Credit Analysis

Moody's Global
Banking

October 2007

Glitnir banki hf

Reykjavik, Iceland

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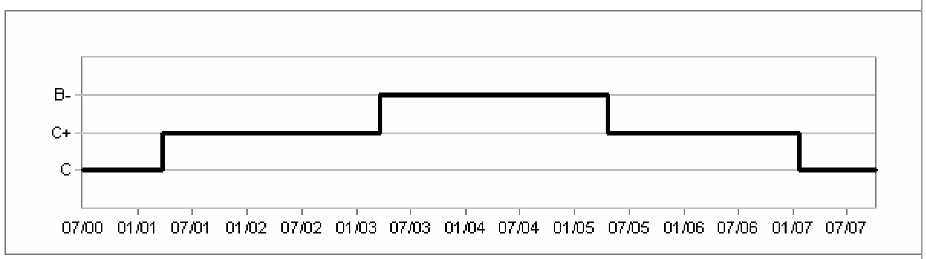
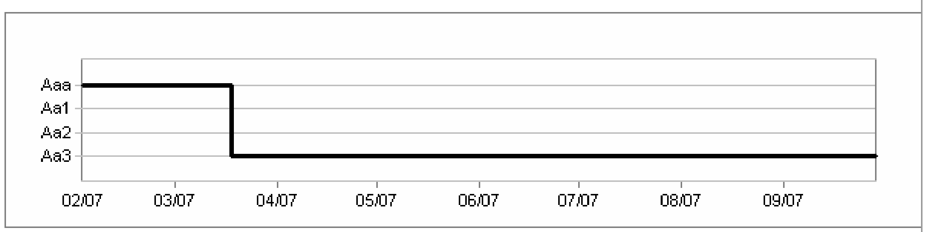
Summary Rating Rationale

Rating history – Bank Financial Strength



Rating history – Long-term Deposit Rating



Moody's assigns a bank financial strength rating (BFSR) of C to Glitnir banki hf (Glitnir), which translates into a Baseline Credit Assessment (BCA) of A3. (Glitnir changed its name from Íslandsbanki hf in March 2006.) The rating outlook is stable and reflects Glitnir banki's strong domestic franchise as well as its broad diversification by industry sector and country – approximately half of the bank's income is earned abroad with most of it coming from the bank's various business operations in Norway.

The rating also incorporates the bank's high levels of profitability and efficiency. However, it also takes into account the potential for variability in the bank's earnings due to the relatively high proportion of income that is derived from sources such as corporate and investment banking activities.

This Credit Analysis provides an in-depth discussion of credit rating(s) for Glitnir banki hf and should be read in conjunction with Moody's most recent Credit Opinion and rating information available on Moody's website. Click here to link.

Moody's Investors Service

One of the main challenges that Glitnir faces is the execution risk related to integrating and controlling its significant expansion since 2004. This risk is compounded by the recent changes in the structure of the shareholders, which gave rise to dramatic changes in the board of directors (five of the seven directors are new) as well as a complete change in the top management positions: the CEO, CFO and COO departed in the first half of 2007. Moreover, Glitnir banki has over recent years been subject to shifts in shareholders. Over 30% of Glitnir's shares are presently controlled by the FL Group.

Another main challenge the bank faces is to maintain a protective liquidity profile, given the bank's reliance on market funding. The bank's good liquidity profile helped it to come through investors' nervousness towards Icelandic risk in early 2006 and once again in 2007, with the recent market turbulence that began with problems in US sub-prime lending.

An upgrade of Glitnir banki's BFSR would depend on the steps taken by the bank to (i) increase the stability of its earnings while remaining a very profitable institution; (ii) ensure that potential corporate governance issues relating to shareholder structure are rendered more transparent; (iii) maintain the positive effects of effectively integrating its acquisitions; (iv) address the borrower and industry concentration risks in the loan portfolio; and (iv) maintain a reduced related-party exposure and make further improvements to the bank's liquidity and funding profile.

A downgrade of the bank's BFSR might occur if (i) the bank were to make meaningful acquisitions that placed pressure on its management, systems or controls; (ii) there was a notable increase in the bank's risk appetite; (iii) the independence of the board of directors becomes constrained; and/or (iv) the bank experienced difficulties with its liquidity and/or funding.

Group Structure

Glitnir banki (formerly Islandsbanki hf) is one of the three large universal banks in Iceland and had total assets of ISK2,335 billion (€27.77 billion) as at 30 June 2007. The bank is organised into six functional divisions, over which there is a matrix of reporting responsibilities set on a country-by-country basis. Glitnir banki operates in ten countries. Its largest presence is in Iceland with 61% of total assets and 45% of total lending, followed by Norway with 28% of total assets and 39% of total lending as at 31 December 2006. In addition, Glitnir provides services and lending on a global basis in three niche specialisations: seafood, renewable energy and offshore service vessels.

Key Issues

The key issues for Glitnir banki are

- **Acquisition-driven growth.** The bank is experiencing heightened execution risk related to integrating and controlling its multiple acquisitions and significant expansion since 2004.
- **New management.** The bank is under new management and is controlled by shareholders that first began investing in the bank in 2005 and have no previous experience of bank ownership.
- **Funding profile.** Due to the bank's reliance on market funding, it is imperative for the bank to maintain a solid liquidity profile and ensure that the maturity profile of its funding remains evenly spread. That said, we acknowledge the bank's continued focus on retail funding.
- **Earnings predictability.** Due to the high proportion of earnings produced by corporate and investment banking, the predictability of the bank's earnings is lower than most of its similarly-sized European peers.
- **Ownership.** Over recent years the bank has been subject to shifts in shareholders and continues to be vulnerable as over 30% of Glitnir's shares are presently controlled by the FL Group. One of the risks concerning the concentrated ownership relates to potential changes in the strategy and management of the bank if the FL Group was to sell its stake.

Analysis of Rating Considerations

Discussion of Qualitative Rating Drivers

Franchise Value

- **Market Share and Sustainability**

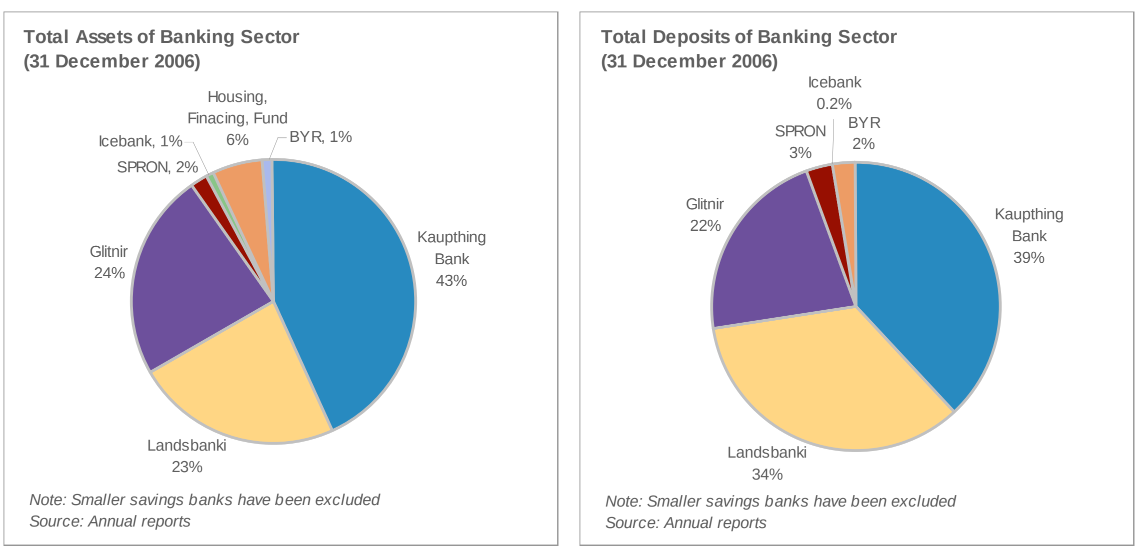
Significant domestic market share and strong international growth

Glitnir banki hf changed its name from Íslandsbanki hf in March 2006. Glitnir is one of the three leading commercial banks in Iceland. It is a universal bank, providing its customers with a full range of products including retail and corporate banking services; fund management; bond, money market and equity trading; foreign exchange services; asset management and leasing products.

