are recognised using trade date accounting, i.e. they are recognised on the date on which the Bank commits to purchase or sell the asset, except for loans which are recognised when cash is advanced to the borrowers.

Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the Bank has transferred substantially all risks and rewards of ownership.

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

17. Offsetting financial assets and financial liabilities

Financial assets and liabilities are set off and the net amount reported in the Balance Sheet when, and only when, the Bank has a legal right to offset the recognised amounts and intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

Income and expenses are presented on a net basis only when permitted by the accounting standards, or for gains or losses arising from a group of similar transactions such as in the Bank's trading activity.

18. Amortised cost measurement of financial assets and financial liabilities

The amortised cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between the initial amount recognised and the maturity amount, minus any reduction for impairment.

19. Repurchase agreements

A repurchase agreement involves the sale of securities subject to the simultaneous agreement to repurchase the same securities at a certain later date and at an agreed price. In repurchase agreements, the cash received, including accrued interest is recognised in the Balance Sheet. The proceeds from the legal sale of these securities are reported as borrowings.

The control of the securities remains with the Bank throughout the entire term of the transaction and the securities continue to be reported in the Bank's Balance Sheet as *Bonds and debt instruments*, as appropriate. Interest incurred is recognized as interest expense over the life of each agreement.

20. 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 an operating lease if the lessor does not transfer substantially all the risks and rewards incidental to ownership.

Finance leases - lessor
When the Bank is the lessor in a lease agreement that transfers substantially all of the risks and rewards incidental to ownership of an asset to the lessee, the arrangement is presented within loans.

Operating leases - lessee
Property and equipment which the Bank leases to third parties under operating leases are classified in the Balance Sheet as Investment property or Property and equipment on a property-by-property basis. 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.

21. Intangible assets

a) *Goodwill*
Goodwill arises on the acquisition of subsidiaries.

Acquisitions prior to 1 January 2004
In respect of acquisitions prior to 1 January 2004, goodwill is included on the basis of its deemed cost, which represents the amount recognised under previous GAAP.

Acquisitions on or after 1 January 2004
All business combinations after 1 January 2004 are accounted for by applying the purchase method. Goodwill has been recognised on the acquisition of subsidiaries and associates. In respect of business acquisitions that have occurred since 1 January 2004, goodwill represents the difference between the cost of the acquisition and the net fair value of the net identifiable assets, liabilities and contingent liabilities of the acquiree.

21. cont.

Acquisitions of minority interests
Goodwill arising on the acquisition of a minority interest in a subsidiary represents the excess of the cost of the additional investment over the carrying amount of the net assets acquired at the date of exchange.

Subsequent measurement
Goodwill is measured at cost less any accumulated impairment losses.

b) *Other intangible assets*
Intangible assets other than goodwill that are acquired by the Bank are stated at cost less accumulated amortisation and impairment losses. Software and customer base are examples of other intangible assets.

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 recognised in the Income Statement on a straight-line basis over the estimated useful lives of intangible assets. Goodwill is systematically tested for impairment at each reporting date. Other intangible assets are amortised from the date they are available for use. The estimated useful lives are as follows:

Software	5 years
Customer base	10 years

22. Investment property

An investment property is a property which is held either to earn rental income or for capital appreciation or for both. Investment property is stated at fair value. The Bank uses independent professionally quailified valuers who determine the fair value of investment property by applying recognised valuation techniques. In cases where prices of recent market transactions of comparable properties are available, fair value is determined by reference to these transactions. The fair values are based on market values, being the estimated amount for which a property could be exchanged on the date of valuation between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion.

23. Property and equipment

a) *Recognition and measurement*
Items of property and equipment are measured at cost less accumulated depreciation and impairment losses.

When parts of an item of property and equipment have different useful lives, they are accounted for as separate items of property and equipment.

b) *Subsequent costs*
The cost of replacing part of an item of property and equipment is recognised in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Bank and its cost can be measured reliably. All other costs are recognised in the Income Statement as an expense as incurred.

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

Real estate	25-50 years
Machinery and equipment	3-5 years
Operating lease	3-10 years

The depreciation methods, useful lives and residual values are reassessed annually.

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

Immediately before classification as held for sale, the measurement of the qualifying assets and all assets and liabilities in a disposal group is brought up-to-date in accordance with applicable IFRS. Then, 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. Investment property held for sale is carried at fair value. 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 and disposal entities. Disposal entities are consolidated.

25. Deposits

Deposits are initially measured at fair value plus transaction costs, and subsequently measured at their amortised cost using the effective interest method, except where the Bank chooses to carry the liabilities at fair value through profit or loss.

26. Borrowings

Some of the borrowings of the Bank are classified as other financial liabilities and are initially recognised at fair value less attributable transaction costs. Subsequent to initial recognition, borrowings are measured at amortised cost with any difference between cost and redemption amount being recognised in the Income Statement over the period of the borrowings on an effective interest basis. Accrued interest is included in the carrying amount of the borrowings.

27. Subordinated loans

Subordinated loans are classified as other financial liabilities and consist of liabilities in the form of subordinated 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 met. In the calculation of the capital ratio, the bonds are included within Tier I and Tier II, as shown in note 83. On the one hand, there are subordinated loans with no maturity date that the Bank may not retire until 2011 and 2014 and then only with the permission of the Financial Supervisory Authority. These liabilities 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 over the next 25 years.

Subordinated loans are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, subordinated loans are stated at amortised cost with any difference between cost and redemption value being recognised in the Income Statement over the period of the borrowings on an effective interest basis.

28. Financial liabilities measured at fair value

a) *Trading liabilities*

Trading liabilities primarily consist of derivatives with negative fair values and delivery obligations for short sales of securities. Hedging derivatives such as those used for internal risk control but not qualifying for hedge accounting under IAS 39 are also disclosed under this item.

Trading liabilities are measured at fair value. Gains and losses realised on disposal or redemption and unrealised gains and losses from changes in the fair value of trading liabilities are reported as Net gain on financial assets and liabilities measured at fair value. Interest expenses on trading liabilities are included in Interest expenses.

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 with fair value changes recognised in profit or loss if doing so results in more relevant information because:

i) 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 base or

ii) 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.

If the Bank becomes a party to instruments containing embedded derivatives which meet specific conditions, the Bank classifies the instruments into this category in order to avoid the complexity of applying the rules on separation and accounting for the embedded derivatives.

The liabilities classified according to the above-mentioned conditions consist of:

- Mortgage bonds issued by the Bank are financial liabilities that are created by the Bank by issuing bonds that correspond to the terms of the underlying mortgage loans.

- Transaction costs related to financial liabilities designated at fair value through profit and loss are included in the Income Statement as interest expense.

- Mortgage funding is recognised when cash is advanced to the Bank from issuing bonds. They are initially recorded at fair value, which is the cash received and are subsequently measured at fair value. Fair value of issued mortgage bonds is the current market price. Illiquid mortgage bonds will be carried at a value calculated by discounting cash flows.

- Financial liabilities designated at fair value through profit or loss are measured at fair value and changes in their fair value are recognised in the Income Statement as Net financial income. Interest expenses that arises from these liabilities is recognised on an accrual basis in Interest expense.

29. Provisions

A provision is recognised if, as a result of a past event, the Bank has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. 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.

A provision for restructuring is recognised when the Bank has approved a detailed and formal restructuring plan, and the restructuring either has commenced or has been announced publicly. Future operating costs are not provided for.

A provision for onerous contracts is recognised when the expected benefits to be derived by the Bank from a contract are lower than the unavoidable cost of meeting its obligations under the contract. The provision is measured at the present value of the lower of the expected cost of terminating the contract and the expected net cost of continuing with the contract. Before a provision is established, the Bank recognises any impairment loss on the assets associated with that contract.

30. Other assets and other liabilities

Other assets and other liabilities are stated at cost.

31. Financial guarantees

Financial guarantees 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 payment when due in accordance with the terms of a debt instrument.

Financial guarantee liabilities are initially recognised at their fair value, which is amortised over the life of the financial guarantee. The guarantee liability is subsequently carried at the higher of this amortised amount and the present value of any expected payment (when a payment under the guarantee has become probable). Financial guarantees are included within *Other liabilities*.

32. Employee benefits

a) *Defined contribution plans*

Obligations for contributions to defined contribution pension plans are recognised as an expense in the Income Statement when they are due.

b) *Share-based payment transactions*

The grant date fair value of options granted to employees is recognised as an employee expense, with a corresponding increase in equity, over the period in which the employees become unconditionally entitled to the options. The amount recognised as an expense is adjusted to reflect the actual number of share options that vest.

The fair value of share appreciation rights is measured using the Black-Scholes formula. Measurement inputs include share price on measurement date, exercise price of the instrument, expected volatility (based on weighted average historic volatility adjusted for changes expected due to publicly available information), weighted average expected life of the instruments (based on historical experience and general option holder behaviour), expected dividends, and the risk-free interest rate (based on government bonds). Service and non-market performance conditions attached to the transactions are not taken into account in determining fair value.

33. Share Capital

a) *Treasury shares*

Acquired own shares and other 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. Consideration paid or received is recognised directly in equity.

Incremental transaction costs of treasury share transaction are accounted for as a deduction from equity (net of any related income tax benefit).

When classifying a financial instrument (or component of it) in the Consolidated Financial Statements, all terms and conditions agreed between members of the Bank and the holders of the instrument are considered. To the extent there is an obligation that would give rise to a financial liability, the instrument is classified as financial liability, rather than an equity instrument.

b) *Dividend on shares*

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

34. Earnings per share

The Bank presents basic and diluted earnings per share data for its ordinary shares.

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

Diluted earnings per share are calculated by adjusting the weighted average number of ordinary shares outstanding to assume conversion of all dilutive potential ordinary shares. The Bank calculates dilutive potential ordinary shares by determining the number of shares that could have been acquired at fair value (determined as the average annual market share price of the Company´s shares) based on the monetary value of the subscription rights attached to outstanding share options. The number of shares calculated as above is compared with the number of shares that would have been issued assuming the exercise of the share options.

35. 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 full comparative information.

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.

36. 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:

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 41-43). The Bank has not yet determined the potential effect of IFRS 8 on the consolidated financial statements.

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.

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.

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.

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.

36. cont.

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.

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.

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.

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.

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.

37. Segment reporting

Business segment is a distinguishable component of the Bank that is engaged either in providing products or services (business segment) which is subject to risks and rewards that are different from those of other segments. The Bank´s primary format for segment reporting is based on business segments.

38. Critical accounting estimates and judgements in applying accounting policies

The Bank makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

These disclosures supplement the risk management disclosure, provided elsewhere in these consolidated financial statements.

a) *Key sources of estimation uncertainty*

i) Impairment losses on loans
The Bank reviews its loan portfolios to assess impairment at least on a quarterly basis. In determining whether an impairment loss should be recorded in the Income Statement, the Bank makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there 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. Management uses estimates based on historical loss experience for assets with 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.

ii) Fair value of financial instruments
The fair value of financial instruments that are not quoted in active markets are determined by using valuation techniques. Where valuation techniques (for example, models) are used to determine fair values, they are validated and periodically reviewed by qualified personnel independent of the area that created them. All models are certified before they are used, and 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. Changes in assumptions about these factors could affect reported fair value of financial instruments.

iii) The Bank is subject to income taxes in numerous jurisdictions. 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. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will affect the income tax and deferred tax provisions in the period in which such determination is made.

38. cont.

b) *Critical accounting judgements in applying the Bank's accounting policies*

i) Qualifying hedge relationships

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

ii) Securitisations

In applying its policies on securitised financial assets, the Bank has considered both the degree of transfer of risk and rewards on assets transferred to another entity and the degree of control exercised by the Bank over the other entity:

- When the Bank, in substance, controls the entity to which financial assets have been transferred, the entity is included in these consolidated financial statements and the transferred assets are recognised in the Bank's Balance Sheet.
- When the Bank has transferred financial assets to another entity, but has not transferred substantially all of the risk and rewards relating to the transferred assets, the assets are recognised in the Bank's Balance Sheet.
- When the Bank has transferred substantially all the risk and rewards relating to the transferred assets to an entity that it does not control, the assets have been derecognised from the Bank's Balance Sheet.

Details of the Bank's securitisation activities are given in note 71.

39. Changes within the Bank

On 4 April the Bank sold all shares in the wholly owned subsidiary Eik fasteignafélag hf. The total sale price was ISK 6.109 million and the Bank generated a profit before taxes of ISK 4,262 million on this transaction, which was booked in the second quarter of 2007. Total assets of Eik fasteignafélag hf. at the end of March 2007 amounted to ISK 37.645 million, of which investment properties totalled ISK 6.807 million.

In December the Bank sold its operation in the Faroe Islands to Eik Banki P/F.

Segment Reporting

40. Segment information is presented in respect of the Bank's business and geographical segments. The primary format, business segments, is based on the Bank´s management and internal reporting structure.

Inter-segment pricing is determined on an arm's length basis. Business segments pay and receive interest to and from Treasury on an arm's length basis to reflect the allocation of capital and funding cost.

Segment capital expenditure is the total cost incurred during the year to acquire property and equipment and intangible assets other than goodwill.

Business segments

The Bank comprises the following main business segments:

Capital Markets is divided into two parts: Capital Markets and Proprietary Trading. Capital Markets handles securities, derivatives and foreign exchange trading and brokerage for the Bank's clients. Proprietary Trading handles transactions for the Bank's own account in all major markets, as well as undertaking the Bank's market making for stocks and bonds.

Investment Banking provides various services to corporate clients through its four main products areas: M&A advisory, Capital Markets Advisory , Acquisition and Leverage Finance and Principle Investment.

Treasury is responsible for inter-bank trading and the Bank’s funding.

Banking provides general banking services to retail customers in Iceland and services such as advice and assistance in financing to medium-sized and large companies, particularly in Iceland, Sweden, the United Kingdom (UK) and Denmark.

Asset Management and Private Banking manage financial assets for institutional, corporate and private clients. Asset Management is organised into three units: Alternative and Mutual Fund Management, Asset Management for Institutional Investors and Services for Institutional Investors. Private Banking consists of two units: Customer Relations and Portfolio Management.

Cost Centres are: Overhead, Back Office, Risk Management, Finance, Legal Department, Information Technology, Human Resources, Sales and Marketing.

Geographical segments

The Bank operates in four main geographical regions, being: Iceland, Scandinavia, the United Kingdom and Luxembourg.

