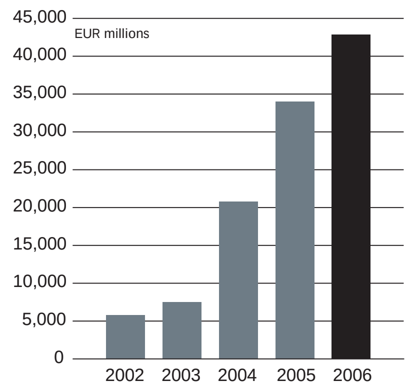
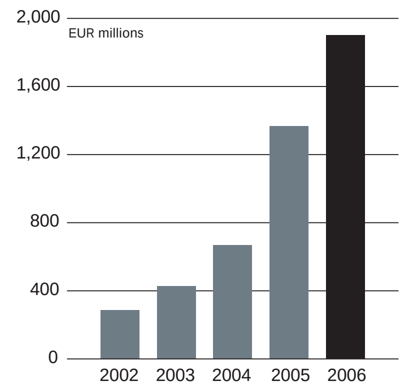
KAUPTHING BANK | ANNUAL REPORT 2006

KEY FIGURES

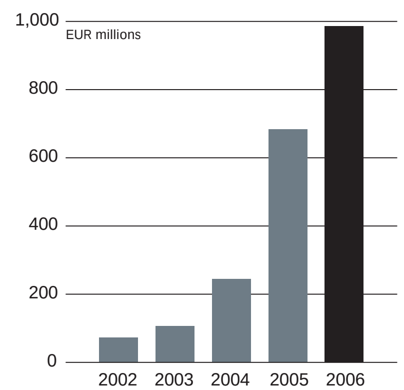
Total assets



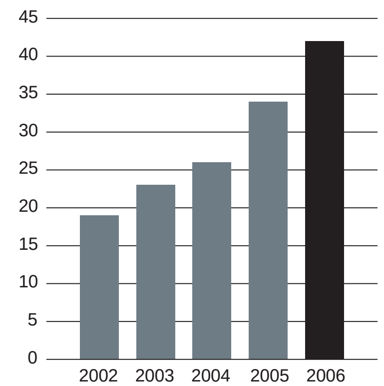
Operating income



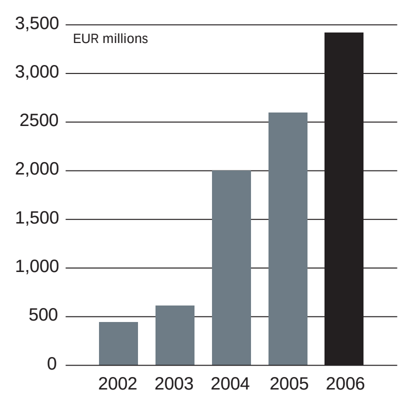
Net earnings



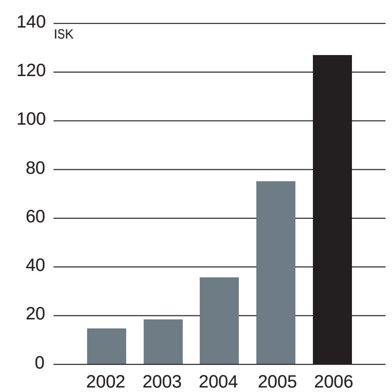
Return on equity (%)



Equity



Earnings per share



EUR millions*	2006	2005	Change
Income Statement			
Net interest income	595	438	36%
Net fee and commission income	426	300	42%
Net financial income	687	499	38%
Other income	194	131	49%
Operating income	1,902	1,368	39%
Operating expenses	-683	-476	44%
Impairment	-68	-59	16%
Income tax	-165	-150	10%
Net earnings	986	683	44%
Attributable to:			
Shareholders of Kaupthing Bank	972	659	47%
Minority interest	14	24	-42%
Net earnings	986	683	44%
Balance Sheet			
Assets			
Cash and cash balances with central banks	1,131	467	142%
Loans to credit institutions	5,130	2,618	96%
Loans to customers	26,832	20,665	30%
Financial assets	7,028	8,198	-14%
Intangible assets	722	736	-2%
Other assets	2,021	1,330	52%
Total assets	42,864	34,014	26%
Liabilities and equity			
Credit institutions and central banks	1,167	932	25%
Deposits	7,934	6,508	22%
Borrowings	25,367	20,838	22%
Subordinated loans	2,283	1,375	66%
Other liabilities and minority interest	2,693	1,761	53%
Shareholders' equity	3,419	2,600	32%
Total liabilities and equity	42,864	34,014	26%