As of 30 June 2007, 54% of Glitnir banki's pre-tax profits were earned in Iceland - and its market share there is strong and sustainable. Glitnir follows a diversified channel approach in its domestic market to maximise the availability for clients as well as long-term cost efficiency. The bank operates through a network of 29 branches in Iceland, of which 19 are based in the Greater Reykjavik area. The bank also provides Internet services for its clients together with telephone banking products.

Recognising that growth opportunities provided by the domestic market are limited – Iceland had a population of 311,000 and GDP of US$18 billion at the end of 2006 - Glitnir banki has targeted growth through international expansion, largely in Norway. At 31 December 2006, 28% of the bank's assets and 39% of its loans were located in Norway. In Iceland, Glitnir accounts for approximately 24% of the total banking system assets (see Exhibit 1).

Exhibit 1: Distribution of total assets and deposits within the Icelandic banking sector



The bank first began building operations in Norway in August 2004 with the acquisition of KredittBanken, now Glitnir Bank ASA, a small regional bank based in the northwest coast of the country with a niche focus on seafood, offshore supply vessels and financing for construction projects at Norwegian shipyards. In 2005, a local factoring company, FactoNor AS (now Glitnir Factoring AS), was acquired and is now a subsidiary of Glitnir Bank ASA. This acquisition was made with the aim of broadening the base of operations in northwest Norway and creating a larger organisation less dependent on key people.
The company specialises in factoring for small- and medium-sized companies. In 2005, Glitnir banki also acquired BNbank, located in Oslo and a provider of residential and commercial real estate mortgage loans.

In 2006, the bank made three further acquisitions in Norway and one in Sweden: (i) Norske Securities, now Glitnir Securities, a small brokerage house serving private investors; (ii) Glitnir Property Group (former Union Gruppen), a commercial real estate brokerage firm with a niche investment bank and the management of real estate funds and syndications; (iii) BNbank acquired 45% of Norsk Privatøkonomi ASA, an independent financial advisory company with 12 branches in key areas of Norway; and (iv) Fischer Partners AB, a Swedish institutional brokerage firm based in Sweden, acquired to strengthen the bank's platform in the Nordix stock exchange, OMX.

In terms of market share and sustainability in Norway, BNbank has a strong brand name but this is limited to its niche in residential and commercial mortgage lending. Glitnir Bank ASA is a regional business with only a limited share of the national banking market. With respect to its other businesses in Norway, Glitnir is not yet a widely recognised brand and is a relatively new entrant with very small market shares in each product line.

Glitnir banki aims to leverage its expertise globally in three niche market segments: the food sector, primarily the seafood sector outside Iceland; sustainable energy, focusing principally on geo-thermal energy; and off-shore supply vessels. As part of this strategy, Glitnir Banki opened a new branch in Halifax, Canada in April 2006, a new representative office in Shanghai, China in November 2006; and an office in New York in September 2007.

In February 2007, Glitnir banki completed the acquisition of FIM, the fourth-largest asset management company in Finland, as measured by assets under management (AuM). With FIM, it acquired €3 billion in additional AuM, bringing the total for the group to ISK913 billion (€10.9 billion) at end-June 2007. FIM has ten operating offices located in the major cities of Finland and one in Moscow. FIM benefits from a strong brand name and has a national reputation for quality - eight of its funds have a 5-star Morningstar rating. Moreover, the acquisition strengthened Glitnir's market position in brokerage business. Reporting a combined market share of 6.2% in the first six months of 2007 in terms of market turnover, FIM/Glitnir was the third-largest equity broker in the Nordic capital markets. It is also worth mentioning that FIM is authorised to operate as a credit and deposit-taking bank. Now being part of the Glitnir Group, FIM operates under the name of Glitnir Bank.

In July 2007, Glitnir Property Holding AS, a subsidiary of Glitnir Bank ASA, completed the acquisition of 91% of the shares in Leimdörfer Holding AB, a Swedish commercial real estate adviser operating mainly in the Swedish and Finnish property market. The acquisition will contribute to Glitnir Property Holding's position in the Nordic commercial real estate market, its subsidiaries having offices in Oslo, Stockholm and Helsinki.

Glitnir banki has branches in London, Copenhagen, Luxembourg.

Geographic Diversification

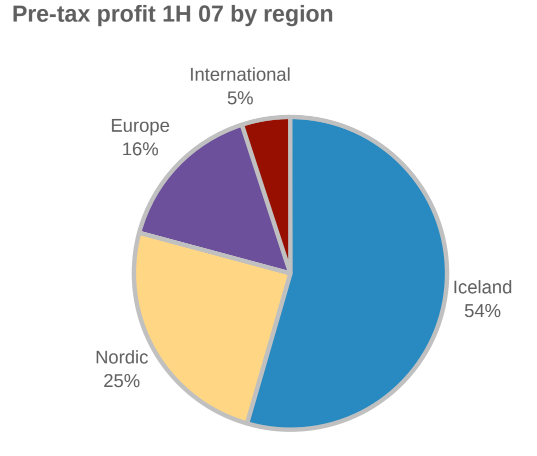
Strong geographic diversification

Revenues from international activities provided Glitnir with 46% of its pre-tax profit from outside Iceland in the first half of 2007 (see Exhibit 2). Geographic diversification into Norway and several other countries helps to dampen possible volatility related to the Icelandic economy. In terms of diversification by assets, 61% of total assets were booked in Iceland, 28% in Norway and 11% elsewhere as of year-end 2006. As at 1H 2007, the loan portfolio was 51% in Iceland and 35% in Norway, with the remaining 14% broadly spread.

While we view Glitnir's broad geographic diversification positively, we remain cautious with respect to a continuation of the bank's hitherto aggressive acquisition strategy until the integration process - in terms of organisation and systems - has been completed for its many acquisitions since 2005.

Glitnir banki hf

Exhibit 2: Geographic revenue diversification



Source: Glitnir

- **Earnings Stability**

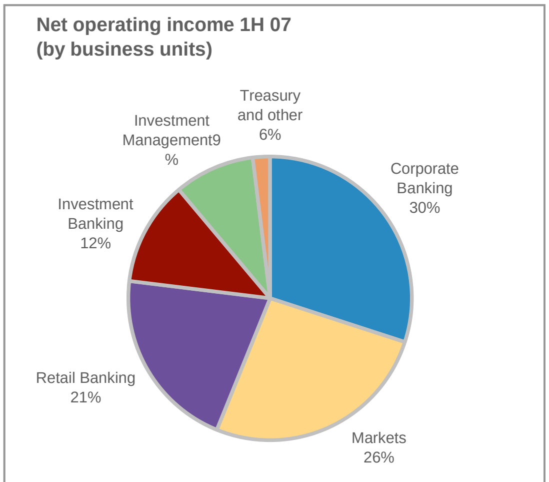
Earnings are largely from business lines that are more variable

Moody's estimates that in average 20%-40% of Glitnir's earnings come from business lines that produce stable earnings, i.e. retail and small business banking, asset management and fees arising from the provision of fiduciary transactions. In H1 2007, retail banking and asset management accounted for 30% of net operating income (see Exhibit 3).