41. Summary of the Bank's business segments:

2007	Capital Markets	Investment Banking	Treasury	Banking	Asset Managem. and Private Banking	Elimination and Cost Centres	Total
Net interest income	2,436	(3,027)	22,759	60,664	1,183	(3,902)	80,113
Net fee and commission income	20,957	13,715	(707)	6,668	13,801	587	55,021
Net financial income	9,069	14,724	(17,793)	393	310	7,730	14,433
Other income	225	223	91	6,539	164	9,009	16,251
Operating income	32,687	25,635	4,350	74,264	15,458	13,424	165,818
Operating expense	(11,562)	(5,573)	(3,988)	(19,149)	(7,947)	(30,512)	(78,731)
Impairment	1	(24)	33	(6,162)	-	(28)	(6,180)
Total expense	(11,561)	(5,597)	(3,955)	(25,311)	(7,947)	(30,540)	(84,911)
Earnings before cost allocation	21,126	20,038	395	48,953	7,511	(17,116)	80,907
Allocated cost	(4,072)	(565)	(2,244)	(8,828)	(4,011)	19,720	-
Earnings before income tax	17,054	19,472	(1,848)	40,125	3,501	2,604	80,907
Net segment revenue from external customers	48,519	27,293	(117,868)	200,807	7,950	(883)	165,818
Net segment revenue from other segments	(15,832)	(1,658)	122,218	(126,543)	7,508	14,308	0
Operating income	32,687	25,635	4,350	74,264	15,458	13,425	165,818
Depreciation and amortisation	86	27	19	4,052	79	2,287	6,550
Total assets	289,634	177,278	2,580,162	3,209,018	49,197	(957,944)	5,347,345
Total liabilities	253,004	135,857	2,517,943	3,006,550	38,451	(960,891)	4,990,914
Allocated equity	36,630	41,421	62,219	202,468	10,746	2,947	356,431
Total liabilities and equity	289,634	177,278	2,580,162	3,209,018	49,197	(957,944)	5,347,345
Capital expenditure	192	23	140	3,163	95	11,493	15,106

2006	Capital Markets	Investment Banking	Treasury	Banking	Asset Managem. and Private Banking	Elimination and Cost Centres	Total
Net interest income	(408)	(3,348)	10,386	45,903	817	(988)	52,362
Net fee and commission income	9,881	9,577	443	5,744	11,230	409	37,284
Net financial income	7,913	42,984	8,411	750	531	(432)	60,157
Other income	0	43	25	6,631	962	9,752	17,413
Operating income	17,386	49,256	19,266	59,028	13,540	8,741	167,216
Operating expense	(6,394)	(3,636)	(2,889)	(14,969)	(7,380)	(24,738)	(60,006)
Impairment	(123)	1	(5)	(4,851)	(1,138)	(11)	(6,127)
Total expense	(6,517)	(3,635)	(2,894)	(19,820)	(8,518)	(24,749)	(66,133)
Earnings before cost allocation	10,869	45,621	16,372	39,208	5,022	(16,008)	101,083
Allocated cost	(3,247)	(888)	(1,973)	(8,744)	(3,427)	18,279	-
Earnings before income tax	7,622	44,733	14,399	30,464	1,595	2,271	101,083
Net segment revenue from external customers	24,288	53,425	(55,756)	135,108	9,516	637	167,216
Net segment revenue from other segments	(6,902)	(4,169)	75,022	(76,080)	4,025	8,104	-
Operating income	17,386	49,256	19,266	59,028	13,541	8,741	167,216
Depreciation and amortisation	10	7	19	3,529	34	2,376	5,976
Total assets	328,176	108,946	1,536,197	2,597,032	12,386	(527,341)	4,055,396
Total liabilities	297,380	47,998	1,487,116	2,421,953	4,171	(538,114)	3,720,504
Allocated equity	30,796	60,948	49,081	175,079	8,215	10,773	334,892
Total liabilities and equity	328,176	108,946	1,536,197	2,597,032	12,386	(527,341)	4,055,396
Capital expenditure	259	38	285	6,957	705	7,383	15,627

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Geographical analysis

42. Operating income specified by location of its markets and customers.

The geographical analysis of operating income is provided in order to comply with IFRS and does not reflect the way the Bank is managed.

2007	Iceland	Scandi-navia	UK	Luxem-bourg	Other	Total
Net interest income	26,747	21,092	23,759	6,706	1,809	80,113
Net fee and commission income	22,241	9,319	16,270	6,115	1,076	55,021
Net financial income	446	6,272	7,411	369	(65)	14,433
Other income	5,315	6,117	4,517	284	18	16,251
Operating income	54,749	42,800	51,957	13,474	2,837	165,818

2006						
Net interest income	16,592	17,311	12,099	4,882	1,478	52,362
Net fee and commission income	14,724	5,935	10,543	4,355	1,727	37,284
Net financial income	34,995	17,181	5,975	1,842	164	60,157
Other income	12,233	993	4,168	-	19	17,413
Operating income	78,544	41,420	32,785	11,079	3,388	167,216

Financial gains relating to the sale of Exista hf. in 2006, amounting to ISK 26,084 million, is included in Net financial income in Iceland. Financial gains relating to the sale of VÍS hf. in 2006, amounting to ISK 7,421 million, is included in Other income in Iceland.

43. Assets specified by location of its markets and customers.

2007	Iceland	Scandi-navia	UK	Luxem-bourg	Other	Total
Cash and balances with central banks	1,034	14,632	79,719	2,156	418	97,959
Loans to credit institutions	198,079	118,112	82,715	71,881	117,655	588,441
Loans to customers	884,885	1,160,486	662,132	382,342	214,563	3,304,408
Financial assets measured at fair value	506,135	262,092	10,662	63,886	2,680	845,455
Other assets	118,164	286,088	81,791	22,080	2,959	511,082
Total assets	1,708,297	1,841,410	917,019	542,345	338,274	5,347,345

2006						
Cash and balances with central banks	964	40,616	65,007	42	332	106,961
Loans to credit institutions	88,421	126,909	139,308	50,414	80,282	485,334
Loans to customers	573,238	1,085,119	506,626	271,469	102,157	2,538,609
Financial assets measured at fair value	332,744	261,918	30,621	36,426	3,420	665,129
Other assets	76,149	111,686	66,316	4,899	313	259,363
Total assets	1,071,516	1,626,248	807,878	363,250	186,504	4,055,396

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Notes to the Consolidated Income Statement

Net interest income

44. Interest income and expense is specified as follows:

2007	Interest income	Interest expense	Net interest income
Cash and balances with central banks	4,743	-	4,743
Loans, receivables and deposits	242,097	(90,375)	151,722
Borrowings	-	(114,642)	(114,642)
Subordinated loans	-	(15,130)	(15,130)
Securities	46,661	(2,153)	44,508
Finance leases	6,197	-	6,197
Other	4,633	(1,918)	2,715
Interest income and expense	304,331	(224,218)	80,113
Interest income and expenses from assets and liabilities at fair value	46,588	(2,153)	44,435
Interest income and expenses from assets and liabilities not at fair value through profit or loss	257,743	(222,065)	35,678
Interest income and expense	304,331	(224,218)	80,113
2006			
Cash and balances with central banks	911	-	911
Loans, receivables and deposits	150,405	(43,470)	106,935
Borrowings	-	(77,613)	(77,613)
Subordinated loans	-	(10,665)	(10,665)
Securities	28,191	(2,372)	25,819
Finance leases	5,359	-	5,359
Other	2,585	(969)	1,616
Interest income and expense	187,451	(135,089)	52,362
Interest income and expenses from assets and liabilities at fair value	28,164	(2,371)	25,793
Interest income and expenses from assets and liabilities not at fair value through profit or loss	159,287	(132,718)	26,569
Interest income and expense	187,451	(135,089)	52,362

Net fee and commission income

45. Fee and commission income and expense is specified as follows:

Fee and commission income	2007	2006
Securities trading	16,862	11,413
Derivatives	4,783	3,582
Lending	8,347	2,901
Asset management fees	7,492	6,548
Other fee and commission income	27,381	16,460
Fee and commission income	64,865	40,904
Fee and commission expense		
Purchased guarantees	(477)	(139)
Securities trading	(2,652)	(2,052)
Other fee and commission expense	(6,715)	(1,429)
Fee and commission expense	(9,844)	(3,620)
Net fee and commission income	55,021	37,284

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45. cont.

Included above is fee and commission income of ISK 60,082 million (2006: ISK 37,321 million) and fee and commission expense of ISK 5,552 million (2006: ISK 2,623 million), (other than fees included in determining the effective interest rate), relating to financial assets and liabilities not carried at fair value.

Asset management fees is earned by the Bank on trust and fiduciary activities where the Bank holds or invests assets on behalf of the customers.

Net financial income

46. Net financial income is specified as follows:

	2007	2006
Dividend income	5,658	5,074
Net (loss) gain on financial assets and liabilities at fair value	(1,426)	52,023
Net foreign exchange gain	10,151	2,918
Net gain on financial assets and liabilities not at fair value through profit or loss	50	142
Net financial income	14,433	60,157

Dividend income

47. Dividend income is specified as follows:

Dividend income on trading assets	5,341	3,757
Dividend income on assets at fair value through profit or loss	317	1,317
Dividend income	5,658	5,074

Net (loss) gain on financial assets and liabilities at fair value through profit or loss

48. Net (loss) gain on financial assets and liabilities at fair value through profit or loss are specified as follows:

Net (loss) gain on trading portfolio	(18,380)	12,997
Net gain on assets designated at fair value through profit or loss	16,512	38,668
Fair value adjustments on hedge accounting	442	358
Net (loss) gain on financial assets and liabilities at fair value	(1,426)	52,023

49. Net (loss) gain on trading portfolio are specified as follows:

Net (loss) gain on equity instruments and related derivatives	(3,435)	11,226
Net (loss) gain on foreign exchange trading	(363)	463
Net loss on interest rate instruments and related derivatives	(305)	(3,643)
Net (loss) gain on other derivatives	(14,277)	4,951
Net (loss) gain on trading portfolio	(18,380)	12,997

50. Net gain on assets designated at fair value through profit or loss are specified as follows:

Net loss on interest rate instruments designated at fair value	(6,814)	(2,623)
Net gain on equity instruments designated at fair value	23,326	41,291
Net gain on assets designated at fair value through profit and loss	16,512	38,668

Net gain on financial assets and liabilities not at fair value through profit or loss

51. Net gain on financial assets and liabilities not at fair value through profit or loss are specified as follows:

Net realised gain on loans and finance leases	-	103
Net realised gain on available-for-sale assets	50	32
Other net realised gain	-	7
Net gain on financial assets and liabilities not at fair value	50	142

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Other operating income

52. Other operating income is specified as follows:

	2007	2006
Gain on disposals of assets other than held for sale	6,012	8,784
Income from operating leases	4,748	4,128
Fair value adjustments on investment property	(196)	513
Realised gain on investment property	-	216
Other income	2,228	2,578
Other operating income	12,792	16,219

Personnel

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

	2007	2006
Average number of full time equivalent positions during the year	3,109	2,553
Full time equivalent positions at the end of the year	3,334	2,719

54. Salaries and related expenses are specified as follows:

	2007	2006
Salaries	21,902	16,388
Bonus payments	16,327	11,606
Salary related expenses	8,418	5,576
Salaries and related expense	46,647	33,570

A subsidiary of the Bank, Kaupthing Singer & Friedlander, has a defined benefit pension scheme. All accrued cost in respect of the plan has been entered into the Financial Statements. Based on actuarial calculation the total liability is ISK 1,242 million at year end 2007.

55. Salaries to the executives of the Bank, their stock options and shares owned at year-end are specified as follows:

	Salaries	Benefits	Bonuses	Pension fund payment	Stock options shares	Shares at year-end
CEO:						
Hreidar Már Sigurdsson	70.5	4.4	35.0	28.3	3.2	7.2
Directors:						
Sigurdur Einarsson, Chairman	70.5	37.3	35.0	26.7	3.2	8.2
Antonios P. Yerolemou	3.6					9.5
Ásgeir Thoroddsen	6.2					-
Bjarnfredur Ólafsson	7.5					-
Brynja Halldórsdóttir	6.2					-
Gunnar Páll Pálsson	6.2					-
Hjörleifur Thor Jakobsson	6.2					-
Niels de Coninck-Smith	5.9					-
Tommy Persson	6.2					-
Managing director of a division and CEO of subsidiaries which accounts for 25% or more of the Bank's equity and performance:						
Ingólfur Helgason CEO in Iceland	30.0	10.1	40.0		0.4	3.7
Lars Johansen CEO in Denmark	52.9	1.6	35.8		-	-
Bjarki Diego CCO	16.6	1.8	36.0		0.4	1.7
Five Group Managing Directors	140.0	9.6	127.4	7.1	1.5	5.3

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55. cont.

The remuneration of the Chairman of the Board and the other directors of the Board is decided by the Annual General Meeting of shareholders. In addition Board members receive remuneration for work in committees of the Board, such as audit, compensation and credit committees.

Remuneration to the Chairman of the Board, CEO and other members of "senior management" consist of base salary, variable salary/bonus, other benefits, extra pension contributions and stock-based compensation. The other members of senior management comprise the five persons who together with the CEO make up senior management. For the Chairman of the Board and CEO, the bonus is maximized at 100% of base salary. For the other members of senior management bonus is generally maximized at 100% of the base salary. Bonus to the Chairman of the Board, CEO and other senior management is based on the banks 15% minimum return on equity. Pension contributions and remuneration in the form of stock-based compensation and other benefits to the CEO and other members of senior management are part of the total remuneration package.

Remuneration to the CEO and the Chairman of the Board for the financial year 2007 was decided by the Board based on the recommendation from the compensation committee. Remuneration to other members of Group management was decided by the CEO.

Pension fund payments are extra pension contributions to the senior management and the Chairman of the Board. The Bank pays as well pension contributions to Board members and senior management based on Icelandic law. There are no pension liabilities related to board members or senior management.

Bjarnfredur Ólafsson, a board member of the Bank, is a partner in the law firm Logos. The firm has provided the Bank legal services. Total fee paid to the firm was ISK 17 million for the year 2007 (2006 ISK: 32 million).

The CEO and the Chairman of the Board exercised in 2007 stock options that were granted 2003. The difference in exercise price and market price were ISK 599 million for each of them.

Should the Chairman of the Board resign he shall receive salary payments for 12 months onwards, but otherwise his salary payments shall continue for 48 months from the date of the termination of employment. The CEO's term of notice is 12 months, but should his employment terminate due to other reasons his salary payments shall continue for 48 months.

Additional information on stock options can be found in note 116.