Key ratios	2006	2005
Cost / Income ratio	35.9%	34.8%
Return on shareholders' equity	42.4%	34.0%
Loan-loss ratio	0.2%	0.2%
NPL / Loans to customers	1.00%	0.98%
Total credit reserves	0.4%	0.6%
CAD ratio	15.0%	12.2%
Tier 1 ratio	10.5%	9.4%
Earnings per share, ISK	127.1	75.2

*All amounts in the annual report are in ISK except on this page and were otherwise stated.

FINANCIAL CALENDAR 2007

2007 Annual General Meeting 16 March

Q1 2007 Results 26 April

Q2 2007 Results 25 July

Q3 2007 Results 26 October

2007 Annual Results 31 January 2008

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KAUPTHING BANK

CHANGING PERCEPTIONS

Sigurdur Einarsson, Executive Chairman

The most significant development for Kaupthing Bank in 2006 was the radical change in the way the Bank is perceived. There has been an appreciable leap in quality with regard to the market's understanding of the Bank and its prudent growth policy. Kaupthing Bank's shares were hit hard early last year when financial markets were shaken by concerns over the sustainability of economic growth in Iceland. However, as a result of more comprehensive coverage from international analysts, Kaupthing Bank is no longer perceived primarily as an Icelandic entity, but as a well diversified northern European banking group. It has become evident that our operations in the UK and in Scandinavia are already as important as the Icelandic business segment and actually hold greater potential for growth. For this reason, stock in Kaupthing Bank will become even better known in the coming years and its value will increase accordingly.

Strong Business Model

The way the Bank is perceived has changed in another manner as well, one which has been equally as consequential. International analysts have realized that organic growth is a stronger force in Kaupthing Bank's expansion and profit-making than acquisitions. In fact, about two-thirds of the rapid revenue growth in the past five years has been achieved organically. As the accounts for 2006 make clear, we have, without any acquisitions over the year and in spite of negative forecasts and turbulence in the market last winter, enjoyed close to a 30% increase (in euros) in the Bank's Balance Sheet. The demand in Europe for Kaupthing Bank's comprehensive services—tailor-made solutions combined with integrated financing—is steadily growing. We are confident that the Bank's business model and our way of implementing it are the reasons for our success.

Sigurdur Einarsson,
Executive Chairman

Creative Consolidation

The sizeable acquisitions of recent years have already been integrated successfully into Kaupthing Bank's operations. At the outset of last year we stated that 2006 would be a year of consolidation, and we can now conclude that this consolidation has occurred as the result of a creative process. Under this process of transformation FIH in Denmark and Kaupthing Singer & Friedlander in the UK have been equipped with all the necessary means to become vehicles of profit and expansion in the coming years.

Successful Diversification

Our efforts to diversify sources of income, both geographically and in terms of business segments, have not gone unnoticed. The increase in deposits is a promising future trend. The international equity offering in November 2006 was of a transforming character. It constituted a resolute step towards the broadening and the internationalization of the shareholder base. As a result the Bank's operations will be subject to more extensive equity research coverage from international brokerage houses. We have every reason to expect to see the benefits of our diversified shareholder base and the increased liquidity of the Bank's shares, as has already been evidenced by our performance on the Stockholm Stock Exchange. Likewise, we have continued to diversify the funding base, expanding into issues in the US, Canada, Japan and Australia.