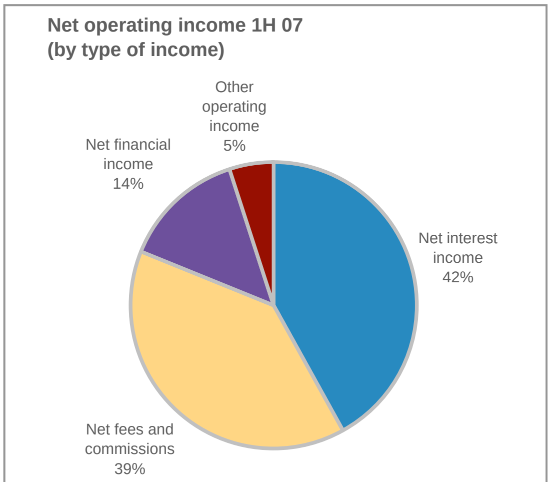
Typically, more than half of Glitnir's income is derived from investment banking and capital markets, corporate banking and proprietary investments. While these business lines provide the bank with its higher level of profitability, the income from these sources is viewed as being less predictable and leading to potentially more volatile results.

Much of Glitnir's income is sensitive to market factors often outside the bank's control. Were the percentage of stable earnings to rise above 40% for a sustained period, Moody's would view Glitnir's earnings stability more favourably.

Exhibit 3: Earnings diversification



Source: Glitnir



Source: Glitnir

- **Earnings Diversification**

Not a mono-line business

No Glitnir business accounts for 80% or more of net income. As such, Glitnir banki is not a mono-line entity. Overall, Glitnir exhibits a well-diversified earnings base (see exhibit 3). However, as noted above, the major part of earnings stems from less predictable and potentially more volatile sources. In H1 2007, this type of earnings generated 68% of reported net operating income.

Risk Positioning

Reduced related party exposure

- **Corporate Governance**

Corporate governance has not yet reached best practice

Glitnir Banki's shares are publicly quoted and listed on the Nordic OMX Iceland stock exchange. As at 3 September 2007, the bank's shareholders numbered just over 11,000. The bank's ownership is relatively concentrated, with the ten largest owners holding nearly 70% of the stock.

Glitnir's major shareholder is FL Group, which owns 30.23% of the bank. Although FL Group has less than a third of the shares of the bank, it has significant influence within the Board of Directors; this may be to the disadvantage of other minority shareholders. Furthermore, five of the seven directors were appointed in May 2007 and therefore lack experience in governing Glitnir. It would also appear that none of them are independent of shareholders' interests. In Moody's view, a truly independent board of directors is best practice for the corporate governance of a bank; this standard is not yet in place at Glitnir.

Some of the shareholders are closely connected to each other. In May this year, the Icelandic financial supervisory authority (FME) investigated the matter. FME's view was that of the Glitnir's shareholders FL Group, Jotunn Holding, Ellidahamar/Ellidatindur and Sund/Sund Holding were closely connected. Following the FME's decision, FL Group and Jotunn Holding signed a shareholder agreement whereby the companies are free to reduce or increase their shareholding in Glitnir, but the combined shareholding cannot exceed 39.9%. According to the agreement, the companies will cooperate on the election of board members at shareholders' meetings. Otherwise, the companies are uncommitted to each other on the exercise of their shareholding in Glitnir. As of the time of writing, the FME is processing the application. Also, Ellidatindur and Sund are no longer shareholders in Glitnir. As of September 3, 2007 FL Group and Jotunn Holding had 30.23% and 6.85% shareholdings in Glitnir, respectively (i.e. a total of 37.08%). Jotunn Holding is owned by West Coast Capital (60%), Baugur Group hf. (30%) and Fons eignarhaldsfelag ehf. (10%).

With regard to related party lending, we note positively that loans to related parties fell to below 25% of Tier 1 capital at the end of June 2007. However, it is worth pointing out that, only six months earlier, that figure had been over 60%. Therefore we will continue to monitor the level of related party lending to see whether it stabilises at the lower level.

- **Controls & Risk Management**

Risk management and controls are challenged by extensive acquisitions

In April 2007, the former CEO announced his resignation with the Q1 results; the CFO and COO resigned within two months thereafter. Mitigating to some extent the major change in management structure was the continuing presence of the former CEO as advisor for a further six months and the fact that managers from within the bank have been promoted to replace the CFO and COO. Nevertheless, senior management will be challenged by ensuring that the newly introduced matrix organisation structure functions as intended, overseeing the progress of several other new members of the management team, integrating the many new acquisitions made in 2006/2007 and managing the cost and progress of the upgrade of the bank's systems that is in progress to cope with the enlarged business.

Glitnir banki's risk management practices are generally good and no major control issues or qualified audits have occurred within the bank; however, there is no fully independent Chief Risk Officer. The bank's significant extensions of credit to insiders and related parties have been higher than levels with which we have been generally comfortable in the past. However, in this respect, we do take some comfort in the new regulations introduced by the FME under which a bank's external and internal auditors must verify that related party lending is contracted on a similar basis as that for unrelated clients. Also positively, the bank's related party exposure has declined to below 2% of total loans.

In order to better control the multiple acquisitions made in the past three years, Glitnir has appointed a team to facilitate and manage the integration process. In tandem, Glitnir has announced Project Albatross, which will work to restructure its Nordic activities outside Iceland.

In the near term, we view the overall trend in risk positioning as weakening because the bank faces challenges in its new management team and the integration of the financial companies acquired during 2006 and 2007: FIM, Leimdörfer Holding AB, Fischer Partners (now Glitnir AB), Norse Securities (now Glitnir Securities), Union Gruppen (now Glitnir Property Group) and Norsk Privatøkonomi ASA.

- **Financial Reporting Transparency**

Financial reporting is timely – management disclosure and analysis are adequate

Glitnir banki's 2006 financial statements are prepared under IFRS and audited by Price Waterhouse Coopers hf. (the bank had previously been audited by KPMG for several years). Glitnir also provides quarterly reports and presentations. Financial reporting is prompt: the annual report is issued within eight weeks of the reporting date with quarterly results released within four weeks.

Management's analysis provides an adequate insight into the bank's business and financial performance but it is sometimes difficult to develop an insight the current performance and financial status or to compare them with previous years. The disclosures on credit risk could be improved by providing the amount of gross impaired loans (problem loans), problem loan coverage by provisions and some broader discussion of large credit exposures. Market risk disclosure could be improved by a discussion of its stress-testing methodology. Also, disclosure on derivatives could be improved, especially given the significant increase in derivatives exposure in 2006. Additionally, information on funding could be improved by disclosing the annual maturity of long-term debt, particularly as the bank is reliant on market funding. In general, Icelandic banks typically lag major Scandinavian banks in financial reporting transparency.

- **Credit Risk Concentration**

Credit risk concentration is very high

While the level of Glitnir banki's impaired loans has remained low, this is counterbalanced by very high borrower concentration levels compared to other banks globally. The bank's twenty largest exposures exceeded 200% of its Tier 1 capital as at 30 June 2007 and represent a credit challenge. The bank's industry concentration risk is also high; the largest sector exposure is commercial real estate (mainly in Norway), which represented 30% of the loan portfolio at 30 June 2007. We view the level of sector exposure in commercial real estate as uncomfortable in an environment of rising interest rates in the Nordic countries.