Auditor's fee

56. Auditor's fee is specified as follows:

	2007	2006
Audit of the Financial Statements and other related audit service	389	295
Review of Interim Financial Statements	32	36
Other service	74	121
Auditor's fee	495	452
Fee to others than the Parent Company's auditors, included in the above total	398	366

Impairment

57. Impairment is specified as follows:

Impairment on loans	6,098	4,857
Impairment on goodwill	75	451
Impairment on intangible assets	7	819
Impairment on other assets	82	1,270
Impairment on assets	6,180	6,127

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Income tax expense

58. Income tax recognised in the Income Statement are specified as follows:

Current tax expense	2007	2006
Current year	7,872	10,154
Deferred tax expense		
Changes in temporary differences	1,844	4,482
Total income tax expense	9,716	14,636

Reconciliation of effective tax rate:	2007		2006	
Earnings before income tax		80,907		101,083
Income tax using the domestic corporation tax rate	18.0%	14,447	18.0%	18,195
Effect of tax rates in foreign jurisdictions	3.5%	2,775	(0.3%)	(290)
Non-deductible expense	(1.6%)	(1,297)	1.4%	1,394
Tax exempt revenues	(5.1%)	(4,091)	(2.8%)	(2,786)
Tax incentives not recognised in the Income Statement	0.0%	0	0.2%	171
Other changes	(2.6%)	(2,118)	(2.0%)	(2,048)
Effective tax rate	12.0%	9,716	14.5%	14,636

Earnings per share

59. Earnings per share are specified as follows:

	2007	2006
Net earnings attributable to the shareholders of Kaupthing Bank hf.	70,020	85,302
Weighted average share capital:		
Weighted average of outstanding shares for the year	735.7	671.0
Effects of stock options	14.9	20.3
Weighted average of total shares for the year, diluted	750.6	691.3
Basic earnings per share	95.2	127.1
Diluted earnings per share	93.3	123.4
Number of outstanding shares at the end of the year, million	736.5	732.1
Number of total shares at the end of the year, million, diluted	751.5	752.4
Average number of own shares, million	8.8	8.4
Number of own shares at the end of the year, million	3.9	8.4

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Notes to the Consolidated Balance Sheet

Cash and balances with central banks

60. Cash and balances with central banks are specified as follows:

	2007	2006
Cash and cash balances	50,269	10,537
Cash equivalent	47,690	96,424
Cash and balances with central banks	97,959	106,961

Loans to credit institutions

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

Money market loans	228,348	242,284
Bank accounts	197,240	95,828
Overdrafts	3,855	7,902
Reverse repos	18,869	50,753
Other loans	140,129	88,567
Loans to credit institutions	588,441	485,334

Loans to customers

62. Loans to customers specified by types of loans:

Overdrafts	85,624	113,354
Finance leases	73,597	93,006
Reverse repos and related agreements	41,971	-
Subordinated loans	38,328	7,369
Other loans	3,084,291	2,341,462
Provision on loans	(19,403)	(16,582)
Loans to customers	3,304,408	2,538,609

63. Loans to customers specified by sectors:

Individuals	17.1%	16.6%
Holding companies	14.7%	13.5%
Industry	17.1%	20.3%
Real estate	20.7%	15.6%
Service	18.3%	19.9%
Trade	10.1%	12.5%
Transportation	2.0%	1.6%
Loans to customers	100.0%	100.0%

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64. Changes in the provision for losses are specified as follows:

2007	Overdrafts	Finance leases	Subodinated loans	Other loans	Total
Balance at 1 January	899	619	516	14,548	16,582
Provision for losses during the year	94	226	42	5,949	6,311
Exchange rate difference on translation	0	(51)	(13)	(640)	(704)
Write-offs during the year	(269)	(245)	-	(2,071)	(2,585)
Payment of loans previously written off	-	(3)	-	(210)	(213)
Disposals due to sale of subsidiary	-	-	-	13	13
Balance at 31 December	724	545	545	17,589	19,403
Collective	273	105	8	5,618	6,004
Specific	451	440	537	11,971	13,399
	724	545	545	17,589	19,403
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	558	2,005	585	25,758	28,906

2006	Overdrafts	Finance leases	Subodinated loans	Other loans	Total
Balance at 1 January	1,008	310	413	11,222	12,953
Provision for losses during the year	168	397	(5)	4,395	4,955
Exchange rate difference on translation	-	174	109	1,875	2,158
Actual losses during the year	(277)	(262)	-	(2,847)	(3,386)
Payment of loans previously written off	-	-	-	(98)	(98)
Balance at 31 December	899	619	516	14,548	16,582
Collective	82	97	0	2,999	3,178
Specific	817	522	516	11,549	13,404
	899	619	516	14,548	16,582
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	853	2,204	604	20,196	23,856

Included within interest income is ISK 780 million (2006: ISK 568 million) with respect of interest income accrued on impaired financial assets and ISK 203 million (2006: ISK 148 million) with respect to the unwind of the impairment provision discount.

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65. Impaired loans by geographical analysis:

	2007		2006	
	Impaired amount	Impaired loans	Impaired amount	Impaired loans
Iceland	3,323	4,792	5,081	6,474
Scandinavia	3,287	8,921	3,477	5,127
UK	6,265	13,952	3,997	10,763
Luxembourg	28	482	17	49
Other	496	759	832	1,443
Impairment on loans	13,399	28,906	13,404	23,856

66. Impaired loans by sector:

Individuals	1,081	2,034	1,780	2,280
Holding companies	910	2,562	166	849
Industry	3,116	7,955	4,537	6,503
Real estate	3,224	9,333	1,982	5,559
Service	2,474	3,252	3,192	5,221
Trade	2,461	3,243	1,340	2,471
Transportation	133	527	407	973
Impairment on loans	13,399	28,906	13,404	23,856

67. Status of monitoring of loans to customers:

2007	Neither past due nor specifically impaired						
	Standard Monitoring	Special Monitoring	Substandard Loans	Total	Past due	Specifically impaired	Total
Overdrafts	83,523	429	27	83,979	1,087	558	85,624
Finance leases	68,799	-	-	68,799	2,793	2,005	73,597
Subordinated loans	37,743	-	-	37,743	-	585	38,328
Other loans	3,011,258	27,496	25,970	3,064,724	35,780	25,758	3,126,262
Total	3,201,323	27,925	25,997	3,255,245	39,660	28,906	3,323,811
Provision on loans							(19,403)
Loans to customers							3,304,408

2006	Neither past due nor specifically impaired						
	Standard Monitoring	Special Monitoring	Substandard Loans	Total	Past due	Specifically impaired	Total
Overdrafts	109,986	356	22	110,364	2,137	853	113,354
Finance leases	88,921	-	-	88,921	1,881	2,204	93,006
Subordinated loans	6,765	-	-	6,765	-	604	7,369
Other loans	2,259,595	18,924	16,439	2,294,958	26,308	20,196	2,341,462
Total	2,465,267	19,280	16,461	2,501,008	30,326	23,856	2,555,191
Provisions on loans							(16,582)
Loans to customers							2,538,609

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68. Analysis of loans that are past due but not impaired:

2007	Overdrafts	Finance leases	Other loans	Total loans to customers
Past due up to 29 days	255	1,271	17,140	18,666
Past due 30-59 days	440	227	7,043	7,710
Past due 60-89 days	166	402	3,451	4,019
Past due 90-179 days	140	501	4,181	4,822
Past due 180-365 days	65	277	3,012	3,353
Above 365 days	21	115	953	1,089
Non-impaired loans	1,087	2,793	35,780	39,660
2006				
Past due up to 29 days	137	821	14,139	15,097
Past due 30-59 days	989	155	7,268	8,412
Past due 60-89 days	815	351	1,010	2,176
Past due 90-179 days	109	402	1,706	2,217
Past due 180-365 days	61	102	1,963	2,126
Above 365 days	26	51	221	298
Non-impaired loans	2,137	1,882	26,307	30,326

Loans and securities 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.

Non-performing loans are classified as aggregated exposures for which the Bank has made specific provisions in part or in full. Non-performing loans amounted at the end of the year to ISK 32,503 million (2006: ISK 25,506 million), 0.98% of total loans to customers (2006: 1.00%).

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Financial assets and liabilities

69. Financial assets and liabilities are specified as follows:

2007

	Loans and receivables	Trading	Designated at fair value	Available for sale	Derivatives used for hedging	Financial liabilities at amort. cost	Total
Loans and receivables							
Cash and balances with central banks	97,959	-	-	-	-	-	97,959
Loans to credit institutions	588,441	-	-	-	-	-	588,441
Loans to customers	3,304,408	-	-	-	-	-	3,304,409
Loans and receivables	3,990,808	-	-	-	-	-	3,990,808
Bonds and debt instruments							
Listed	-	18,859	317,004	-	-	-	335,863
Unlisted	-	15,506	8,070	-	-	-	23,576
Mortgage loans	-	-	7,911	-	-	-	7,911
Bonds and debt instruments	-	34,365	332,985	-	-	-	367,350
Shares and instruments with variable income							
Listed	-	51,980	15,256	-	-	-	67,236
Unlisted	-	4,142	82,745	165	-	-	87,052
Bond funds with variable income	-	5,172	1,337	-	-	-	6,509
Shares and instruments with variable income	-	61,294	99,338	165	-	-	160,797
Derivatives							
OTC derivatives	-	110,052	-	-	-	-	110,053
Other trading derivatives	-	24,804	-	-	-	-	24,805
Derivatives	-	134,856	-	-	-	-	134,856
Derivatives used for hedging							
Fair value hedge	-	-	-	-	16,617	-	16,617
Portfolio hedge of interest rate risk	-	-	-	-	5,886	-	5,886
Derivatives used for hedging	-	-	-	-	22,503	-	22,503
Securities used for hedging							
Bonds and debt instruments	-	68,051	-	-	-	-	68,051
Shares and equity instruments	-	91,898	-	-	-	-	91,898
Securities used for hedging	-	159,949	-	-	-	-	159,949
Other financial assets	263,993	-	-	-	-	-	263,993
Financial assets	4,254,801	390,464	432,323	165	22,503	-	5,100,256
Liabilities at amortised cost							
Due to credit institutions and central banks	-	-	-	-	-	339,088	339,088
Deposits	-	-	-	-	-	1,381,457	1,381,457
Borrowings	-	-	-	-	-	2,615,960	2,615,960
Subordinated loans	-	-	-	-	-	267,289	267,289
Liabilities at amortised cost	-	-	-	-	-	4,603,794	4,603,794
Financial liabilities measured at fair value							
Short position in equity held for trading	-	2,305	-	-	-	-	2,305
Derivatives held for trading	-	100,273	-	-	-	-	100,273
Repos and related agreements held for trading	-	96,865	-	-	-	-	96,865
Derivatives used for hedging	-	-	-	-	10,815	-	10,815
Mortgages funding	-	-	7,687	-	-	-	7,687
Financial liabilities measured at fair value	-	199,443	7,687	-	10,815	-	217,945
Other financial liabilities	-	-	-	-	-	72,212	72,212
Financial liabilities	-	199,443	7,687	-	10,815	4,676,006	4,893,951

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69. cont.

2006	Loans and receivables	Trading	Designated at fair value	Available for sale	Derivatives used for hedging	Financial liabilities at amort. cost	Total
Loans and receivables							
Cash and balances with central banks	106,961	-	-	-	-	-	106,961
Loans to credit institutions	485,334	-	-	-	-	-	485,334
Loans to customers	2,538,609	-	-	-	-	-	2,538,609
Loans and receivables	3,130,904	-	-	-	-	-	3,130,904
Bonds and debt instruments							
Listed	-	26,208	246,620	-	-	-	272,828
Unlisted	-	3,559	31,369	-	-	-	34,928
Mortgage loans	-	-	10,508	-	-	-	10,508
Bonds and debt instruments	-	29,767	288,497	-	-	-	318,264
Shares and instruments with variable income							
Listed	-	77,638	33,931	-	-	-	111,569
Unlisted	-	2,471	34,559	164	-	-	37,194
Bond funds with variable income	-	8,835	1,422	-	-	-	10,257
Shares and instruments with variable income	-	88,944	69,912	164	-	-	159,020
Derivatives							
OTC derivatives	-	50,011	-	-	-	-	50,011
Futures	-	15	-	-	-	-	15
Other trading derivatives	-	15,428	-	-	-	-	15,428
Derivatives	-	65,454	-	-	-	-	65,454
Derivatives used for hedging							
Fair value hedge	-	-	-	-	2,953	-	2,953
Portfolio hedge of interest rate risk	-	-	-	-	3,500	-	3,500
Derivatives used for hedging	-	-	-	-	6,453	-	6,453
Securities used for hedging							
Bonds and debt instruments	-	66,732	-	-	-	-	66,732
Shares and equity instruments	-	47,011	2,195	-	-	-	49,206
Securities used for hedging	-	113,743	2,195	-	-	-	115,938
Other financial assets	99,044	-	-	-	-	-	99,044
Financial assets	3,229,948	297,908	360,604	164	6,453	-	3,895,077
Liabilities at amortised cost							
Due to credit institutions and central banks	-	-	-	-	-	110,455	110,456
Deposits	-	-	-	-	-	750,658	750,658
Borrowings	-	-	-	-	-	2,399,939	2,399,939
Subordinated loans	-	-	-	-	-	216,030	216,030
Liabilities at amortised cost	-	-	-	-	-	3,477,081	3,477,081
Financial liabilities measured at fair value							
Short position in equity held for trading	-	2,122	-	-	-	-	2,122
Derivatives held for trading	-	48,973	-	-	-	-	48,973
Derivatives used for hedging	-	-	-	-	8,768	-	8,768
Mortgages funding	-	-	11,401	-	-	-	11,401
Financial liabilities measured at fair value	-	51,095	11,401	-	8,768	-	71,264
Other financial liabilities	-	-	-	-	-	96,072	96,072
Financial liabilities	-	51,095	11,401	-	8,768	3,573,153	3,644,418

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69. cont.

Hedges of net investments in foreign operations

The Bank's Consolidated Balance Sheet is affected by exchange differences between the Icelandic krona and all the non-Icelandic krona functional currencies of subsidiaries. The Bank uses forward foreign exchange contracts to hedge the forward foreign currency translation risk on its net investment in foreign subsidiaries.

The fair value of the forward contracts used to hedge the Bank's net investment in foreign subsidiaries is included in the amount shown in the table above.

The ineffectiveness recognised in Net financial income during the year ended 31 December 2007 that arose from hedges in foreign operations was nil (2006: nil).

Fair value hedges

Kaupthing's fair value hedges principally consist of interest rate swaps that are used to protect against changes in the fair value of fixed-rate long-term financial instruments due to movements in market interest rates. For qualifying fair value hedges, all changes in the fair value of the derivative and in the fair value of the item in relation to the risk being hedged are recognised in the Income Statement. If the hedge relationship is terminated, the fair value adjustment to the hedged item continues to be reported as part of the basis of the item and is amortised to income as a yield adjustment over the remainder of the hedging period.

Other derivatives held for risk management

The Group uses other derivatives, not designated in a qualifying hedge relationship, to manage its exposure to foreign currency, interest rate, equity market and credit risks. The instruments used include interest rate swaps, cross-currency interest rate swaps, forward contracts, futures, options, credit swaps and equity swaps. The fair values of those derivatives are shown in the table above.

70. Bonds and debt instruments designated at fair value specified by issuer:

	2007	2006
Financial institutions	293,845	270,879
Governments	11,375	1,032
Corporates	25,373	16,586
Other	2,392	-
Bonds and debt instruments designated at fair value	332,985	288,497

Derecognition

71. Pledged assets are specified as follows:

Mortgage loans in Kaupthing mortgages Fund	88,374	84,165

In the ordinary course of business, the Bank enters into transactions that result in the transfer of financial assets to third parties or special entities. The Bank has transferred retail mortgage loans to the Kaupthing mortgages Fund, but has retained substantially all of the credit risk associated with the transferred assets, and continues to recognise these assets within loans to customers.

Pledged assets

72. Financial assets that may be repledged or resold by counterparties

	2007	2006
Bonds	194,695	88,216
Shares	125,278	32,311
Pledged assets	319,973	120,527

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.

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Investments in associates

73. Investment in associates are specified as follows:

	2007	2006
Carrying amount at the beginning of the year	5,304	13,888
Additions during the year	26,329	5,400
Sold during the year	(512)	(11,868)
Transferred from financial assets at fair value due to step acquisition	44,111	-
Share of profit	3,459	1,194
Dividend received	(149)	(4,103)
Exchange rate difference	5,289	792
Carrying amount at the end of the year	83,831	5,304

Main associates are specified as follows:	Currency	Total assets	Total liabilities	Owner-ship	Share of profit	Nominal value	Book value
Storebrand ASA, Norway	NOK	2,874,809	2,589,505	20.0%	3,072	35,130	73,807
Kaupthing Capital Partners	GBP	9,666	3	40.0%	0	3,000	3,815
Drake Management LLC, USA	USD	13,122	8,748	20.0%	87	10	2,561
Valitor hf., Iceland	ISK	35,070	33,156	39.5%	19	400	1,657
FiNoble Advisors Private Ltd., India	USD	367	52	20.0%	(4)	314	310
Mezzanin Kapital A/S, Denmark	DKK	5,839	3,754	22.7%	(49)	154	474
FMS Holding af 2004 A/S, Denmark	DKK	1,157	66	25.0%	16	109	274
Reiknistofa Bankanna, Iceland	ISK	1,740	222	17.3%	-	-	263
Other associates					318		670
					3,459		83,831

On 14 May 2007 the Bank increased its holding in the Norwegian insurance and financial services company Storebrand ASA to 20.0% of the company's outstanding shares. This entails that the Bank will hereafter book 20.0% of Storebrand's earnings through the Income Statement. The effects of these changes, net of tax, were a decrease in equity of ISK 5,111 million. The investment, ISK 44,111, was transferred from shares and equity instruments to investments in associates. At year-end the fair value of the investment in Storebrand ASA was ISK 59,496 million.