Overall, this program of diversification means that the performance of the Bank has been effectively disengaged from the domestic economy of Iceland, which reduces investment risk in the eyes of international investors.

Another positive development that brings the Bank closer to international investors is the acquisition of the Iceland Stock Exchange (ICEX) by the OMX Nordic Exchange. In an integrated Nordic securities market, Kaupthing Bank will benefit from strict adherence to good governance and regulatory procedure throughout the organization. The incorporation of the Iceland Stock Exchange into OMX will enhance the Bank's visibility in the market by making it a component of several new Nordic indices as well as further increasing the liquidity of shares in the Bank.

Unique Culture

In an operation such as Kaupthing Bank's, it becomes apparent that attracting and keeping the best people in the right positions is of the utmost importance in sustaining our level of achievement. Last year we welcomed a number of seasoned members to our enterprise and were grateful for our crew's overall performance in staying the course through the turbulent sailing early on in the year. In an effort to create further value among personnel by aligning their interests with those of shareholders, the Board of Directors decided to increase employee ownership by introducing new stock incentives and stock option programs.

It has been said that success in the global economy requires massive investments in people; a passion for product improvement; and a deeply caring attitude for customers. Add to that a passion for building businesses and good capitalization, supported also by rigorous cost-effectiveness, and you have Kaupthing Bank's approach to business. We have the ambition of becoming a universal bank in the sense that all our locations will offer all services, including corporate banking, investment banking, capital market services, asset management and comprehensive wealth management for private banking clients.

Northern European Profile

Kaupthing Bank is strong and our strength lies in our business model. The willingness and ability to invest in the success of our clients and align the interests of its employees and shareholders gives us a competitive edge.

We are better equipped to take on new challenges than ever before. Kaupthing Bank is well positioned to participate in the consolidation of the financial market because of good capitalization, swift and able management and our record of successful acquisitions and mergers. We would like to strengthen our profile as a northern European investment and corporate bank. The northern countries will continue to act as the economic locomotive of Europe in the coming years. For this reason we are first and foremost considering opportunities to expand our operations in locations where we are currently active or in neighboring countries. But the world is flatter than ever before and we will certainly not sit on our hands if lucrative opportunities emerge outside Europe. However, in the valuation of such opportunities we will be selective and conservative in our decisions.

Dividends

At the Bank's Annual General Meeting the Board of Directors will propose that ISK 10,366 million be paid as dividends to shareholders for 2006, which corresponds to ISK 14 per share and represents 12.2% of last year's net earnings. This is consistent with Kaupthing Bank's dividend policy of paying out dividends which represent between 10% and 30% of annual net earnings. In addition, as the final step in a process meant to reduce the Bank's holdings in Exista to an unsubstantial level, an extraordinary dividend was paid out to shareholders in October 2006. The extraordinary payment consisted of dividends in the form of shares in Exista hf., representing 7.7% of the Exista's total share capital.

In conclusion I would like to extend my thanks to my fellow Board members for their diligent work over the year. To our 32,000 shareholders, who again showed their lasting faith in Kaupthing Bank in 2006 I would like to express my thanks and gratitude. Nothing satisfies a banker more than keeping the customers' and shareholders' invaluable trust during turbulent times. After all, when it comes down to it, banking is all about trust.

Sigurdur Einarsson

YEAR OF ORGANIC GROWTH

Hreidar Már Sigurdsson, CEO

Kaupthing Bank recorded its best earnings ever in 2006. This is particularly pleasing given the doubts concerning the imbalances in the Icelandic economy and speculation about the possible effect this might have had on the Bank. Nevertheless in the face of this adversity, the Bank reached all its operating targets this year and has never been better positioned to further build its businesses. When all is said and done, 2006 will be remembered as a solid year - another record year for Kaupthing Bank.

Prudent Growth

Kaupthing Bank reported net earnings of ISK 85.3 billion (€972 million) in 2006, an increase of 73% from the previous year. Earnings per share amounted to ISK 127.1, increasing by 69% from 2005. Return on shareholders' equity was 42.4% in 2006, which is well above the Bank's long-term target of 15%. Kaupthing Bank's capital base is strong with the CAD ratio at 15.0% at the end of 2006 and Tier 1 ratio at 10.5%.