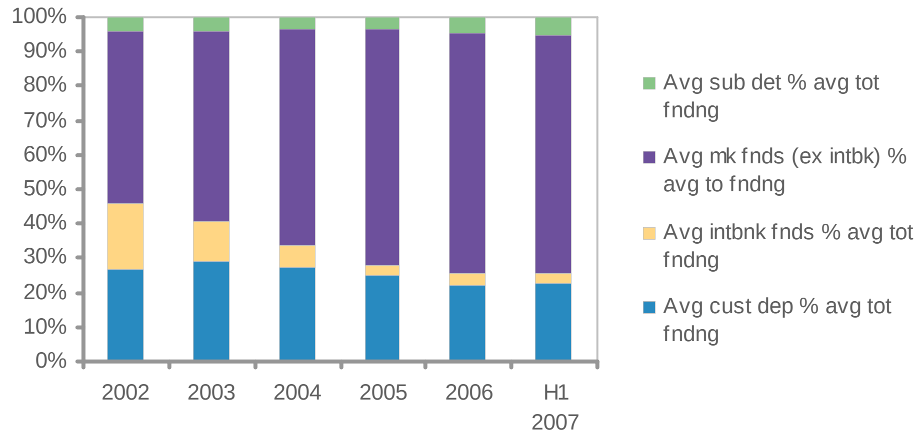
- **Liquidity Management**

Liquidity management is good

Glitnir is reliant on wholesale funding, with customer deposits accounting on average for only 23% of its total funding on a consolidated basis. Glitnir banki issues bonds on an international basis but the Norwegian subsidiaries are mainly self-sufficient in their funding, which they source primarily in the domestic Norwegian market. BNbank plans to diversify its funding by issuing covered bonds, but does not expect to do so until later in 2007. The bank has recognised the need to build a strong presence in foreign funding markets and generate a diversified investor base. Norwegian covered bonds should open up access to new investors as well as decrease the cost of funding.

In 2006, the bank put a covered bond programme in place to refinance its Icelandic residential mortgages. This has contributed to a diversification of the bank's sources of funding and provides the opportunity to better match the longer-term maturities of its mortgage loans. At the same time, Glitnir banki has further diversified its sources of market funding. Although the bank has made progress in expanding its deposit base, representing 23% of total funding at 30 June 2007 – an improvement over year-end 2006 (21%) – the percentage remains lower than levels seen in 2005 and previous years due to the more rapid growth in assets (see Exhibit 4).

Exhibit 4: Glitnir's Funding Profile



Source: Moody's calculations

Glitnir banki developed an improved liquidity policy in 2006. Its policy is to be able to cover all maturing debt of the parent company over a period of six months with immediately available funds and, taking other somewhat less readily realisable assets into account and the inflow from long-term assets, cover all maturing debt over a period of 12 months. Moody's views its improved liquidity policy positively and believes that, to underpin investor confidence, it is important for the bank to continue to extend the average maturity of its funding and smooth out the repayment profile so that 'lumpy' repayment years are avoided.

Despite the recent market turmoil triggered by the US sub-prime market, the bank's announcement on 20 August 2007 confirms that it has no sub-prime exposure and that its immediately available funds covered all maturing debt for just under the next six months and, by adding realizable assets and inflow from maturing assets, all maturing debt would be covered over a period of twelve months.

Market Risk Appetite

Market risk appetite is low on average but high peaks are experienced

Glitnir banki's market risk appetite for interest rate risk and foreign exchange risks are very low for the banking book due to conservative management. The bank's average VaR for its trading portfolio is relatively low as well. Positions taken are mainly for market-making purposes and we believe that this risk is well monitored and controlled. However, Glitnir banki has over the past two years also acquired shares or underwritten initial public offerings sometimes also on behalf of its major shareholder and does, from time to time, experience periods of elevated, concentrated, market risk.

The growth of Glitnir Securities by acquisition in 2006 and 2007 gives rise to some concern about the potential for increased operation risk in a young and rapidly growing organisation. Nevertheless, we note that the bank has changed its management structure to address these issues and appointed a new head of Glitnir Securities - who will not be diverted by other responsibilities, as was his predecessor.

With respect to interest rate risk, a parallel shift of the yield curve of 1% in the banking book would have resulted in a loss of ISK7 billion at year-end 2006, which is manageable as it counts for 3% of total capital. The bank's foreign exchange risk is also maintained at low levels. The bank's assets are largely denominated in foreign currency, but equity is issued in Icelandic kronur and its exchange rate has an effect on the measured capital ratios. As part of its strategy to protect its capital ratios the bank held long positions in Norwegian kroner, Swedish kronor and euros amounting to ISK27.8 billion. Other currency mismatches are monitored and kept within strict limits.

Regulatory Environment

Increased focus on regulation and supervision of the financial sector

The growth and international expansion of Iceland's financial sector have been substantial during the last few years. This has resulted in further strengthening of the banking supervision resources and increased cooperation between the FME (the Icelandic financial supervisory authority) and its foreign counterparts. Also, as Icelandic banks are to a large extent financed by foreign loan capital and are thus highly dependent on financial markets abroad, the FME has placed increased emphasis on assessing refinancing risk. The FME has increased information requirements in this area and reviewed the banks' strategies for offsetting refinancing risks. In addition, FME deploys stress-testing on capital adequacy and eligibility assessment of CEOs and board members of the banks. Indeed, Icelandic legislation stipulates stricter requirements than corporation law. The FME has authority to unilaterally dismiss CEOs and board members if they fail to meet the statutory eligibility conditions. In general, Icelandic banks' regulatory framework is similar to that of other Nordic countries. However, some differences remain, e.g. with respect to the proportion of Tier 1 capital that can be comprised of hybrid securities. Regulations in most other Nordic countries have more restrictive limits than in Iceland. As a whole, the regulatory environment has a neutral effect on the bank's BFSR.

Operating Environment

Capable of withstanding shocks

In assessing the quality of the operating environment, Moody's considers economic stability (GDP growth volatility) and also looks at issues such as integrity and corruption and the effectiveness of the legal system.

Except for economic stability, on these metrics the Icelandic operating environment is very similar to other Nordic countries. In Iceland, macroeconomic volatility is mainly due to the small size of the economy, foreign investment activity and reliance on exports. That said, the Icelandic economy has proven itself to be unusually flexible and highly capable of withstanding shocks. With regards to other metrics, the World Bank's indicator on Control of Corruption places Iceland as the least corrupt country in the world.

Moody's Aaa rating on the government of Iceland reflects the country's advanced economic development, its longstanding political stability, its high and evenly distributed standard of living, and its healthy government finances. For a more complete discussion on the quality of the macroeconomic environment, please refer to Moody's sovereign research on Iceland.

Discussion of Quantitative Rating Drivers

Profitability

Glitnir is a highly profitable bank

Glitnir banki is a highly profitable financial institution but the bank's profits and profitability levels do vary from year to year and profit levels for the first half of 2007 fell to ISK19.7 billion, down 19% year-on-year. The problem did not lie with income generation; in fact, net operating income rose by 17% year-on-year. Rather, profits were driven down due to the level of expenditure needed to integrate the newly acquired asset management company, FIM, as well as the securities businesses acquired in Norway and Sweden earlier in 2006 and one-off senior management severance costs.