On 18 June 2007 the Bank signed an agreement to acquire a 20.0% stake in the Indian investment services company FiNoble Advisors Private Ltd. with an option to acquire the remaining 80.0% in five years. The investment creates a foothold for the Bank in the fast growing Indian financial market.

Intangible assets

74. The Bank performed impairment test on the carrying amount of goodwill as at 31 December 2007. Impairment tests are performed in the 4th quarter each year, based on the budgets and business plans approved by the Board of Directors and other assumptions.

Goodwill is distributed among cash-generating units (CGU) in keeping with the main emphasis of monitoring and managing activities. The emphasis of the Bank has been shifting such that the subsidiaries are less considered as the core of operations. Instead, operations are tending more towards placing emphasis on the Bank's operational units.

The Bank has defined the five independent CGU of the Bank's operation, each devising its own budget and responsible for its own results. The costs of the ancillary units are distributed to each CGU. The CGU are as follows: 1) Capital Markets, 2) Investment Banking, 3) Asset Management & Private Banking, 4) Treasury, and 5) Banking. With regard to this operational restructuring and planning within the group, goodwill in the Bank's accounts has been distributed among the 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 basis for results for the first year of the scheme, after which the next three years are based on the return objectives for each CGU and after that it is based on long-term yield of comparable units. The Bank aims to achieve consolidated 15% return on equity over the next four years. Return objectives are different within each CGU.

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74. cont.

2007	Goodwill	Discount rate	Net earnings: Est. CAGR, year 1-4
Capital Markets	5,524	13.6%	<2%
Investment Banking	8,140	13.6%	<2%
Treasury	4,767	13.6%	<2%
Asset Management and Private Banking	5,120	11.3%	<2%
Banking	36,463	10.2%	<2%
	60,014		
2006			
Capital Markets	5,815	12.7%	<2%
Investment Banking	8,596	12.7%	<2%
Treasury	5,001	12.7%	<2%
Asset Management and Private Banking	5,454	10.6%	18.0%
Banking	38,252	9.6%	<2%
	63,118		

The management assesses that likely changes in the key parameters discussed will not cause the carrying amount of goodwill to exceed the recoverable amount.

75. Intangible assets are specified as follows:

2007	Goodwill	Other intangible assets	Total
Balance at the beginning of the year	63,118	5,183	68,301
Exchange rate difference	(2,952)	(246)	(3,198)
Additions during the year	-	2,654	2,654
Sold during the year	(77)	-	(77)
Impairment	(75)	-	(75)
Amortisation	-	(831)	(831)
Intangible assets	60,014	6,760	66,774

2006			
Balance at the beginning of the year	50,481	4,462	54,943
Exchange rate difference	13,088	792	13,880
Additions during the year	-	1,810	1,810
Impairment	(451)	(819)	(1,270)
Amortisation	-	(1,062)	(1,062)
Intangible assets	63,118	5,183	68,301

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Investment property

76. Investment property are specified as follows:

	2007	2006
Balance at the beginning of the year	31,584	24,156
Exchange rate difference	(30)	3,426
Additions during the year	1,586	3,475
Disposals through the sale of a subsidiary	(13,473)	-
Other disposals during the year	-	(2,347)
Fair value adjustments	(219)	96
Transferred to investment property	8,707	2,778
Investment property	28,155	31,584

The Bank's investment properties were revalued at 31 December 2007 by independent professionally qualified valuers which have recent experience in the location and category of the investment property being valued. Valuations were based on current prices in an active market for all properties except for the properties located in Iceland where the Bank used discounted cash flow projections.

77. Leases as lessor

The Bank leases investment property as operating leases (see note 20). The future minimum lease payments under non-cancellable leases are as follows:

	2007	2006
Less than one year	952	1,682
Over 1 year and up to 5 years	2,172	4,391
Over 5 years	15,146	21,682
Minimum lease payments under non-cancellable leases	18,270	27,755

During the year 2007 ISK 1,263 million (2006: ISK 2,274 million) was recognised as rental income in the Income Statement and ISK 38 million (2006: ISK 20 million) in respect of repairs and maintenance was recognised as an expense in the Income Statement relating to Investment Property.

In the Income Statement, direct operating expenses include ISK 1 million relating to Investment Property that was unlet compared to ISK 32 million for the year before.

Property and equipment

78. Property and equipment are specified as follows:

	Real estate	Machinery and equipm.	Operating lease	Total 2007	Total 2006
Balance at the beginning of the year	9,084	11,702	29,082	49,868	35,642
Acquisitions through business combination	-	304	-	304	-
Exchange rate difference	(173)	(710)	(3,384)	(4,267)	7,848
Additions during the year	5,666	3,674	3,113	12,453	13,818
Disposals during the year	(832)	(1,020)	(431)	(2,283)	(4,627)
Transfers	-	-	(1,237)	(1,237)	(2,813)
Impairment	-	(7)	-	(7)	-
Gross carrying amount at the end of the year	13,744	13,943	27,143	54,831	49,868
Previously depreciated	2,044	7,524	9,834	19,402	13,209
Acquisitions through business combination	-	269	-	269	-
Exchange rate difference	(68)	(572)	(1,206)	(1,846)	2,961
Depreciation during the year	455	1,760	3,505	5,720	4,914
Transfers	-	-	(583)	(583)	(35)
Disposals during the year	(101)	(479)	(265)	(845)	(1,647)
Total depreciation at the end of the year	2,330	8,503	11,284	22,117	19,402
Property and equipment	11,414	5,441	15,858	32,714	30,466

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79. Depreciation and amortisation in the Income Statement is specified as follows:

	2007	2006
Depreciation of property and equipment	5,720	4,914
Amortisation of intangible assets	830	1,062
Depreciation and amortisation	6,550	5,976

80. Leases as lessor

The Bank leases out property and equipment under operating leases (see note 20). The future minimum lease payments under non-cancellable leases are as follows:

	2007	2006
Less than one year	4,286	851
Over 1 year and up to 5 years	9,450	3,322
Over 5 years	1,099	4,414
Minimum lease payments under non-cancellable leases	14,835	8,587

During the year ended 31 December 2007 ISK 300 million was recognised as rental income in the Income Statement and ISK 0 million in respect of repairs and maintenance was recognised as an expense in the Income Statement relating to property and equipment. Comparative amounts for the year 2006 amounted ISK 2,033 million and ISK 8 million, respectively.

Other assets

81. Other assets are specified as follows:

	2007	2006
Unsettled securities trading	239,988	90,427
Accounts receivables	24,005	8,617
Accrued income	15,808	8,004
Prepaid expenses	2,879	2,846
Non-current assets and disposal groups classified as held for sale	1,842	2,334
Sundry assets	8,187	5,646
Other assets	292,709	117,874

Unsettled securities trading was settled in less than three days from the reporting date.

Borrowings

82. Borrowings are specified as follows:

Bonds issued	1,638,113	1,762,483
Bills issued	136,813	156,203
Money market loans	555,606	373,285
Other loans	285,428	107,968
Borrowings	2,615,960	2,399,939

Included are Repurchase agreements with banks amounting to ISK 178,014 million at the end of the year compared to ISK 94,913 millon at year end 2006.

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Subordinated loans

83. Subordinated loans are specified as follows:

	2007	2006
Tier I - Non-innovative hybrid capital	74,403	23,614
Tier I - Innovative hybrid capital	26,427	28,203
Tier II	166,459	164,213
	267,289	216,030

	Currency	Orginal interest	Interest change	Interest after change	Maturity date	2007 Book value	2006 Book value
Loans that qualify as Tier I capital:							
Issued in 2001	ISK	8.65%	2011	Min 8,75 %[1]	No maturity date	1,369	1,310
Issued in 2004	EUR	5.90%	2014	3 m Euribor + 245bp	No maturity date	14,292	15,095
Issued in 2005	EUR	6.25%			No maturity date	15,978	16,685
Issued in 2005	ISK	3 m Reibor + 1,4%			No maturity date	3,353	3,353
Issued in 2005	USD	6.60%	2015	3 m USD Libor + 248bp	No maturity date	10,767	11,798
Issued in 2006	ISK	3 m Reibor + 1,4%			No maturity date	3,578	3,576
Issued in 2007	EUR	6.75%			No maturity date	23,976	-
Issued in 2007	USD	9.00%			No maturity date	27,519	-
						100,831	51,817
Loans that qualify as Tier II capital:							
Issued in 1996	DKK	0.00%			2007	-	228
Issued in 1999	EUR	6.40%			2009	2,893	3,067
Issued in 1999	JPY	4.80%			2032	6,787	7,461
Issued in 2000	ISK	7.00%	2007	9.00%	2012	29	2,135
Issued in 2001	ISK	6.00%	2006	7.50%	2011	-	122
Issued in 2002	ISK	6.00%	2007	7.50%	2012	-	1,021
Issued in 2002	ISK	7.50%	2009	10.00%	2014	1,514	1,429
Issued in 2002	ISK	8.00%			2026	-	264
Issued in 2002	EUR	3 m Euribor + 115bp	2007	3 m Euribor + 365bp	2012	-	474
Issued in 2003	GBP	7.50%			2019	6,252	6,976
Issued in 2004	ISK	5.40%	2009	7.4%	2014	1,764	1,666
Issued in 2004	EUR	3 m Euribor + 65bp	2009	3 m Euribor + 165bp	2014	27,408	28,281
Issued in 2004	DKK	3.00%			2008	-	142
Issued in 2005	USD	7.50%	2010	4x(CMS 10y/2y) 10%/3,75%	2045	4,816	5,512
Issued in 2005	EUR	6.50%	2010	4x(CMS 10y/2y) 9%/3%	2045	7,667	7,903
Issued in 2005	EUR	3 m Euribor + 40bp	2012	3 m Euribor + 140bp	2017	4,616	4,758
Issued in 2006	USD	7.13%			2016	84,401	92,774
Issued in 2007	EUR	4.30%	2007	5.10%	2013	18,312	-
						166,459	164,213
Subordinated loans						267,289	216,030

1. Maximum of i) 8,75% or ii) Yield of 10 year Icelandic inflation linked government bonds + 5,73%

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Financial liabilities measured at fair value

84. Financial liabilities measured at fair value are specified as follows:

	2007	2006
Trading liabilities	199,443	51,095
Derivatives used for hedging - portfolio hedge of interest rate risk	10,815	8,768
Mortgage funding measured at fair value	7,687	11,401
Financial liabilities measured at fair value	217,945	71,264

85. Trading liabilities are specified as follows:

Short position in equity instruments held for trading	2,305	2,122
Derivatives held for trading	100,273	48,788
Repos and related agreements held for trading	96,865	-
Other liabilities held for trading	-	185
Trading liabilities	199,443	51,095

86. Derivatives used for hedging are specified as follows:

Fair value hedge	1,859	1,070
Portfolio hedge of interest rate risk	8,956	7,698
Derivatives used for hedging	10,815	8,768

Tax assets and tax liabilities

87. Tax assets and liabilities are specified as follows:

	2007		2006	
	Assets	Liabilities	Assets	Liabilities
Current tax	1,766	9,636	26	10,180
Deferred tax	5,133	12,842	5,808	13,029
Tax assets and liabilities	6,899	22,478	5,834	23,209

88. Deferred tax assets and liabilities are specified as follows:

2007	Assets	Liabilities	Net
Balance at the beginning of the year	5,808	13,030	(7,222)
Acquisition through business combination	47	(39)	86
Disposals during the year	-	395	(395)
Exchange rate difference on translation	632	1,168	(536)
Calculated income tax for the year	412	10,128	(9,716)
Income tax recognised in equity	-	(2,202)	2,202
Income tax to be paid in next year	(1,766)	(9,638)	7,872
Net tax assets and (liabilities)	5,133	12,842	(7,709)

2006			
Balance at the beginning of the year	5,004	10,343	(5,339)
Exchange rate difference on translation	234	690	(456)
Other changes	-	(581)	581
Calculated income tax for the year	596	15,232	(14,636)
Income tax recognised in equity	-	(2,474)	2,474
Income tax to be paid in next year	(26)	(10,180)	10,154
Net tax assets and (liabilities)	5,808	13,030	(7,222)

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89. Changes in deferred tax assets and liabilities are specified as follows:

2007	At Jan. 1	Exchange rate and other adjustment	Addition/ disposal during the year	Recognised in profit or loss	Recognised in equity	At Dec. 31
Shares in other companies	3,032	225	(196)	1,294	-	4,355
Foreign currency denominated assets and liabilities	1,540	116	-	4,589	(2,202)	4,043
Loans	5,425	402	(3)	(5,644)	-	180
Derivatives	97	7	-	(113)	-	(9)
Investment property and property and equipment	1,447	107	(1)	3,769	-	5,322
Other assets and liabilities	(2,704)	(201)	(83)	1,206	-	(1,782)
Tax loss carry forward	(1,615)	(119)	591	(3,257)	-	(4,400)
Change in deferred tax	7,222	537	308	1,844	(2,202)	7,709

2006						
Shares in other companies	1,516	190	-	1,326	-	3,032
Foreign currency denominated assets and liabilities	502	65	-	3,447	(2,474)	1,540
Loans	5,643	724	-	(942)	-	5,425
Derivatives	(841)	(183)	-	1,121	-	97
Investment property and property and equipment	455	104	-	888	-	1,447
Other assets and liabilities	(667)	(734)	-	(1,303)	-	(2,704)
Tax loss carry forward	(1,269)	(291)	-	(55)	-	(1,615)
Change in deferred tax	5,339	(125)	-	4,482	(2,474)	7,222

90. Deferred tax assets and liabilities are attributable to the following:

	2007		2006	
	Assets	Liabilities	Assets	Liabilities
Shares in other companies	-	4,355	(18)	3,015
Foreign currency denominated assets and liabilities	54	4,096	35	1,574
Loans	2	182	291	5,716
Derivatives	75	66	(32)	65
Investment property and property and equipment	-	5,323	1,454	2,901
Other assets and liabilities	1,783	-	1,788	(918)
Tax loss carry forward	3,219	(1,180)	2,290	676
Deferred tax assets and liabilities at the end of the year	5,133	12,842	5,808	13,029

Other liabilities

91. Other liabilities are specified as follows:

	2007	2006
Unsettled securities trading	64,560	91,661
Provisions	2,303	4,666
Accounts payable	7,652	4,410
Sundry liabilities	72,182	48,211
Other liabilities	146,697	148,948

Unsettled securities trading was settled in less than three days from the reporting date.