Hreidar Már Sigurdsson,
Chief Executive Officer

Many important steps were taken during the year designed to distinguish Kaupthing Bank as one of the leading corporate and investment banks in northern Europe. Key areas of focus were the consolidation of operations across the Group, increased inter-office collaboration and cross-selling between profit centers. By attaining these goals we have reinforced the Bank's income stream and thus reduced operating risk. We increased the number of employees by 351 or 15% during the year, mainly outside Iceland. New profit centers were set up, including Capital Markets at Kaupthing Singer & Friedlander in the United Kingdom and Investment Banking and Capital Markets at our Danish subsidiary FIH Erhvervsbank. These three new profit centers are already fully up and running.

Considerable energy was invested in the integration of Singer & Friedlander, now Kaupthing Singer & Friedlander, following its acquisition in mid-2005, into the Kaupthing Bank Group. At the time of the acquisition we made it clear that we intended to take up to 18 months to reorganize the business and attain a satisfactory return on equity. There is no doubt in my mind that the acquisition of Singer & Friedlander has been a resounding success and that the UK business holds significant growth potential. We expect 2007 to be an excellent year for Kaupthing Singer & Friedlander.

In recent years Kaupthing Bank has demonstrated rapid growth through both acquisitive and organic means. Owing to the number of acquisitions, it has been difficult for market participants to establish how much of the Bank's growth has been generated by acquisitions and how much has actually been organic. However, the past year has differed to some extent from previous years in that the Bank made no acquisitions in 2006. In this way it has helped simplify direct comparisons between quarters, and it is quite revealing to note what a powerful force organic growth has been in the Bank.

Weathering the Storm

Over the last few years the size of the Bank's activities outside Iceland has steadily gained momentum. Although we take great pride in our Icelandic roots we are first and foremost a northern European bank. An overwhelming proportion of the Bank's growth originates outside Iceland as does the Bank's risk exposure. Despite this very positive aspect of growth abroad, the funding methods of banks based in Iceland fell into the limelight of international financial analysis during 2006.

After a surge of activity by Icelandic enterprises expanding overseas, the international research community turned its gaze to Iceland's economy, and the financial sector in particular. While there was considerable discussion based on conjecture and a lack of insight into the nation's economy, many of the observations from international analysts were indeed helpful. Some of these reports from international analysts alluded to systemic risk in the Icelandic financial sector, which led the market to back away from financial companies based in Iceland. However, during this period of uncertainty Kaupthing Bank managed to stay its course by resolving any needed improvements, and refuting all unfounded criticism beyond the point of any doubt.

Specific measures to this effect included the unwinding of our crossholdings in Exista in 2006, issuing new equity, improving the flow of information to the international media and market analysts, increasing deposits, and finally, diversifying our funding sources to avoid reliance on any single market or type of funding. We broadened our funding sources by issuing bonds to investors in the United States, Australia, and Japan. These markets and other markets such as the EMTN market, the Canadian Maple bond market and the local Swiss bond market will be important sources of funding for us, as the Bank intends to remain a regular issuer in all these markets. At the same time we have concentrated on extending our debt maturity profile and enhancing our liquidity.

Trumping Bureaucracy & Taking Intelligent Risks

We seek to provide our clients with the best service possible. To this end we have defined a set of principles intended to serve as guideposts of our corporate culture. Two of these principles have held particular significance for us this past year and I would like to address them especially: Trumping Bureaucracy and Taking Intelligent Risk.

A critical factor in providing the best possible service to our customers is to keep the channels of communication as short as possible and to cut out unnecessary bureaucracy, something we call Trumping Bureaucracy. As the Bank expands this becomes an increasingly vital facet of business. We believe that efficient procedures and a clear definition of responsibility enable us to deliver on our customers' demands. We don't believe that efficiency in decision making entails more risk, quite the contrary; we believe that slow and cumbersome processes undermine accuracy.