Glitnir banki hf

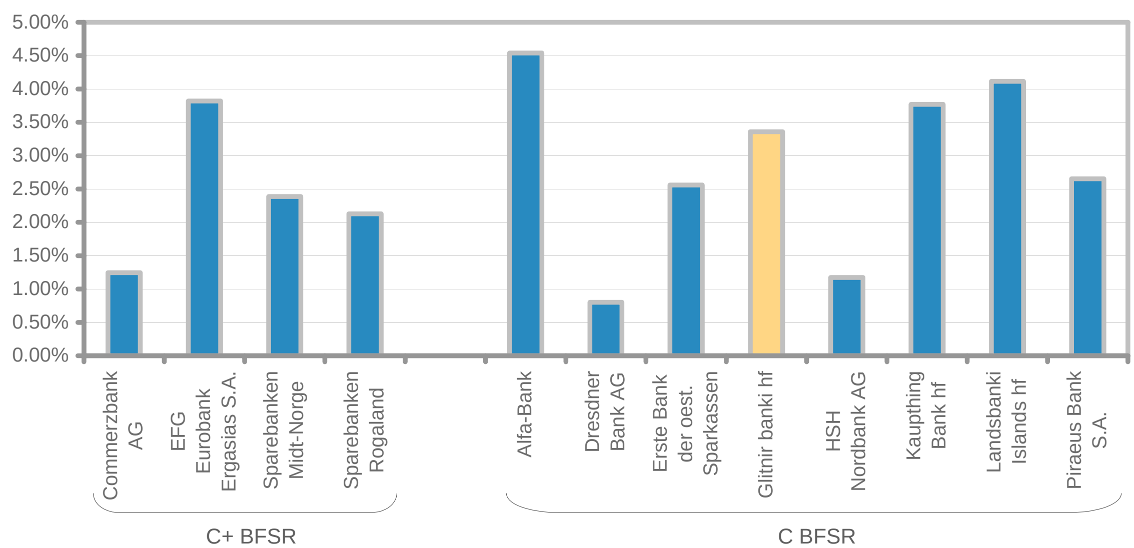
Although interest rates have started to rise in the Nordic area, which will eventually relieve margin compression, Glitnir Banki is still experiencing pressure on its net interest margins not only in its domestic market, but in particular due to the fierce competition and low interest rate environment in Norway - where more than a third of the bank's loan portfolio is located. Margins in Norway are generally lower than in Iceland. Overall, the bank's net interest margin was squeezed to 2.05% in 2006, down from 2.30% in 2005, and looks likely to be driven below 2.0% in 2007. Nevertheless, Glitnir's net interest margin is at the median of its Icelandic peer group.

Trading income fell as a percentage of net operating revenues to 12% in 2005 from 26% in 2004 and remained at that level during 2006. We observed an increase to 14% in the first half of 2007 and will watch the evolution of this for signs of strategic change under the new controlling shareholders, FL Group, and the new management team. This type of income is viewed by the rating agency as 'income at risk' due to the potential for losses as well as gains. Therefore, as part of our analysis, we run a stress test in which we strip out this income to assess the profitability of core income. Using the same profitability measure as above, Glitnir Banki's core risk-weighted recurring earning power in 2006 remained better than that of its BFSR C peers at 2.9%, up from 2.54% in 2005.

Glitnir's overall risk-weighted recurring earning power, a profitability ratio of pre-provision income as a percent of average risk-weighted assets, rose to 3.54% in 2006 from 2.69% in 2005. Profits were exceedingly high in 2006 due to the success of some large investment banking transactions which earned the bank very large fees – fees tripled in 2006 over the previous year's levels. However, due to heavy expenses, profitability fell back in the first half of 2007 to 2.56% on an annualised basis. Nevertheless, as demonstrated by the chart below, Glitnir's profitability is higher than most of its similarly rated peer group in Europe.

Exhibit 5:

Pre-provision Profit % of Avg. RWA



Source: Moody's calculation

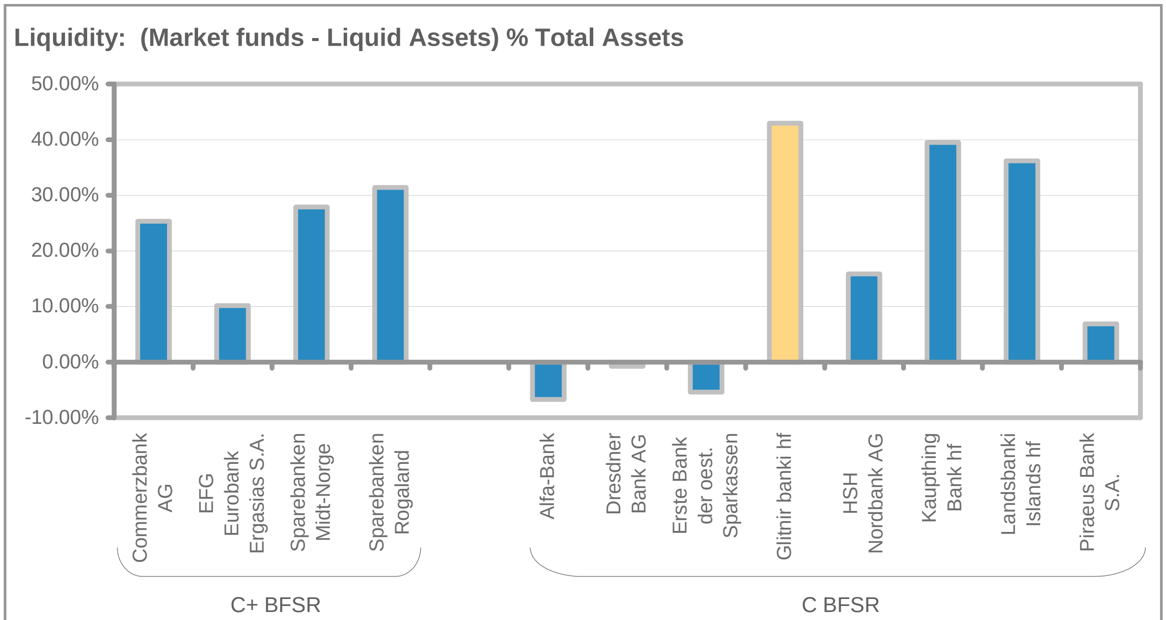
Liquidity

Poor liquidity ratio reflects the bank's reliance on market funding

The bank's liquidity ratio is very high compared to its similarly rated peer group. This is due to its reliance on market funding. The poor liquidity ratio is tempered by the bank's liquidity management policies. The bank's announcement on 20 August 2007 confirmed that its immediately available funds covered all maturing debt for just under the next six months and, by adding realisable assets and inflow from maturing assets, all maturing debt would be covered over a period of twelve months.

Glitnir banki hf

Exhibit 6:



Source: Moody's calculation

Although the bank has made progress in expanding its deposit base, representing 23% of total funding at 30 June 2007 – an improvement over year-end 2006 (21%) – the percentage remains lower than levels seen in 2005 and previous years due to the more rapid growth in assets. Positively, market funding sources remain well diversified.