92. Provisions are specified as follows:

Provision for pensions	1,738	3,679
Provision for losses on guarantees	61	263
Other provisions	504	724
Provisions	2,303	4,666

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Equity

Shareholders' equity

93. According to the Parent Company's Articles of Association, total share capital amounts to ISK 7,405 million. At year-end 2007 own shares amounted to ISK 34 million and share capital, according to the Balance Sheet, thus amounted to ISK 7,371 million. One share has a nominal value of ISK 10. The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at shareholders' meetings of the Bank.

Increase of share capital during the year is broken down as follows:	2007		2006	
	Share capital	Market value	Share capital	Market value
Shares outstanding at 1 January	7,321	615,696	6,638	495,195
Issued new shares	-	-	759	55,558
Purchases and sales of treasury stock	50	(4,045)	(76)	(5,730)
Changes in market value		36,997	-	70,673
Shares outstanding at 31 December	7,371	648,648	7,321	615,696
Own shares	34	2,992	84	7,064

94. Movement in share capital during the year segregates as follows:

2007	Share capital	Share premium	Stock options	Total
Balance at 1 January	7,321	163,512	516	171,349
Purchases and sales of treasury stock	50	(4,045)	-	(3,995)
Exercised stock options	-	1,220	(504)	716
Stock option expense	-	-	1,522	1,522
Balance 31 December	7,371	160,687	1,534	169,592

2006				
Balance at 1 January	6,638	114,437	169	121,244
Issued new shares	759	54,799	-	55,558
Purchases and sales of treasury stock	(76)	(5,948)	-	(6,024)
Exercised stock options	-	224	(224)	-
Stock option expense	-	-	571	571
Balance 31 December	7,321	163,512	516	171,349

Share premium represents excess of payment above nominal value (ISK 10 per share) that shareholders have paid for shares sold by the Bank. According to Icelandic Companies Act, 25% of the nominal value of share capital must be held in reserve which can not be paid out as dividend to shareholders.

The share option reserve includes the accrued part of the fair value of share options. This reserve is reversed if share options are exercised or forfeited.

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Other reserves

95. Movement in other reserves were as follows:

2007	Fair value reserve	Translation reserve	Total
Balance at 1 January	(11)	17,231	17,220
Translation difference	-	(31,866)	(31,866)
Deferred pension reserve	19	-	19
Balance 31 December	8	(14,635)	(14,627)

2006	Pension reserve	Fair value reserve	Translation reserve	Total
Balance at 1 January	(480)	(2)	(1,058)	(1,540)
Translation difference	-	-	18,289	18,289
Changes in fair value of available-for-sale financial assets	-	(9)	-	(9)
Deferred pension reserve	480	-	-	480
Balance 31 December	-	(11)	17,231	17,220

Fair value reserve

The fair value reserve includes the cumulative portion of the cumulative net change in fair value of available-for-sale investments until the investment is derecognised.

Translation reserve

The translation reserve compromise all foreign exchange differences arising from the translation of the financial statements of foreign operations that are not integral to the operations of the Bank, as well as from the translation liabilities that hedge the Bank's net investment in foreign subsidiaries.

Pension reserve

The pension reserve includes the changes in the pension obligation.

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Derivatives

96. Derivatives remaining maturity date of principal and book value are specified as follows:

2007	Principal				Book value	
	Up to 3 months	Over 3 months and up to a year	Over 1 year	Total	Assets	Liabilities
Currency and interests rate derivatives, agreements unlisted:						
Forward exchange rate agreements	2,329,301	136,964	24,394	2,490,659	20,269	15,946
Interest rate and exchange rate agreements	764,533	515,492	2,728,407	4,008,431	65,957	44,733
Options - purchased agreements	59,555	20,344	45,670	125,569	5,679	-
Options - sold agreements	44,911	23,813	48,762	117,486	29	4,127
	3,198,300	696,613	2,847,233	6,742,145	91,934	64,806
Equity derivatives:						
Equity swaps, agreements unlisted	131,682	12,217	211,076	354,975	19,506	3,953
Equity options, purchased unlisted agreements	12,064	601	-	12,666	598	-
Equity options, sold unlisted agreements	9,762	4,386	-	14,148	-	2,091
Futures, agreements listed	2,484	-	-	2,484	-	-
Contracts for differences	90,345	-	211,075	301,420	30,716	19,264
	246,337	17,205	422,152	685,693	50,820	25,309
Credit derivative contracts:						
Credit default swap and Corporate Synthetic CDOs	-	-	32,081	32,081	96	13,304
Total rate of return swaps	-	-	48,052	48,052	1,786	-
	-	-	80,133	80,133	1,882	13,304
Bond derivatives:						
Bond swaps, agreements unlisted	39,792	18,373	22,828	80,993	6,128	765
Options - purchased agreements	600	3,122	6,850	10,572	6,595	-
Options - sold agreements	600	3,122	6,850	10,572	-	6,905
	40,992	24,617	36,528	102,137	12,722	7,670
Derivatives	3,485,629	738,434	3,386,045	7,610,108	157,359	111,088

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96. cont.

2006	Principal				Book value	
	Up to 3 months	Over 3 months and up to a year	Over 1 year	Total	Assets	Liabilities
Currency and interests rate derivatives, agreements unlisted:						
Forward exchange rate agreements	1,428,174	137,042	4,879	1,570,095	13,178	12,575
Interest rate and exchange rate agreements	117,595	364,708	1,942,931	2,425,234	37,976	30,529
Options - purchased agreements	53,139	22,730	62,242	138,111	2,870	63
Options - sold agreements	48,438	24,876	40,738	114,052	93	2,452
	1,647,346	549,356	2,050,790	4,247,492	54,117	45,619
Equity derivatives:						
Equity swaps, agreements unlisted	35,888	9,076	4,886	49,850	8,430	3,369
Equity options, purchased unlisted agreements	4,308	-	2,700	7,008	90	73
Equity options, sold unlisted agreements	338	-	2,700	3,038	151	10
Futures, agreements listed	1,527	-	-	1,527	15	-
Contracts for differences	3,959	-	-	3,959	32	-
	46,020	9,076	10,286	65,382	8,718	3,452
Credit derivative contracts:						
Credit default swap and Corporate Synthetic CDOs	4,257	-	212,929	217,186	36	8
Total rate of return swaps	-	-	45,999	45,999	-	1,733
	4,257	-	258,927	263,185	36	1,741
Bond derivatives:						
Bond swaps, agreements unlisted	22,360	2,939	25,471	50,770	2,307	102
Options - purchased agreements	-	401	13,931	14,332	6,729	-
Options - sold agreements	-	401	13,931	14,332	-	6,717
	22,360	3,741	53,333	79,434	9,036	6,819
Derivatives	1,719,983	562,173	2,373,336	4,655,493	71,907	57,631

The objective of the above-mentioned agreements is to control currency and interest rate risk of the Bank. The credit risk is valued at ISK 71,379 million when calculating the capital ratio of the Bank at 31 December 2007 and ISK 30,575 million at 31 December 2006.

Off Balance Sheet information

Obligations

97. The Bank has granted its customers guarantees, overdraft permissions and loan commitments. These items are specified as follows:

	2007	2006
Guarantees	152,581	324,929
Credit default swaps, investment grade	319,065	217,186
Unused overdrafts	73,844	50,927
Loan commitments	278,481	317,689

The credit risk is valued at ISK 235 billion at the end of the year 2007 (2006: ISK 226 billion) for guarantees, credit default swaps, unused overdrafts and loan commitments when calculating the capital ratio of the Bank.

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Operating lease commitments

98. At 31 December 2007, the Bank was obligated under a number of non-cancellable operating leases for premises and equipment. The significant premises leases usually include renewal options and escalation clauses in line with general office rental market conditions as well as rent adjustments based on price indices. However, the lease agreements do not contain contingent rent payment clauses and purchase options.

99. The Bank has concluded lease agreements regarding the real estate it uses for its operations. The lease agreement is for a period of up to 14 years and the Bank has priority right of purchase or right to extend the lease agreement at the end of that period.

Future minimum lease payments	10,528

Risk management disclosures

100. Kaupthing is a northern European bank offering comprehensive retail, corporate and investment banking services to individuals, companies and institutional investors. The Bank has five core business areas: Banking; Asset Management and Private Banking; Investment Banking; Capital Markets and Treasury (see note 40). It also has ancillary divisions such as Risk Management, IT, Finance and Sales and Marketing.

The Bank faces various types of risks related to its business as a financial institution arising from its day to day operations. Management devotes a significant portion of its time to the management of these risks. The mainstays of effective risk management are the identification of significant risk, the quantification of the risk exposure, actions to limit risk and the constant monitoring of risk. The most significant of these risks are discussed below.

Material risks

a) *Credit risk*

Credit risk is the current or prospective risk to earnings and capital arising from the failure of an obligor to repay principal or interest at the stipulated time or otherwise to perform as agreed. This risk is enhanced if the assigned collateral only partly covers the claims made on the borrower or if its value is variable or uncertain. Credit risk arises anytime the Bank commits its funds, resulting in capital or earnings being dependent on counterparty, issuer or borrower performance. The risk comprises concentration risk, residual risk, credit risk in securitisation, cross border (or transfer) risk and more.

b) *Market risk*

Market risk is the current or prospective risk that changes in financial market prices and rates will fluctuate the value and cash flows of financial instruments. The risk arises from market making, dealing, and position taking in bonds, securities, currencies, commodities, derivatives, and any other commitment depending on market prices and rates.

c) *Liquidity risk*

Liquidity risk is the risk arising from the possible inability of the Bank to meet its liabilities when they come due. It is an unavoidable source of risk in the Bank's operations as the Bank requires funding to support its investments.

d) *Operational risk*

Operational risk is the risk of loss, resulting from inadequate or failed internal processes, human and system error, or from external events that affect the Bank's operations and can result in direct losses. The risk is present in all five core business areas and in the ancillary divisions.

Credit Risk Strategy

Carefully monitored credit risk is a base for stable profits. Undertaking credit risk is a cornerstone in the Bank's strategy for maintaining at least 15% long-term return on equity. The main asset of the Bank is its loan portfolio, and therefore managing and analysing the loan portfolio is very important. The emphasis is on keeping a high quality credit portfolio, by seeking business with strong parties, maintaining a strict credit process, critically inspecting loan applications, identifying and reacting to possible problem loans at an early stage and other measures.

a) *Credit structure*

A fundamental requirement is to have a comprehensive structure for credits which is coherent across the Bank and within each subsidiary as well. The highest authority in credits is the Parent Company Board Credit Committee. The structure is based on a hierarchy of Credit Committees below the Board Credit Committee which operate on 2-3 levels and within different limits depending on the size of subsidiaries. The principle of central management of risk is maintained by having the Bank's CEO or his deputy as a member of the Board Credit Committee in each subsidiary. This is necessary since the CEO is responsible for maintaining the bank's exposures within legal and policy limits.

The pricing of each credit granted should reflect the risk taken. The client's interests must be guarded at all times and it must be considered likely that the client will be able to repay a given loan. In particular, the quality of collateral can never be the sole reason for a positive credit decision.

100. cont.

It is the aim of the credit strategy that, in the long run, write-offs should be less than 5% of interest income. All aspects of the credit process should be designed and implemented with this long-term goal in mind.

Provisions for losses reflect the expected loss, both for loans for which specific provisions exist as well as for portfolios of performing loans. The collective assessment of such portfolios is based on default predictions and loss given default parameters.

The Bank's total credit risk should be limited through diversification of the loan portfolio across sectors and by limiting large exposures.

b) *Quantification and Rating model description*

The basic elements for the quantification of credit risk are the probability of default, the loss given default, and exposure at default. These quantities need to be measured with an effective and accurate credit rating system. Information, both quantitative and qualitative, must be gathered, both specifically in regard to the counterparty and to its general economic situation in order to estimate its creditworthiness. Furthermore, a facility rating should be performed to determine the loss parameters in case of a default.

The policy of the Bank is to apply sophisticated credit models to monitor credit risk. These credit models are also the foundation for the application of internal rating based approach to calculate capital requirements. Therefore, the development, implementation and application of these models must be in accordance with the Bank's Basel II strategy.

Sources of Credit Risk

a) *Loan portfolio*

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

b) *Commitments and guarantees*

The Bank often commits itself to and ensures that funds are available to customers as required. The most common commitments to extend credit are in the form of limits on check accounts, credit cards and credit lines. Potential loss on these accounts is equal to the amount of the limits although they may only be partly used at any one time. In practice, the potential loss is less severe since many of these commitments can be recalled immediately by the Bank in case the clients do not meet credit standards.

Guarantees carry the credit risk to the full amount similar as loans, since they represent irrevocable assurances that the Bank will make payments in the event that a customer cannot meet its obligations to third parties.

c) *Derivatives trading*

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

d) *Master netting agreements*

Frequently, exposure to credit losses is reduced by entering into master netting agreements with clients that counterparties have significant and/or diverse credit related business with the Bank. Master netting agreements do not generally result in an offset of balance sheet assets and liabilities, as transactions are usually settled on a gross basis. However, the credit risk associated with favourable contracts is reduced by these types of agreements since in the case of default all amounts of the counterparty are terminated and settled on a net basis.

Loan provisioning

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

100. cont.

a) *Counterparty-specific*

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

The estimated recoverable amount is the present value, using the loan's original effective interest rate, of expected future cash flows, which may result from restructuring or liquidation. Impairment is measured and allowances for credit losses are established for the difference between the carrying amount and the estimated recoverable amount.

Upon impairment, the accrual of interest income based on the original terms of the claim is discontinued, but the increase of the present value of impaired claims due to the passage of time is reported as interest income.

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

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

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

b) *Collectively*

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

101. Maximum exposure to credit risk by geographical

Maximum exposure to credit risk related to on-balance sheet assets:

2007	Iceland	Scandi-navia	UK	Luxem-bourg	Other	Total
Cash and balances with central banks	*1,034*	*14,632*	*79,719*	*1,653*	*921*	*97,959*
Loans to credit institutions	*207,884*	*138,275*	*98,720*	*7,902*	*135,660*	*588,441*
Loans to customers	*837,761*	*1,100,163*	*735,344*	*62,643*	*568,497*	*3,304,408*
Overdrafts	83,550	1,814	260	-	0	85,624
Finance leases	-	39,845	31,110	-	2,642	73,597
Subordinated loans	30,303	7,714	311	-	-	38,328
Other loans	723,908	1,050,790	703,663	62,643	565,855	3,106,859
Bonds and debt instruments	*23,499*	*193,555*	*17,052*	*4,168*	*129,076*	*367,350*
Listed	21,452	179,955	13,546	4,168	116,742	335,863
Unlisted	2,047	5,689	3,506	(0)	12,334	23,576
Mortgage loans - Real credit loans	-	7,911	-	-	-	7,911
Derivatives	*35,003*	*11,533*	*48,672*	*199*	*39,449*	*134,856*
Derivatives used for hedging	*16,617*	*1,872*	*1,724*	-	*2,290*	*22,503*
Bonds and debt instruments used for hedging	*63,723*	*867*	*3,102*	-	*359*	*68,051*
Listed	63,349	128	2,531	-	38	66,045
Unlisted	374	739	571	-	321	2,005
Other financial assets	*28,933*	*201,270*	*26,538*	*1,638*	*5,614*	*263,993*
Total on-balance sheet maximum exposure to credit risk	1,214,453	1,662,167	1,010,871	78,203	881,866	4,847,561

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101. cont.