Risk management has always been the key element in our operations. Some might fear that quick and efficient decision-making means poorer decisions. However, taking longer to reach a decision doesn't mean the decision is necessarily any better. Banking primarily revolves around taking risks. The heart of the matter is to be fully aware of the risk involved in every decision and to ensure that the risk is never more than is necessary. For this reason Risk Management forms the foundation for everything we do.

Prospects

Our prudent growth strategy will continue in other countries, but not at the expense of profitability. The year 2006 left the Bank in a strong position, with good diversification in terms of income streams and geography and strong asset quality. We still consider the Bank a growth company and see a wide range of opportunities to add to the Bank's strength. The year ahead looks promising and at the moment there is little to suggest anything other than a good year in front of us. Nevertheless one must not forget that companies such as Kaupthing Bank are dependent on a variety of external factors, which can have an impact on operations.

Following the completion of a successful offering to international institutional investors last November, Kaupthing Bank has now secured excess equity capital. It is our intention to use this excess capital to reinforce the Bank, either to support further organic growth or to finance acquisitions. I would therefore like to reiterate that, as always, the interests of shareholders will be the prime consideration when deciding what the next steps will be. Growth in and of itself is not the goal; profit comes first followed by growth.

In conclusion I would like to thank our customers for their business and trusting us to help them make their visions into reality. I am also grateful to our shareholders for having faith in the worth of our organization. Lastly, I would like to extend my gratitude to our remarkable team of employees for their diligence and commendable performance during the year. And to the skilled individuals who have joined us this year and will enable us to reach new heights, I welcome you. The Bank faced a host of challenges in 2006, but the most important achievement of the year was the growth we gained from rising to these challenges and beyond.

Hreidar Már Sigurdsson

Gordon Ramsay

Despite Gordon Ramsay's booming culinary empire (with nine restaurants in the UK alone, ten Michelin stars, five television programs, and three Catey awards), food remains Ramsay's bread and butter, just as it should be. But his great taste extends beyond the palate, as he has entrusted his private banking business to Kaupthing Bank, as well as mortgage services for his properties and debt financing for funding. Our quick decision-making coupled with rational flexibility make us the ideal complement to his rapidly expanding enterprise. Gordon Ramsay's relentless pursuit of culinary perfection has led to well earned prosperity and acclaim – in no small part because the UK's premiere chef is a notorious stickler for detail. Fortunately, so are we. We'll stand the heat, so he can stay in the kitchen.

YEAR IN REVIEW

Results 2006

- Another record year for Kaupthing Bank.
- Net shareholders' earnings increased by 73%, amounting to ISK 85 billion (€971 million).
- Earnings per share amounted to ISK 127 compared with ISK 75 in 2005.
- Return on equity was 42%, well above the Bank's target of 15%.
- Equity grew by 67%, amounting to ISK 324 billion at year end (€3.4 billion).
- The equity ratio was 15.0% and the Tier 1 ratio was 10.5% at year end, which is above the Bank's targets of 11.0% and 8.0%, respectively.
- Total assets amounted to ISK 4,055 billion (€42.9 billion) at year end 2006, growing by 60% during the year.

Integration in the UK

- Kaupthing Bank's UK activities, including Kaupthing Limited and Singer & Friedlander's headquarters, relocated to a single building on Hanover Street in the heart of London. At the same time Kaupthing Bank's activities in the UK took on the name Kaupthing Singer & Friedlander (KSF) and commenced operations as a truly unified operation.
- Key employees in the Kaupthing Bank Group were strategically placed in management positions at, Singer & Friedlander to facilitate the integration, and during 2006 a number of key management appointments were made.
- During 2006 Kaupthing Bank put considerable effort into integrating Kaupthing Singer & Friedlander into the Group. The integration efforts were aimed at simplifying and sharpening the focus of the entire organization and aligning it with the structure already in place across the Kaupthing Bank Group.