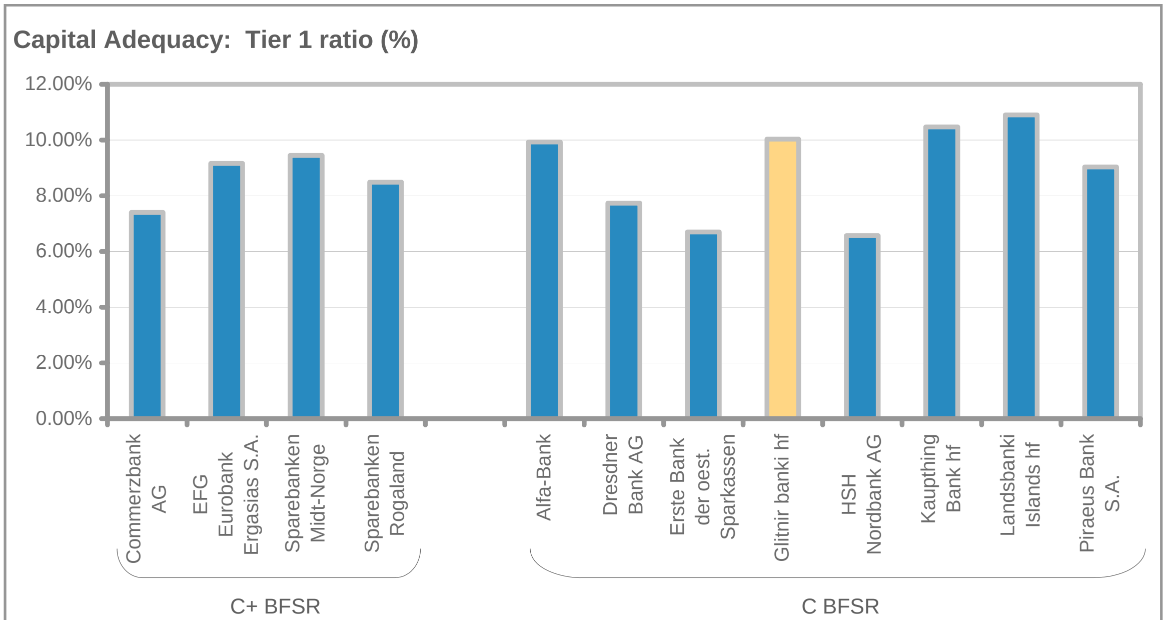
Capital Adequacy

Adequate capitalisation

Glitnir banki's overall capital ratios are healthy, but Moody's notes that hybrid securities constitute 25% of Tier 1 capital while regulations in many other European countries have more restrictive limits than those of Iceland with respect to the proportion of Tier 1 capital that can be comprised of hybrid securities. However, Glitnir banki's internal capital growth has historically been strong (44% in 2006, 28% in 2005), reflecting the bank's earning power, which could rebuild its equity base earnings if so needed. Moody's regards the bank as having adequate levels of capital given its current strategy and risk profile. As at 30 June 2007, its Tier 1 ratio was 9.4% and total capital ratio 13.2%, down from levels at year-end 2006 of 10.8% and 15% respectively.

Glitnir banki hf

Exhibit 7:



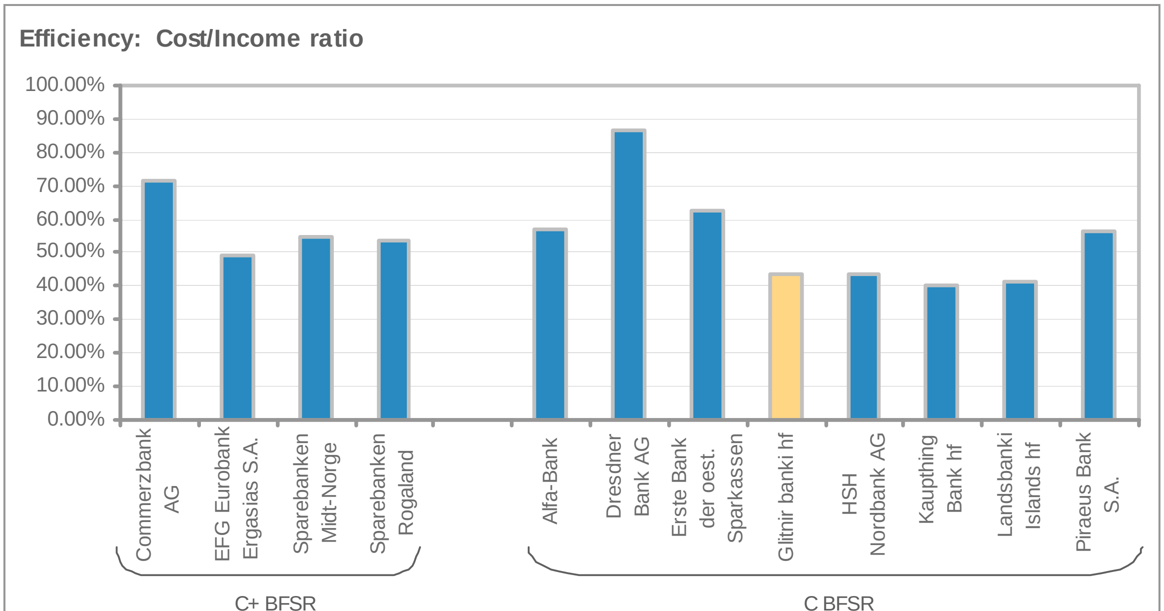
Source: Moody's calculation

Efficiency

Efficiency indicators suffer as the bank integrates acquisitions

Glitnir banki has historically shown strong cost efficiency; however, its cost-income ratio moved out from 37.6% at year-end 2006 to 51.5% at 1H 2007. The deterioration in this metric was not caused by a decline in operating income, which in fact rose by 17% on an annualised basis. Instead, the bank's operating expenses increased significantly. Going forward, we believe the bank's cost base will remain under pressure as it now has to invest in infrastructure to bring its systems into line with the enlarged operation.

Exhibit 8:



Source: Moody's calculation

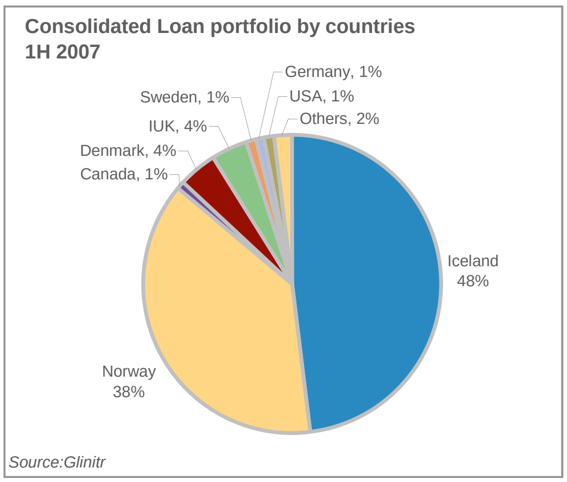
Glitnir banki hf

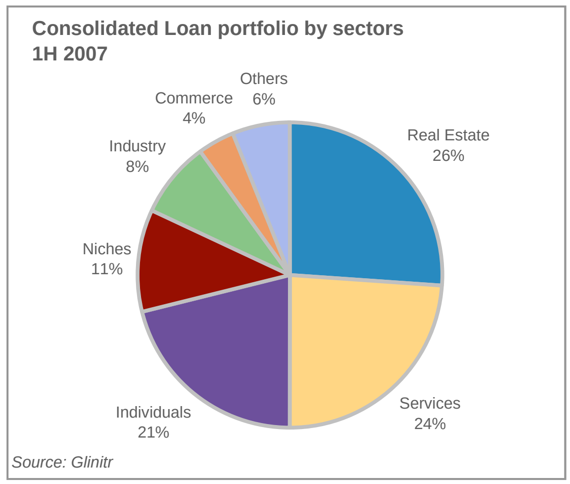
Asset Quality

High exposure to commercial real estate

The bank's present risk-management tools and underwriting standards are generally prudent and problem loans are at a three-year low, indicating good asset quality. However, improved asset quality is partly explained by the inclusion of new housing loans and the consolidation of Norwegian BNbank in 2005. In total, Norway accounted for 35% of the bank's loan portfolio at end-June 2007 (see Exhibit 9). These loans are predominantly real estate and mortgage loans. Accordingly, accounting for 26% of Glitnir's total loans and leasing contracts (as of end-June 2006), commercial real estate represents the bank's single largest industry exposure. The exposure largely stems from BNbank and is primarily to Norwegian real estate companies and, to a smaller extent, to Norwegian building societies. Correspondingly, Icelandic household mortgages accounted for 7% of the bank's loan portfolio. Internationally, Glitnir specialises in three industry niches: seafood/food, sustainable energy and off-shore industry. As of end-June, these niches accounted for 11% of the total loan portfolio.