Maximum exposure to credit risk related to off-balance sheet items:

	Iceland	Scandi-navia	UK	Luxem-bourg	Other	Total
Financial Guarantees	29,795	43,970	65,135	44	13,636	152,580
Credit default swaps, investment grade	-	4,583	45,280	-	269,202	319,065
Unused overdrafts	56,296	14,906	-	-	2,642	73,844
Loan Commitments	31,242	125,854	87,558	-	33,827	278,481
Total off-balance sheet maximum exposure to credit risk	117,333	189,313	197,973	44	319,308	823,970

2006

	Iceland	Scandi-navia	UK	Luxem-bourg	Other	Total
Cash and balances with central banks	*986*	*40,616*	*64,677*	-	*683*	*106,961*
Loans to credit institutions	*306,849*	*98,755*	*70,668*	*4,754*	*4,308*	*485,334*
Loans to customers	*635,056*	*1,016,530*	*615,170*	*56,793*	*215,061*	*2,538,609*
Overdrafts	69,978	-	25,116	18,259	-	113,354
Finance lease	-	62,337	27,678	-	2,990	93,006
Subordinated loans	7,369	-	-	-	-	7,369
Mortgages	2,036	155	62,478	-	9,791	74,460
Other loans	555,673	954,037	499,896	38,534	202,280	2,250,421
Bonds and debt instruments	*20,091*	*189,461*	*5,165*	*1,911*	*101,636*	*318,264*
Listed	17,154	152,048	2,452	10	101,164	272,827
Unlisted	2,937	26,904	2,713	1,901	471	34,927
Mortgage loans - Real credit loans	-	10,509	-	-	-	10,509
Derivatives	*18,387*	*6,533*	*15,680*	*4,204*	*20,650*	*65,454*
Derivatives used for hedging	-	*1,474*	*1,899*	-	*3,080*	*6,453*
Bonds and debt instruments used for hedging	*64,831*	*539*	*788*	-	*575*	*66,732*
Listed	64,452	66	259	-	563	65,340
Unlisted	379	472	529	-	12	1,391
Other financial assets	*11,644*	*79,187*	*6,392*	*1,331*	*491*	*99,044*
Total on-balance sheet maximum exposure to credit risk	1,057,844	1,433,093	780,439	68,992	346,484	3,686,850

Maximum exposure to credit risk related to off-balance sheet items:

	Iceland	Scandi-navia	UK	Luxem-bourg	Other	Total
Financial Guarantees	11,886	34,233	184,892	83,861	10,056	324,928
Credit default swaps, investment grade	-	231	93,270	-	123,684	217,186
Unused overdrafts	50,557	370	-	-	-	50,927
Loan Commitments	23,002	168,981	112,214	986	12,507	317,690
Total off-balance sheet maximum exposure to credit risk	85,445	203,815	390,376	84,847	146,248	910,731

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102. Maximum exposure to credit risk by sector

Maximum exposure to credit risk related to on-balance sheet assets:

2007	Individuals	Holding companies	Industry	Real estate	Service[1]	Other	Total
Cash and balances with central banks	-	-	-	-	*97,959*	-	*97,959*
Loans to credit institutions	-	-	-	-	*588,441*	-	*588,441*
Loans to customers	*563,592*	*488,957*	*564,943*	*684,224*	*604,589*	*398,103*	*3,304,407*
Overdrafts	54,744	-	6,437	15	16,547	7,881	85,624
Finance lease	5,477	-	17,464	744	41,192	8,721	73,597
Subordinated loans	-	28,815	224	2,307	6,982	-	38,328
Mortgages	59,096	-	-	32,320	1,170	-	92,586
Other loans	444,275	460,142	540,818	648,838	538,698	381,502	3,014,273
Bonds and debt instruments	-	*2,865*	*26,149*	*5,435*	*201,201*	*131,699*	*367,350*
Listed	-	79	22,623	1	183,309	129,851	335,863
Unlisted	-	2,786	426	5,192	15,141	31	23,576
Mortgage loans - Real credit loans	-	-	3,100	242	2,751	1,819	7,911
Derivatives	*4,909*	*24,969*	*5,622*	*1,379*	*80,318*	*17,659*	*134,856*
Derivatives used for hedging	-	*773*	*410*	*31*	*14,882*	*6,406*	*22,503*
Bonds and debt instruments used for hedging	-	*571*	*2,642*	-	*64,838*	-	*68,052*
Listed	-	-	2,215	-	63,829	-	66,044
Unlisted	-	571	426	-	1,008	-	2,005
Other fianancial assets	*420*	*7,587*	*1,443*	*18*	*246,780*	*7,744*	*263,993*
Total on-balance sheet maximum exposure to credit risk	568,921	525,722	601,209	691,087	1,899,008	561,614	4,847,561

Maximum exposure to credit risk related to off-balance sheet items:

	Individuals	Holding companies	Industry	Real estate	Service[1]	Other	Total
Financial guarantees	3,372	6,170	23,465	13,461	87,872	18,240	152,581
Credit default swaps, investment grade	-	9,804	4,950	4,239	299,155	917	319,065
Unused overdrafts	55,295	-	9,118	376	7,382	1,671	73,843
Loan Commitments	1,674	8,882	153,728	23,189	87,864	3,144	278,481
Total on-balance sheet maximum exposure to credit risk	60,341	24,856	191,261	41,266	482,273	23,973	823,969

2006	Individuals	Holding companies	Industry	Real estate	Service[1]	Other	Total
Cash and balances with central banks	-	-	-	-	*106,961*	-	*106,961*
Loans to credit institutions	-	-	-	-	*485,334*	-	*485,334*
Loans to customers	*421,409*	*342,712*	*616,882*	*396,023*	*505,183*	*256,399*	*2,538,609*
Overdrafts	25,602	73,259	3,078	44	7,684	3,686	113,354
Finance lease	3,178	1,195	16,484	14	63,962	8,172	93,006
Subordinated loans	-	440	951	2,222	3,756	-	7,369
Mortgages	44,377	-	4,011	19,467	4,021	2,583	74,460
Other loans	348,252	267,818	592,358	374,275	425,761	241,957	2,250,421
Bonds and debt instruments	-	-	*36,867*	*7,237*	*159,802*	*114,358*	*318,264*
Listed	-	-	29,236	4,565	137,467	101,560	272,827
Unlisted	-	-	3,631	2,314	18,768	10,215	34,927
Mortgage loans - Real credit loans	-	-	*4,000*	*358*	*3,567*	*2,583*	*10,509*
Derivatives	*754*	*15,425*	*6,104*	*466*	*34,526*	*8,179*	*65,454*
Derivatives used for hedging	-	-	-	-	*2,953*	*3,500*	*6,453*
Bonds and debt instruments used for hedging	-	*529*	*256*	*257*	*65,573*	*117*	*66,732*
Listed	-	-	256	257	64,710	117	65,340
Unlisted	-	529	-	-	863	-	1,391
Other financial assets	*155*	*10,940*	*192*	*7*	*51,736*	*36,014*	*99,044*
Total on-balance sheet maximum exposure to credit risk	422,318	369,606	660,301	403,990	1,412,069	418,567	3,686,851

1. Included is financial service.

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102. cont.

Maximum exposure to credit risk related to off-balance sheet assets:

	Individuals	Holding companies	Industry	Real estate	Service	Other	Total
Financial Guarantees	487	1,855	6,835	441	308,381	6,928	324,929
Credit default swaps, investment grade	-	-	-	-	217,186	-	217,186
Unused overdrafts	36,044	-	3,455	559	8,101	2,768	50,927
Loan Commitments	-	20,908	25,142	-	260,470	11,170	317,689
Total on-balance sheet maximum exposure to credit risk	36,531	22,763	35,432	1,000	794,138	20,866	910,731

Market Risk Strategy

The Bank's strategy is to invest its own capital on a limited and carefully selected basis in transactions, underwritings and other activities that involve market risk. The main types of market risk are equity price risk, interest rate risk and foreign exchange risk.

The Bank keeps firm track of the market risk embedded in market investments at group level and makes sure that the total measured market risk does not exceed the market risk limits set by the Bank’s Board of Directors.

It is essential that procedures in deciding proprietary trading limits are clear and that roles and responsibilities of everyone involved are unambiguous. The Board of Directors decides how much market risk exposure the proprietary trading units within the bank are allowed to assume expressed as a maximum overnight as well as intraday exposure in equities, fixed income and derivatives. The Board entrusts the Group CEO and the CEOs of the subsidiaries with the enforcement of this policy and the Risk Management with the evaluation and monitoring of positions and limits.

The Board of Directors have set a global equity limit based on equity exposure as a percentage of risk capital. At year end 2007 the global equity limit was 35% of risk capital and thereof the total unlisted exposure or private equity should not exceed 15% of risk capital.

The Board of Directors have also limited interest rate risk, measuring the change in value of underlying positions when shifting all yield curves 100bp up, to 8% of risk capital and thereof 3% to trading book exposure.

Derivatives

103. The Bank’s use of derivatives is mainly through derivative sales, but derivatives are also in trading portfolios. The types of derivatives used by the Bank include swaps, futures, forwards, options, credit derivatives, and other similar types of contracts.

Derivative sales offer companies and institutional investors foreign exchange and a range of interest rate and currency derivatives for position taking and risk management. The market risk associated with derivatives sales is hedged on a portfolio basis and on a back-to-back basis.

The Bank’s trading portfolios take positions in traded and over-the-counter instruments, including derivatives, to take advantage of short-term market movements in equities and bonds and in currency prices and interest rates, and they also use derivatives to hedge certain market exposures. The level of exposure is controlled using individual trading limits as with other market risk.

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Interest rate risk

104. Interest-rate risk increased quite significantly at year-end 2004 following the introduction of fixed-interest mortgage products in our banking book. The table below shows the interest rate risk by currency and duration. Trading interest rate risk refers to exposures in trading book where positions are marked-to-market and profit or loss is recognised immediately but banking interest rate risk refers to exposure in banking book where profit or loss is realised over the lifetime of the exposure.

At year end 2007 the Bank's interest rate risk based on 100bp shift of the yield curve was in the banking 3,5% (2006: 5,1%) of risk capital and in the trading book 0.8% (2006: 0,6%) of risk capital.

The Bank is exposed to inflation risk when there is a mismatch between inflation linked assets and liabilities.

The total amount of indexed assets of the Bank amounted to ISK 339,670 million (2006: ISK 325,845 million), and the total amount of indexed liabilities amounted to ISK 192,554 million (2006: 180,241 million), respectively, at year-end.

The Bank's operations are subject to the risk of interest rate fluctuations to the extent that interest-earning assets (including investments) and interest bearing liabilities mature or re-price at different times or in differing amounts. In the case of floating rate assets and liabilities the Bank is also exposed to basis risk, which is the difference in re-pricing characteristics of the various floating rate indices, such as the savings rate and six months LIBOR and different types of interest. Risk management activities are aimed at optimising net interest income, given market interest rate levels consistent with the Bank's business strategies. Interest rate risk is monitored centrally with duration reports and yield curve stress testing for each currency.

Interest rate risk by currency and duration. Interest rate risk is measured by shifting all yield curves by 100 bp simultaneously. The table lists the resulting changes in values broken down by currency and duration buckets for both banking and trading book.

The folllowing table shows the fair value change of interest rate risk by currency and maturity in millions of ISK in the Bank. Risk is measured by assuming a 100bp simultaneous upward shift in all yields curves in the relevant duration band.

2007 Currency:		Within 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Fair value change Total
ISK	Trading	(1)	127	251	454	(579)	252
	Banking	13	(68)	(682)	1,724	(17,957)	(16,970)
DKK	Trading	36	70	116	(1,113)	(3,673)	(4,564)
	Banking	26	91	(12)	479	(1,679)	(1,095)
EUR	Trading	(111)	(112)	298	505	351	931
	Banking	65	139	349	648	(57)	1,144
GBP	Trading	9	(85)	(14)	(15)	5	(101)
	Banking	40	185	(666)	(72)	(84)	(597)
USD	Trading	(29)	(66)	(77)	(285)	125	(332)
	Banking	25	24	4	964	(115)	902
Other	Trading	80	(7)	(193)	(11)	63	(68)
	Banking	(1)	213	(51)	2,022	(2,701)	(518)
2006							
ISK	Trading	(712)	33	535	1,916	(254)	1,518
	Banking	(903)	(109)	(313)	(738)	(15,048)	(17,111)
DKK	Trading	106	1,120	134	103	(2,745)	(1,282)
	Banking	(10)	(37)	(30)	360	(3,673)	(3,390)
EUR	Trading	(40)	135	416	(529)	1,493	1,475
	Banking	55	50	(123)	518	(692)	(192)
GBP	Trading	2	503	(126)	(151)	(2)	226
	Banking	(19)	(87)	(644)	(120)	(853)	(1,723)
USD	Trading	1	(302)	83	828	2	612
	Banking	(8)	(34)	(86)	(72)	(133)	(333)
Other	Trading	(712)	284	(99)	738	(15)	196
	Banking	(11)	(109)	(205)	51	(369)	(643)

Market price risk

105. Market price risk is the risk of loss due to changes in market prices. The Bank's main exposures are through equities and fixed income products, but the management of currency risk is handled separately. Market price risk measured with Value-at-Risk (99%, 10 days) was ISK 5.4 billion (2006: ISK 5.5 billion) at year end 2007. Value-at-Risk is primarily used for sensitivity analysis and is not applied within the Bank's limit framework.

The following table shows the calculated VaR (99% confidence interval 10 day holding period). Results are itemised by type of market risk and market location:

2007	Iceland	Scandi-navia	Other
Equity price risk	1,901	3,083	405
Interest risk	175	500	20
Diversification			(687)
VaR			5,398
2006			
Equity price risk	989	4,374	10
Interest risk	306	697	
Diversification			(900)
VaR			5,476

The following table shows high, low and average values for the calculated VaR (99% confidence interval 10 day holding period).

2007	High	Low	Average
Equity price risk	9,432	2,613	5,030
Interest risk	988	493	696
Overall risk	9,434	2,659	5,064
2006			
Equity price risk	6,422	1,837	3,623
Interest risk	1,522	474	814
Overall risk	6,302	2,218	3,719

Although VaR is an important tool for measuring market risk, the assumptions on which the model is based do give rise to some limitations, including the following:

A 10-day holding period assumes that it is possible to hedge or dispose of positions within that period. This is considered to be a realistic assumption in almost all cases but may not be the case in situations in which there is severe market illiquidity for a prolonged period.

A 99 percent confidence level does not reflect losses that may occur beyond this level. Even within the model used there is a one percent probability that losses could exceed the VaR.

VaR is calculated on an end-of-day basis and does not reflect exposures that may arise on positions during that trading day.

The use of historical data as a basis for determining the possible range of future outcomes may not always cover all possible scenarios, especially those of an exceptional nature.

The VaR measure is dependent upon the Bank's position and the volatility of market prices. The VaR of an unchanged position reduces if the market price volatility declines and vice versa.

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105. cont.

Currency risk

Currency risk is the risk of loss due to adverse movements in foreign exchange rates. The Bank is exposed to some foreign exchange risk, in particular regarding the repatriation of non-ISK results. The Bank hedges part of the equity base against adverse movements in foreign exchange rates. The objective of the hedging is to minimize fluctuations in the capital ratio due to currency fluctuations. Net exposures per currency are monitored centrally in the Bank.

By obtaining the optimal currency hedging ratio the devaluation of the ISK currency can be immunized. If the ISK exchange rate index depreciated by 25% from its year end 2007 level then it would affect the CAD-ratio of the Bank by 0%.

Breakdown of assets and liabilities by currency:
The total amount of assets in foreign currencies in the Banks Financial Statement is ISK 4,626 billion (2006: ISK 3,437 billion), and the total amount of liabilities amounted to ISK 4,456 billion (2006: ISK 3,307 billion), respectively, at year-end. Included in these assets and liabilities are forward contracts and interest rate swaps.

106. Breakdown of assets and liabilities by currency:

Assets	ISK	EUR	DKK	GBP	USD	Other	Total
Cash and balances with central banks	1,034	7,615	3,799	79,854	530	5,127	97,959
Loans to credit institutions	52,326	242,391	81,640	71,692	74,360	66,032	588,441
Loans to customers	440,653	713,534	622,303	742,916	300,194	484,808	3,304,408
Bonds and debt instruments	22,071	131,361	157,031	8,676	43,422	4,789	367,350
Shares and equity instruments	45,139	20,304	15,973	15,329	22,819	41,233	160,797
Derivatives	31,000	61,350	12,935	9,714	12,328	7,529	134,856
Derivatives used for hedging	154	2,559	5,886	1	13,134	769	22,503
Securities used for hedging	86,810	5,749	1,666	47,392	473	17,859	159,949
Investments in associates	2,320	113	902	3,815	2,871	73,810	83,831
Intangible assets	7,619	413	31,199	26,346	143	1,054	66,774
Investment property	1,305	13,598	9,951	3,301	-	-	28,155
Property and equipment	8,343	3,932	398	19,247	56	738	32,714
Tax assets	14	220	-	4,717	-	1,948	6,899
Other assets	22,687	21,855	182,503	33,350	1,900	30,414	292,709
Total assets	721,475	1,224,994	1,126,186	1,066,350	472,230	736,110	5,347,345
Liabilities							
Due to credit institutions and central banks	15,755	160,438	135,497	172	18,962	8,264	339,088
Deposits	266,283	331,026	93,841	492,665	76,633	121,009	1,381,457
Financial liabilities measured at fair value	22,230	108,775	62,541	8,720	9,329	6,350	217,945
Borrowings	185,816	1,373,278	165,555	199,780	423,172	268,359	2,615,960
Subordinated loans	11,428	115,318	-	6,252	130,961	3,330	267,289
Tax liabilities	7,296	3,658	6,083	5,315	-	126	22,478
Other liabilities	25,845	24,924	30,914	25,486	6,041	33,487	146,697
Equity and minority interest	345,607	10,141	427	256	-	-	356,431
Total liabilities	880,260	2,127,558	494,858	738,646	665,098	440,925	5,347,345
Net on-balance sheet position	(158,785)	(902,564)	631,328	327,704	(192,868)	295,185	
Net off-balance sheet position	(205,290)	1,043,441	(518,621)	(255,375)	190,235	(254,390)	
Net position 2007	(364,075)	140,877	112,707	72,329	(2,633)	40,795	
Net position 2006	(172,784)	53,438	59,563	43,737	(1,155)	17,201	

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Liquidity Risk Strategy

107. Liquidity risk is an unavoidable source of risk in the Bank's operations. Liquidity risk is the current or prospective risk that the Bank, though solvent, either does not have sufficient financial resources available to meet its liabilities when they fall due, or can secure them only at excessive cost. Liquidity risk arises from the inability to manage unplanned decreases or changes in funding sources. The funding liquidity risk limit is quantified by calculating liquidity ratios, including the number of days currently covered by expected cash flow.

The Bank calculates the Secured Liquidity from a pool of secured liquid assets (secured assets are: deposits, repo-able bonds, the securitisation pipeline, and unused revolvers with maturity above 360 days and no MAC clauses) against future liabilities. With the Secured Liquidity the Bank has to be able to serve and repay all maturing debts for 360 days without any access to capital markets. Each of the subsidiaries quantifies the Secured Liquidity in the same way as the Secured Liquidity is consolidated on a group level.

At the year-end the number of days covered by the Secured Liquidity was 440 days.

Liquidity of Kaupthing Bank:	Up to 1 month	1-3 months	3-6 months	6-12 months	12-18 months	18-24 months
Secured liquidity	647,000	420,000	247,000	102,000	(95,000)	(471,000)

108. The breakdown by contractual maturity of assets and liabilities.

Assets	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	Total
Cash and balances with central banks	97,959	-	-	-	-	97,959
Loans to credit institutions	222,264	338,345	17,074	7,780	2,978	588,441
Loans to customers	246,355	659,348	436,019	1,105,372	857,314	3,304,408
Bonds and debt instruments	34,364	69,026	15,555	132,645	115,760	367,350
Shares and equity instruments	61,294	99,338	-	-	165	160,797
Derivatives	28,735	36,636	11,598	46,479	11,408	134,856
Derivatives used for hedging	-	2,845	88	10,047	9,523	22,503
Securities used for hedging	159,949	-	-	-	-	159,949
Investments in associates	-	-	-	-	83,831	83,831
Intangible assets	-	-	-	-	66,774	66,774
Investment property	-	-	-	-	28,155	28,155
Property and equipment	-	-	-	-	32,714	32,714
Tax assets	-	-	1,766	5,133	-	6,899
Other assets	239,989	-	52,720	-	-	292,709
Total Assets 31.12.2007	1,090,909	1,205,538	534,820	1,307,456	1,208,622	5,347,345
Total Assets 31.12.2006	693,178	900,669	394,934	1,033,881	1,032,734	4,055,396
Liabilities						
Due to credit institutions and central banks	15,756	268,668	21,429	31,335	1,900	339,088
Deposits	409,995	752,544	151,599	23,237	44,082	1,381,457
Financial liabilities measured at fair value	118,443	17,477	19,843	38,114	24,068	217,945
Borrowings	62,024	527,799	284,895	1,427,770	313,472	2,615,960
Subordinated loans	-	-	337	58,589	208,363	267,289
Tax liabilities	-	-	9,637	12,841	-	22,478
Other liabilities	64,560	-	79,835	2,302	-	146,697
Total Liabilities 31.12.2007	670,778	1,566,488	567,575	1,594,188	591,885	4,990,914
Total Liabilities 31.12.2006	336,083	1,004,574	608,811	1,179,243	591,793	3,720,504
Assets - liabilities 31.12.2007	420,131	(360,950)	(32,755)	(286,732)	616,737	356,431
Assets - liabilities 31.12.2006	357,095	(103,905)	(213,877)	(145,362)	440,941	334,892

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109. Liquidity risk - Residual contractual maturities of financial liabilities:

2007	Carrying amount	Gross nominal inflow / (outflow)	On Demand	0-3 months	3-12 months	1-5 years	More than 5 years
Non-derivative liabilities							
Trading liabilities	-	99,170	99,170	-	-	-	-
Due from Credit Institutions	339,088	339,088	15,756	268,668	21,429	31,335	1,900
Deposits from customers	1,381,457	1,381,458	409,995	752,544	151,600	23,237	44,082
Borrowings	2,615,960	2,619,945	63,207	529,970	285,332	1,427,837	313,599
Subordinated liabilities	267,289	267,289	-	-	-	2,893	264,396
	4,603,794	4,706,950	588,128	1,551,182	458,361	1,485,302	623,977
Derivative liabilities							
Trading: outflow	-	2,281,449	82,055	1,179,469	180,918	580,644	258,363
Trading: inflow	100,272	(2,181,177)	(61,979)	(1,160,687)	(168,304)	(544,583)	(245,624)
Risk management: outflow	-	196,927	-	546	17,408	94,025	84,948
Risk management: inflow	10,815	(186,112)	-	(223)	(17,282)	(91,633)	(76,974)
	111,087	111,087	20,076	19,105	12,740	38,453	20,713
	4,714,881	4,818,037	608,204	1,570,287	471,101	1,523,755	644,690

2006							
Non-derivative liabilities							
Trading liabilities	-	2,306	2,306	-	-	-	-
Due from Credit Institutions	110,456	110,455	10,384	90,269	4,045	3,605	2,152
Deposits from customers	750,658	750,658	226,966	409,317	86,755	21,459	6,161
Borrowings	2,399,939	2,402,923	253,452	554,624	696,104	820,554	78,189
Subordinated liabilities	216,030	216,030	-	-	-	3,437	212,593
	3,477,083	3,482,372	493,108	1,054,210	786,904	849,055	299,095
Derivative liabilities							
Trading: outflow	-	1,404,270	-	425,523	129,608	664,364	184,775
Trading: inflow	47,479	(1,356,791)	-	(412,460)	(122,494)	(641,713)	(180,124)
Risk management: outflow	-	190,449	-	-	11,894	65,867	112,688
Risk management: inflow	8,767	(181,682)	-	(2)	(10,739)	(61,783)	(109,158)
	56,246	56,246	0	13,061	8,269	26,735	8,181
	3,533,329	3,538,618	493,108	1,067,271	795,173	875,790	307,276

110. Capital management and allocation

Capital management

The Bank's capital policy is to maintain a strong capital base to support business development and to meet regulatory capital requirements, even in times of stress. Long term capital planning at Kaupthing Bank currently is based on a benchmark minimum tier 1 capital ratio of 8% and a minimum equity ratio (CAD) of 11%. The Bank recognises that a strong capital base must be balanced against the greater leverage required to achieve its stated goal of achieving a long-term return on equity greater than 15% for its shareholders. Solid growth must be sustained without compromising profitability.

The Bank's capital is divided into two tiers:

Tier 1 capital, which includes ordinary share capital, share premium, perpetual bonds (which are classified as innovative tier 1 securities), retained earnings, translation reserve and minority interest after adjusting for items reflected in shareholders equity which are treated differently for capital adequacy purposes. The book values of goodwill and intangible assets are deducted in arriving at tier 1 capital.

Tier 2 capital, which includes qualifying subordinated loan capital and unrealised gains arising on the fair valuation of equity instruments held as available-for-sale.

Various limits are applied to elements of the capital base. The amount of innovative tier 1 securities cannot exceed 15 per cent of overall tier 1 capital, qualifying tier 2 capital cannot exceed tier 1 capital, and qualifying term subordinated loan capital may not exceed 50 per cent of tier 1 capital. From the total of tier 1 and tier 2 capital are deducted the carrying amounts of unconsolidated investments, investments in the capital of banks, and certain regulatory items.

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110. cont.

Kaupthing's Board of Directors periodically reviews both the level and the optimal composition of capital. Capital can be raised and held either at the group level or at the subsidiary level.

There have been no material changes in the Bank's management of capital during the year 2007.

Capital adequacy and the Basel I and II capital adequacy standards

The Icelandic Financial Supervisory Authority (FME) supervises Kaupthing on a consolidated basis and, as such, receives information on the capital adequacy of, and sets capital requirements for, the Bank as a whole. Individual banking subsidiaries are directly regulated by their local banking supervisors, who set and monitor their capital adequacy requirements relative to risk-weighted assets. In most jurisdictions, non-banking financial subsidiaries are also subject to the supervision and capital requirements of local regulatory authorities.

Banking operations are categorised as either trading book or banking book and the calculation of risk-weighted assets is conducted differently for the assets in different books. Banking book risk-weighted assets are measured by means of a hierarchy of risk weightings classified according to the nature of each asset and counterparty, taking into account any eligible collateral or guarantees. Banking book off-balance-sheet items giving rise to credit, foreign exchange or interest rate risk are assigned risk-weights appropriate to the category of the counterparty, again accounting for eligible collateral or guarantees. Trading book risk-weighted assets are determined by taking into account market related risks such as foreign exchange, interest rate and equity position risks, and counterparty risk.

Bank supervision is currently transitioning from the Basel I capital adequacy standard to the Basel II supervisory framework. Basel II introduces a three pillar approach to banking supervision. Pillar 1 addresses minimum capital requirements through the introduction of new calculation rules for risk weighted assets. In Pillar 2 the bank's internal capital adequacy assessment process (ICAAP) is subject to the FME's supervisory review process (SREP). Pillar 3 introduces requirements for transparent reporting of the bank's risk profile and risk-management methods and processes.

The Bank and its individually regulated operations have complied with all externally imposed capital requirements throughout the year 2007. During 2007 Kaupthing continued to work under Basel I while preparing a migration to Basel II. Kaupthing has applied to FME for permission to use the Basel II Foundation Internal Ratings Based method to calculate the capital requirements for credit risk as of January 1, 2008. FME's ruling is pending. Standardized Basel II methods will be adopted for market risk and operational risk.

An initial ICAAP document has been submitted to FME for review. It outlines Kaupthing's internal capital requirements, which are based on Pillar 1 regulatory capital with diversification discounts and add-ons for stress-scenarios, credit concentration risk, interest rate risk in the banking book and other risks not adequately addressed by Pillar 1.

In the absence of FME's rulings it is premature to draw conclusions about the effect of Basel II on Kaupthing's capital requirements or whether the capital charge on Kaupthing will be reduced when the Basel II rules have gradually taken full effect which is expected to occur at the end of 2010.

Equity at the end of the year 2007 amounts to ISK 356,431 million. The equity ratio, calculated in accordance to Article 84 of the Act on Financial Undertakings, was 11.8%. According to the law the ratio may not be lower than 8.0%.

The ratio is calculated as follows:

	2007		2006	
	Book value	Weighted value	Book value	Weighted value
Risk base:				
Assets recorded in the Financial Statements	5,347,345	3,917,079	4,055,396	2,875,539
Assets deducted from equity		(135,600)		(66,922)
Guarantees and other items not included in the Balance Sheet		331,953		259,023
		4,113,432		3,067,640
Equity:				
Tier I capital:				
Equity		356,431		334,892
Intangible assets		(61,757)		(65,276)
Assets deducted from equity		-		-
Subordinated loans		100,830		51,817
Tier II capital:				
Subordinated loans		164,483		160,717
Investment in credit institutions		(73,843)		(21,324)
		486,144		460,826
Equity ratio		11.8%		15.0%
Thereof Tier I ratio		9.6%		10.5%

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110. cont.

Capital allocation

The allocation of capital between specific operations and activities is, to a large extent, driven by the optimisation of the return achieved on the capital allocated. The amount of capital allocated to each operation or activity is based primarily upon the regulatory capital, but in some cases the regulatory requirements do not reflect fully the varying degree of risk associated with different activities. In such cases the internal capital requirements may be inflated to reflect different risk profiles. The process of allocating capital to specific operations and activities is undertaken independently of those responsible for the operation, by Group Risk and Group Credit, and is subject to review by the Group Credit Committee or ALCO as appropriate.

Although maximisation of the return on risk-adjusted capital is the principal basis used in determining how capital is allocated within the Bank to particular operations or activities, it is not the sole basis used for decision making. Account also is taken of synergies with other operations and activities, the availability of management and other resources, and the fit of the activity with Bank´s longer term strategic objectives. The Bank´s policies in respect of capital management and allocation are reviewed regularly by the Board of Directors.

Operational Risk Strategy

111. Operational Risk is inherent in every activity undertaken within the Bank, in outsourced activities and in all interaction with external parties. The Bank aims to reduce the frequency and impact of operational risk events in a cost-effective manner. The Bank can reduce it's exposure to operational risk with selection of internal control and quality management, well educated and qualified staff. The Bank can choose to transfer operational risk through outsourcing the activity or to transfer the financial consequences through insurance programs.

The Bank keeps firm track of the operational risk that the Bank is exposed to. Measurements are made by the means of Control and Risk Self Assessment, registration of loss events, near misses and quality deficiencies and by monitoring potential risk indicators and other early-warning signals. Operational risk is reduced through staff training, process re-design and enhancement of the control environment.