Exhibit 9: Glitnir's Loan portfolio Breakdown



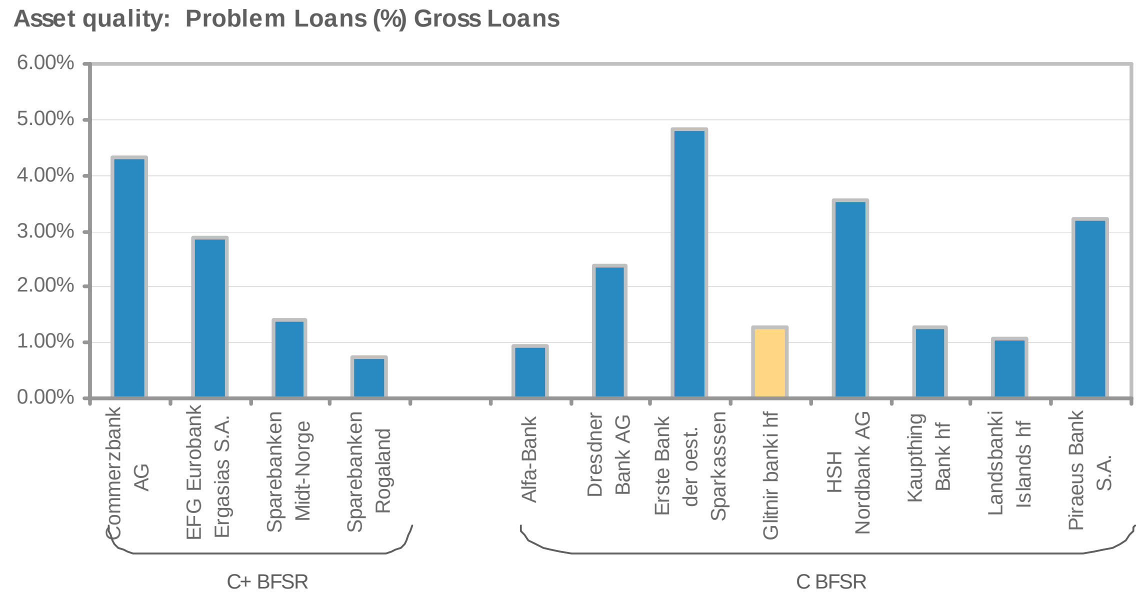


Related party exposure has gradually declined. Related-party lending of ISK30.2 billion at 1H 2007 (ISK56.3 billion at year-end 2006) represented a low 1.9% of the bank's total lending, down from 3.5% at end-2006. As a proportion of Tier 1 capital, the figure was 21% and 33%, respectively.

Given the current imbalances in the Icelandic economy and the very high level of borrower concentration risk (most of which is in the Icelandic loan portfolio), problem loans could potentially increase dramatically, as they did in the previous downturn. Moreover, we have been concerned at the high level of insider and related-party risks in the past. These considerably diminished in the first half of 2007 and we will monitor the bank's progress in keeping these exposures at lower levels.

Glitnir banki hf

Exhibit 10:



Source: Moody's calculation

Discussion of Support Considerations

Glitnir's importance to the Icelandic banking system should merit a strong level of systemic support

Moody's assigns a global local currency (GLC) deposit rating of Aa3 to Glitnir banki hf.

The GLC deposit rating is supported by Glitnir banki's financial strength rating of C, which translates into a Baseline Credit Assessment (BCA) of A3, as well as by the rating of its underlying support provider: the Aaa local-currency deposit ceiling (LCDC) of Iceland. The bank receives a three-notch uplift from the BCA, bringing the GLC rating to Aa3.

The probability of systemic support in the event of a stress situation is judged to be very high. This is based on Glitnir banki's importance to the Iceland's banking system. Moody's estimates that Glitnir banki and the other two Icelandic banks rated by Moody's together represent over 90% of domestic deposits in the Icelandic banking system, and a similar if not larger share of domestic loans. Each bank individually accounts for at least 25% of the system. We believe that the default of any one of these three banks would pose a substantial risk to the Icelandic economy, the consequences of which could be far greater than the cost of rescuing a failing bank.

Notching Considerations

The ratings for Glitnir banki's junior obligations should be notched off the supported deposit rating because Moody's believes that there is no legal authority in place in Iceland to impose losses on subordinated creditors outside of a liquidation scenario.

Glitnir banki hf

Exhibit 11: Mapping the BFSR to the Baseline Credit Assessment (BCA)

The discussions of qualitative and quantitative rating drivers presented in this report form the analytical basis for assigning a Bank Financial Strength Rating (BFSR) of C to Glitnir banki hf (Glitnir).

BFSRs are Moody's opinions on the intrinsic safety and soundness of a bank enterprise and, in effect, address the susceptibility of a particular institution to financial distress.

The BFSR array of ratings is not on Moody's traditional rating scale (Aaa, Aa, etc.). There is a useful method, however, for translating BFSRs to Moody's traditional scale – the Baseline Credit Assessment (BCA). In effect, the BCA measures a bank's stand-alone default risk, assuming there is no governmental or other external support.

Glitnir's C BFSR maps to a BCA of A3. However, considering external support factors, its deposit ratings are Aa3.

BFSR/Baseline Credit Assessment Mapping for Glitnir banki hf	
BFSR	**Baseline Credit Assessment (BCA)**
A	Aaa
A-	Aa1
B+	Aa2
B	Aa3
B-	A1
C+	A2
C	A3
C-	Baa1
C-	Baa2
D+	Baa3
D+	Ba1
D	Ba2
D-	Ba3
E+	B1
E+	B2
E+	B3
E	Caa1
E	Caa2
E	Caa3

Company Annual Statistics

Glitnir banki hf

	06/30/07	12/31/06	12/31/05	12/31/04	12/31/03
Summary Balance Sheet (ISK million)					
Cash & central bank	31,158	18,463	20,447	5,445	4,945
Due from banks	141,508	177,010	75,487	51,634	34,593
Securities	466,505	366,933	235,860	116,006	55,520
Gross loans	1,566,133	1,595,820	1,108,132	482,665	323,215
Loan loss reserves (LLR)	-10,818	-12,462	-9,191	-10,279	-8,931
Insurance assets	0	0	0	1,308	8,464
Fixed assets	6,003	3,296	1,987	4,177	3,283
Other assets	134,519	97,279	39,223	26,360	22,854
Total assets	2,335,008	2,246,339	1,471,945	677,316	443,943
Total assets (USD million) [1]	37,504	31,599	23,274	11,018	6,262
Total assets (EUR million)	27,770	23,963	19,731	8,106	4,964
Demand deposits	511,319	259,156	195,805	71,558	77,896
Savings deposits [2]	-	179,116	108,331	84,044	29,776
Due to banks	40,289	78,576	30,656	22,676	39,436
Market funds	1,445,216	1,382,664	937,794	382,020	220,284
Insurance liabilities	0	0	0	19,454	19,413
Other liabilities	91,773	91,710	67,358	29,724	12,006
Total liabilities	2,088,597	1,991,222	1,339,944	609,476	398,811
Subordinated debt	95,142	108,998	47,464	19,366	15,709
Shareholders' equity	150,013	144,578	84,537	48,474	29,423
Total capital funds	246,411	255,117	132,001	67,840	45,132
Total liabilities & capital funds	2,335,008	2,246,339	1,471,945	677,316	443,943
Derivatives - notional amount	3,569,290	2,870,840	604,467	517,099	258,657
Derivatives - replacement value	77,861	-	-	-	-
Contingent liabilities	100,026	120,441	45,954	26,229	19,087
Risk weighted assets (RWA)	1,517,868	1,564,300	946,428	448,819	287,424
Assets under management (ISK million) [3]	913,364	490,321	344,975	254,163	198,787
Number of employees	-	1,392	1,216	1,126	948

Glitnir banki hf

Glitnir banki hf

	06/30/07	12/31/06	12/31/05	12/31/04	12/31/03
Summary Income Statement					
+Interest income	70,989	119,115	61,526	31,983	24,144
-Interest expense	53,388	82,031	39,175	19,207	13,105
Net Interest income	17,601	37,084	22,351	12,776	11,039
+Trading income	5,646	8,492	4,427	7,486	2,905
+Fee & commission income	16,186	26,459	8,773	6,610	3,752
+Insurance income (Net)	0	0	229	886	366
+Dividend income and other operating income	905	566	631	767	999
operating income	40,338	72,601	36,411	28,525	19,061
-Personnel expenses	0	15,747	8,848	8,554	5,422
-other operating expenses	20,764	10,892	6,402	5,232	3,651
operating funds flow	19,574	45,962	21,161	14,739	9,988
-Amortisation/depreciation	0	662	481	571	437
(Total operating expenses)	20,764	27,301	15,731	14,357	9,510
Preprovision income (PPI)	19,574	45,300	20,680	14,168	9,551
-Loan loss provisions	1,479	4,759	2,125	3,137	2,864
+Impairment of goodwill, fixed assets and investments [4]	1,625	4,244	3,243	2,916	-259
+Result of subsidiaries and associates	-17	1,470	1,262	146	0
+Non-recurring items	0	0	0	0	0
Pretax income	19,703	46,255	23,060	14,093	6,428
-Taxes	3,174	8,024	4,174	2,135	593
Net income	16,529	38,231	18,886	11,958	5,835
-Minority interests	477	871	0	0	0
Net income (group share)	16,052	37,360	18,886	11,958	5,835

Glitnir banki hf

Glitnir banki hf

	06/30/07	12/31/06	12/31/05	12/31/04	12/31/03
Growth Rates (%)					
Gross loans	-3.72	44.01	129.59	49.33	24.99
Total assets	7.89	52.61	117.32	52.57	42.12
Customer deposits (demand and savings)	33.33	44.1	95.46	44.51	25.45
Net interest income	-5.07	65.92	74.95	15.74	13.71
Fee and commission income	22.35	201.6	32.72	76.17	7.82
Operating expenses	52.11	73.55	9.57	50.97	24.93
Preprovision income	-13.58	119.05	45.96	48.34	56.93
Net income	-14.07	97.82	57.94	104.94	71.27
Income Statement in % Average Risk Weighted Assets					
Net interest income	2.3	2.9	2.91	3.47	4.24
Trading income	0.74	0.66	0.58	2.03	1.11
Fee and commission income	2.12	2.07	1.14	1.8	1.44
Insurance income	0	0	0.03	0.24	0.14
Operating income	5.27	5.68	4.73	7.75	7.32
Operating expenses	2.72	2.13	2.04	3.9	3.65
Preprovision income	2.56	3.54	2.69	3.85	3.67
Loan loss provisions	0.19	0.37	0.28	0.85	1.1
Extraordinary profit	0	0	0	0	0
Net income	2.16	2.99	2.45	3.25	2.24
Liquidity, Funding (including sub debt) & Balance Sheet Composition					
Avg. liquid assets % avg. total assets	27.73	22.43	19.54	23.91	19.36
Avg. gross loans % avg. total assets	67.43	73.75	77.56	71.87	76.93
Avg. customer deposits % avg. total funding	22.5	21.89	25.01	27.35	28.96
Avg. interbank funds % avg. total funding	2.99	3.4	2.94	6.45	11.98
Avg. market funds (excl. interbank) % avg. total funding	69.53	70.13	68.31	62.56	55.05
Avg. sub debt % avg. total funding	4.98	4.57	3.74	3.64	4.01
Avg. liquid assets % avg. customer deposits	137.13	115.01	87.1	101.85	75.67
Avg. gross loans % avg. customer deposits	333.44	378.15	345.77	306.1	300.68
Avg. market funds reliance [5]	52.37	54.96	52.79	41.56	38.75
Avg. RWA % avg. total assets	67.11	67.53	66.25	65.66	68.91
Breakdown of Operating Income in %					
Net interest income % operating income	43.63	51.08	61.39	44.79	57.91
Trading income % operating income	14	11.7	12.16	26.24	15.24
Fee & commission income % operating income	40.13	36.44	24.09	23.17	19.68
Insurance income % operating income	0	0	0.63	3.11	1.92
Other operating income % operating income	2.24	0.78	1.73	2.69	5.24

Glitnir banki hf

Glitnir banki hf

	06/30/07	12/31/06	12/31/05	12/31/04	12/31/03
Profitability					
Yield on avg. earning assets (%)	6.62	6.59	5.54	6.06	6.95
Cost of interest bearing liabilities (%)	5.21	4.86	3.76	3.99	3.92
Net interest margin (%) [6]	1.64	2.05	2.01	2.45	3.29
Recurring earning power (Pre-prov. inc. % avg. assets)	1.72	2.39	1.78	2.53	2.53
Risk-weighted recurring earning power (PPI % avg. RWA)	2.56	3.54	2.69	3.85	3.67
Post-provision income % avg. assets	1.59	2.14	1.6	1.97	1.77
Post-provision income % avg. risk weighted assets	2.37	3.17	2.41	3	2.57
Return on average assets (%)	1.45	2.02	1.63	2.13	1.54
Return on avg. RWA (%)	2.16	2.99	2.45	3.25	2.24
Post-provision income % tier 1 capital	25.35	23.91	19.89	26.17	29.08
Return on equity (period end) (%)	21.4	25.84	22.34	24.67	19.83
Net interest income coverage of loan loss provisions	11.9	7.79	10.52	4.07	3.85
Loan loss provisions % preprovision income	7.56	10.51	10.28	22.14	29.99
Pre-tax income % operating income	48.84	63.71	63.33	49.41	33.72
Internal capital growth (%)	9.2	44.19	28.04	25.26	17.02
Dividend payout ratio (%)	58.58	-	28.04	37.84	38.83
Efficiency					
Cost/income ratio (op. expenses % op. income) [7]	51.48	37.6	43.2	50.33	49.89
Adjusted cost/income ratio (incl. non-operating items)	47.49	29.73	30.83	39.6	51.25
Operating expenses % average assets	1.82	1.44	1.35	2.56	2.51
Operating income / employee (ISK thousand)	-	52,155.89	29,943.26	25,333.04	20,106.54
Operating expenses / employee (ISK thousand)	-	19,612.79	12,936.68	12,750.44	10,031.65
PPI / employee (ISK thousand)	-	32,543.10	17,006.58	12,582.59	10,074.89
Asset Quality and Risk Measurement					
Problem loans % gross loans [8]	-	0.72	1.25	2.31	3.27
LLR % problem loans	-	109.06	66.23	92.02	84.48
LLR % gross loans	0.69	0.78	0.83	2.13	2.76
Loan loss provisions % gross loans	0.19	0.3	0.19	0.65	0.89
Problem loans % (shareholders' equity + LLR)	-	7.28	14.81	19.01	27.56
Replacement value % shareholder's equity	51.9	-	-	-	-

Glitnir banki hf

	06/30/07	12/31/06	12/31/05	12/31/04	12/31/03
Capital Adequacy (Period End)					
Tier 1 ratio (%)	9.4	10.8	9.9	9.4	8
Total capital ratio (%)	13.2	15	12.6	12.4	11.4
Shareholders' equity % total assets	6.42	6.44	5.74	7.16	6.63
Equity participations % shareholders' equity	2.45	3.03	9.56	5.37	27.05

[1] Historical exchange rates are applied accordingly for USD and EUR figures.

[2] Full disclosure may not be available for all years. The amount is then included in demand deposits.

[3] As reported by the bank.

[4] Includes goodwill amortisation (pre-IFRS).

[5] Avg. [(market funds-liquid assets) % (earning assets-liquid assets)].

[6] Although not part of net interest income calculation, the NIM includes dividend income.

[7] Cost/income ratio excludes goodwill amortisation, which is included together with net non-operating income in the adjusted cost/income ratio.

[8] In 2002, the classification of problem loans changed from 180 days overdue payment to 90 days overdue payment.

Moody's Related Research

Credit Opinion:

- Glitnir banki hf, September 2007

Banking Statistical Supplements:

- Iceland, January 2007 (104617)

Rating Methodology:

- Guidelines for Rating Bank Junior Securities, April 2007 (102726)
- Incorporation of Joint-Default Analysis into Moody's Bank Ratings: A Refined Methodology, March 2007 (102639)
- Bank Financial Strength Ratings: Global Methodology, February 2007 (102151)

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

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