Risk Capital for Operational Risk is measured as a fixed percentage of gross income for each business unit, measured according to the Standardised approach outlined in the Capital Requirements Directive (CRD). The fixed percentage serves as a proxy for the likely scale of operational risk exposure within the business line. The fixed percentage is as follows:

Business lines:	
Corporate finance	18.0%
Trading and sales	18.0%
Payment and Settlement	18.0%
Commercial banking	15.0%
Agency services	15.0%
Asset Management	12.0%
Retail brokerage	12.0%

The Bank's business units are mapped onto above business lines.

Fair Value of financial instruments

112. The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties, i.e. not during a forced sale or liquidation. The existence of published price quotations in an active market is the best evidence of fair value and when they exist they are used by the Bank to measure financial assets and financial liabilities. If quoted prices for a financial instrument fail to represent actual and regularly occurring transactions in active market transactions or if quoted prices are not available at all, fair value is established by using an appropriate valuation technique.

The following table presents the fair value of financial instruments, including those not reflected in the Financial Statements at fair value. It is accompanied by a discussion of the methods used to determine fair value for financial instruments.

2007 Financial assets	Valuation technique	Carrying value 2007	Fair value 2007	Unrealised gain (loss) 2007
Cash and balances with central banks	c	97,959	97,959	-
Loans to credit institutions	c	588,441	587,263	(1,178)
Loans to customers	c	3,304,408	3,284,405	(20,003)
Bonds and debt instruments	a,b	367,350	367,350	-
Shares and instruments with variable income	a,b	160,797	160,797	-
Derivatives	c	134,856	134,856	-
Derivatives used for hedging	c	22,503	22,503	-
Securities used for hedging	a	159,949	159,949	-
Financial liabilities				
Due to credit institutions and central banks	c	339,088	339,088	-
Deposits	c	1,381,457	1,380,523	934
Financial liabilities measured at fair value	a,b	217,945	217,945	-
Borrowings	c	2,615,960	2,599,269	16,691
Subordinated loans	c	267,289	265,368	1,921
Net unrealised loss not recognised in the Income Statement				(1,635)

2006 Financial assets	Valuation technique	Carrying value 2006	Fair value 2006	Unrealised gain (loss) 2006
Cash and balances with central banks	c	106,961	106,961	-
Loans to credit institutions	c	485,334	489,318	3,984
Loans to customers	c	2,538,609	2,539,605	996
Bonds and debt instruments	a,b	318,264	318,264	-
Shares and instruments with variable income	a,b	159,020	159,020	-
Derivatives	c	65,454	65,454	-
Derivatives used for hedging	c	6,453	6,453	-
Securities used for hedging	a	115,938	115,938	-
Financial liabilities				
Due to credit institutions and central banks	c	110,456	110,456	-
Deposits	c	750,658	750,292	366
Financial liabilities measured at fair value	a,b	71,264	71,264	-
Borrowings	c	2,399,939	2,397,319	2,620
Subordinated loans	c	216,030	217,850	(1,820)
Net unrealised gain not recognised in the Income Statement				6,146

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112. cont.

Methods for establishing fair value

a) *Fair value established from quoted market prices*

The best evidence of the fair value of a financial instrument at initial recognition is the transaction price, unless the fair value can be evidenced by comparison with other observable current market transactions, or is based on a valuation technique whose variables include only data from observable markets.

In some cases, the carrying value of the financial instrument is in note 69 used as an approximation for the fair value of the instrument. This is straight-forward for cash and cash equivalents but is also used for short-term investments and borrowings to highly rated counterparties, such as credit institutions, on contracts that carry interests close to or equal to market rates and expose the Bank to little or no credit risk.

For listed and liquid stocks and bonds, certain financial derivatives and other market traded securities, such as commodities, the fair value is derived directly from the market prices. These instruments are disclosed in following balance sheet items; Trading assets and Trading liabilities.

b) *Fair value established using valuation techniques with observable market information*

For financial instruments, for which the market is not active, the Bank applies specific working procedures and valuation techniques to attain a fair value using as much market information as available. Valuation techniques include using recent arm's length market transactions between knowledgeable, willing parties, if available, reference to the current fair value of another instrument that is substantially the same, discounted cash flow analysis, option pricing models or other commonly accepted valuations techniques used by market participants to price the instrument.

For financial instruments for which quoted prices on active markets are not available, the fair values are derived using various valuation techniques. This applies in particular to OTC-derivatives such as options, swaps, futures and unlisted equities but also some other assets and liabilities.

In most cases the valuation are based on theoretical financial models, such as the Black-Scholes models or variations thereof. These techniques also include forward pricing and swap models using present value calculations.

The fair value for deposits with stated maturities was calculated by discounting estimated cash flows using current market rates for similar maturities. For deposits that can be withdrawn immediately, the fair value is the amount payable on demand, which is equal to the carrying amount in the Balance Sheet.

c) *Fair value established using valuation techniques with significant unobservable market information*

In many cases there is little or no market data to rely on for fair value calculations. The most common valuation technique is present value calculations. Such calculations involve the estimation of future cash flow and the assessment of appropriate discount rate. The discount rate should both reflect current market rates and the uncertainty in the future cash flow. In such cases internal models and methods are used to calculate the fair value. The models may be statistical in nature, based on internal or external history of financial instruments with similar characteristics and/or based on internal knowledge and experience. For example, the credit margin on most loans to customers - which is added to the current and suitable interest rate to arrive at an appropriate discount rate - is estimated using credit rating and loss parameters in case of default that have been derived from internal models.

Equity instruments that do not have a quoted market price are evaluated using methods and guidelines from pertinent international organisations. In most cases intrinsic value is the basis for the assessment but other factors, such as cash flow analysis, can also modify the results.

Although the Bank follows market standards and relies on well accepted methods there is still wide room for choice, both in the models themselves and the assumptions that must be supplied and cannot be derived from market data. Consequently, different assumptions and choices could lead to different estimates.

113. Fair value of financial instruments.

For financial instruments whose fair value is estimated using valuation techniques with non-market observable inputs, the net unrealised amount recorded in the Income Statement in the year due to changes in the inputs amounts to ISK 369 million (2006: ISK 291 million)

The table below shows the movement in the aggregated profit not recognised when financial instruments where first recorded ('Day 1 profit'), because of the use of valuation techniques for which not all the inputs are observable in the market.

	2007	2006
Balance at 1 January	1,130	638
Deferral of profit on new transactions	676	724
Recognised in the Income Statement during the period:		
Subsequent to observability	(82)	(23)
Derecognition of the instruments	(369)	(291)
Exchange differences	30	82
Balance at 31 December	1,385	1,130

Other information

Assets under management and under custody

114. Assets under management and assets under custody are specified as follows:

Assets under management	1,557,395	1,403,376
Assets under custody	2,276,875	1,952,813

The Bank provides asset custody, asset management, investment management and advisory services to its clients. These services require the Bank to make decisions on the treatment, acquisition or disposal of financial instruments. Assets in the Bank´s custody are not reported in its accounts.

Related parties

115. The Bank has a related party relationship with its subsidiaries, associates, the Board of Directors of the Parent Company, the Managing Directors of the Bank, the Managing Directors of the largest subsidiaries, close family members of individuals referred to above and entities with significant influence as the largest shareholders of the Bank which are Exista BV. and related companies (23.26%) and Egla Invest BV. (9.9%). Information regarding related parties are as follows:

Significant related companies:

Loans:	2007	2006
Balance at 1 January	109,556	36,888
Additions	54,810	91,274
Reductions	(57,641)	(18,606)
Balance at 31 December	106,725	109,556

The Bank has issued a contingent guarantee to a related party regarding exposure to a market price of equity shares with a maximum potential exposure of EUR 300 million. At the end of the period the condition for the guarantee was not met. The related party has also issued a guarantee to Kaupthing Bank for the same maximum potential amount.

The Bank has granted loans to the board members and its key management. The outstanding balance of loans to the board members, management and close family members amounted to ISK 34,408 million at the end of the year 2007 and ISK 17,716 million at 31 December 2006. The terms and conditions are similar for the board members and key management as loans granted to other customers of the Bank. The aforementioned amounts do not include loans related to the business activities of the board members and key management.

No unusual transactions took place with related parties in the year of 2007.

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

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Stock options

116. There is still one year left of the option scheme from 2004 with the Executive Chairman and the CEO. According to the scheme they are each entitled to 812,000 shares in 2008. In March 2007 the Annual General Meeting approved to extend the scheme for three years. The amount is to be the same as in the current option scheme or 812.000 shares for each every year in 2009, 2010 and 2011. Stock option holders are entitled to exercise one third of their total stock option in March every year for three years. The option exercise price is ISK 1.007.

The Board of Directors of the Bank has also granted 28 employees stock options to buy 1,1 million shares over a three-year period, during which they can exercise one third of the stock option each year. The period in which options can be exercised is from 20 January to 20 February each year, with the first exercise period in 2010. The option has an exercise price of ISK 1.110 per share during the first exercise period, ISK 1.166 per share during the 2011 exercise period and ISK 1.224 per share during the 2012 exercise period. The exercise of the options can be postponed each time until last exercise date but the strike price will increase to the price indicated by the relevant exercise date.

The terms and conditions of the grants are as follows, whereby all options are settled by physical delivery of shares.

Grant date / employees entitled:	Number of shares in thousands	Vesting conditions:	Contractual life of options	Exercise price
March 2004	1,624	Four years of service. The stock option is exercisable 2007-2008	4 years	303
December 2002	277	Six years of service. One third of total stock option is exercisable each year 2007-2008	6 years	51
November 2005	1,714	Three years of service. One third of total stock option is exercisable each year 2007-2009	3 years	600
November 2005	5,782	Three years of service. One third of total stock option is exercisable each year 2007-2009	3 years	600 / 630 / 660
December 2006	415	Three years of service. One third of total stock option is exercisable each year 2008-2010	3 years	840
December 2006	20,955	Five years of service. One third of total stock option is exercisable each year 2010-2012	5 years	830 / 872 / 916
March 2007	4,872	Four years of service. The stock option is exercisable 2009-2011	4 years	1,007
July 2007	1,110	Five years of service. One third of total stock option is exercisable each year 2010-2012	5 years	1.110 / 1.166 / 1.224
Total share options	36,749			

116. cont.

The number and weighted average exercise prices of share options is as follows:

	2007		2006	
	Weighted average exercise price	Number of options	Weighted average exercise price	Number of options
Outstanding at the beginning of the year	735	38,034	494	20,811
Forfeited during the year	744	(1,779)	521	(1,447)
Exercised during the year	437	(5,488)	278	(3,641)
Granted during the year	1,037	5,982	871	22,311
Outstanding at the end of the year	861	36,749	735	38,034

The options outstanding at 31 December 2007 have an exercise price in the range of 51.22 to 1,224 and a weighted average contractual life of 4.4 years. The weighted average share price at the date of exercise was ISK 992.

The fair value of services received in return for share options granted is measured by reference to the fair value of share options granted. The estimate of the fair value of the services received is measured based on the Black-Scholes model. The contractual life of the option is used as an input into this model. Expectations of early exercise are not incorporated into the Black-Scholes model.

The fair value of options granted to the Executive Chairman and the CEO determined using the Black-Scholes valuations model was ISK 1.433 millions which will be amortised over contractual life of options. The significant inputs into the model were share prices of 1.007, expected volatility of 25%, option life disclosed above, annual risk free interest rate of 8,8%, and expected dividends yield of 2,0%. The expected volatility is based on the historic volatility over the last 36 months before the grant date.

The fair value of options granted during the year determined using the Black-Scholes valuations model was ISK 223 millions which will be amortised over contractual life of options. The significant inputs into the model were share prices of 1.110, 1.166 and 1.224, expected volatility of 30%, option life disclosed above, annual risk free interest rate of 8,5%, and expected dividends yield of 2,0%. The expected volatility is based on the historic volatility over the last 36 months before the grant date.

The fair value of options granted in 2006 determined using the Black-Scholes valuations model was ISK 3,449 millions which will be amortised over contractual life of options. The significant inputs into the model were share prices of 840 (830, 872 and 916 for key management), expected volatility of 22.2%, option life disclosed above, annual risk free interest rate of 8.9%, and expected dividends yield of 2.0%. The expected volatility is based on the historic volatility over the last 36 months before the grant date.

The stock option plan led to personnel expenses of ISK1.505 millions in fiscal year 2007.

The Board of Directors of FIH Erhvervsbank has granted the employees of FIH a stock option scheme which can be exercised 2008, 2009 and 2010. The options can only be exercised for 30 days after the Financial Statements have been published. During 2007 ISK 465 million (2006: ISK 347 million) has been entered among Salaries and related expenses and ISK 713 million (2006: ISK 360 million) in the Balance Sheet as liability.

Events after the Balance Sheet date

117. In August 2007 the Bank entered into an agreement to purchase the entire share capital of NIBC N.V. for EUR 2,985 million. On 29 January 2008 the Bank came to an agreement with the Sellers that both parties relinquish from their prior agreement.

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Subsidiaries and branches

118. Shares in main subsidiaries and main branches are specified as follows:

Company:	Country	Currency	Business Group[1]	Share Capital in millions	Equity interest accum. %
Arion Custody Service hf.	Iceland	ISK	OD	115	100.0
FIH Erhversbank A/S	Denmark	DKK	IB, CM, Tr, Ba, AM & PB	5,917	99.9
Kaupthing Bank Luxembourg S.A.	Luxembourg	EUR	IB, CM, Tr, Ba, AM & PB	16,611	100.0
Kaupthing Holding (Isle of Man) Ltd	UK	GBP	Tr, Ba, AM & PB	1,043	100.0
Kaupthing Holding UK Ltd. (KTSF)	UK	GBP	IB, CM, Tr, Ba, AM & PB	35,890	100.0
Kaupthing New York Inc.	USA	USD	CM	524	100.0
Kaupthing Norge AS	Norway	NOK	IB, CM, Tr, AM & PB	1,433	100.0
Kaupthing Sverige AB	Sweden	SEK	IB, CM, Tr, Ba, AM & PB	2,807	100.0
Kaupthing Líf hf.	Iceland	ISK	Ba	17	100.0
Kirna ehf.	Iceland	ISK	IB, Tr	36,370	100.0
New Bond Street Asset Management LLP	UK	GBP	Tr	43	100.0
Norvestia Oyj	Finland	EUR	CM	4,455	32.7
Rekstrarfélag Kaupthings banka hf.	Iceland	ISK	AM & PB	44	100.0
Sparisjódur Kaupthings hf.	Iceland	ISK	Ba	100	100.0
Branch:					
Kaupthing Bank hf. NUF	Norway	NOK	Tr		
Kaupthing Bank hf. Suomen sivuliike	Finland	EUR	IB, CM, Tr, Ba, AM & PB		
Kaupthing Bank hf. DIFC Branch	Dubai	USD	IB		
Kaupthing Bank hf. QFC Branch	Qatar	USD	IB		
Kaupthing Bank hf. Island, Filial	Sweden	SEK	Tr		

The Bank wields 56.0% of the votes in Norvestia Oyj and the company is thus considered to be a subsidiary of the Bank.

1. IB: Investment Banking, CM: Capital Markets, Tr: Treasury, Ba: Banking, AM & PB: Asset Management and Private Banking, OD: Other Divisions.