Diversification of Funding

- In 2006 the Bank diversified its funding sources by issuing bonds to investors in the United States, Australia and Japan.
- The Bank intends to be a regular issuer in the bond markets in US and Europe as well as in other markets such as Australia, Japan, Canada and Switzerland.
- The Bank's liquidity position was significantly strengthened during 2006 with new, more stringent secured liquidity measures. The Bank's policy is now to hold enough secured liquidity to meet all maturing obligations for the next 360 days.

Share Offering

- In November 75.9 million new shares in Kaupthing Bank were offered for sale at a price of ISK 750 or SEK 75 per share. The offering attracted excess demand and shares were placed with a diverse group of international institutional investors.
- The offering generated proceeds of ISK 55.6 billion which was used to strengthen the Bank's capital base and to support the further expansion of Kaupthing Bank. The offering successfully achieved the international diversification of the Bank's shareholder base.

Dissolving Crossholdings in Exista

- Plans were announced to dissolve crossholdings in the financial service company, Exista, at the AGM in March 2006.
- During the third quarter Kaupthing Bank sold 10.1% of the total shares in Exista, in connection with the listing of Exista on the Iceland Stock Exchange, and in October Kaupthing Bank paid out extra dividends to the Bank's shareholders in the form of 7.7% of the total shares in Exista. The book value of the dividend payment was ISK 18.3 billion.
- By selling shares in connection with the listing of Exista and by paying an extra dividend, the Bank's stake in Exista was reduced from 20.9% to 3.2% by the end of the year.

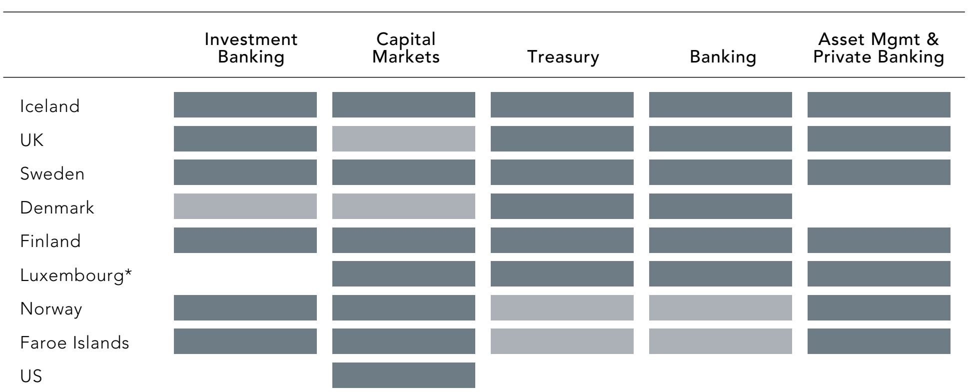
Strengthening Operations

- The year 2006 was used to consolidate the Bank's operations; the number of employees increased by 351 or 15%, mainly outside Iceland; new business segments were set up, such as Capital Markets in the UK and Investment Banking and Capital Markets in Denmark.
- Kaupthing Bank's growth strategy aimed at increasing income diversification, enhancing asset quality, and broadening the services offered.
- The diversification of income is constantly increasing, with the UK, Denmark and Iceland currently the most important markets, but there is strong growth in other countries, particularly in Luxembourg and Sweden.
- At the end of 2006 Kaupthing Bank has operations in ten countries, including all the Nordic countries, the UK, Luxembourg, the US, and Switzerland. During 2006 many important steps were taken towards strengthening the local presence in each market area and, at the same time, establishing the Bank as a leading northern European corporate and investment bank.

OPERATIONS & ORGANIZATION

Kaupthing Bank is a northern European bank operating in ten countries, including all the Nordic countries, the UK, Luxembourg, Switzerland and the US.

Kaupthing Bank offers integrated financial services to companies, institutional investors and individuals. These services include Corporate Banking, Investment Banking, Capital Markets services, Asset Management and comprehensive wealth management for Private Banking clients. In addition the Bank operates a retail franchise in Iceland, where it is headquartered. The Bank employed 2,719 people in ten countries at the end of 2006. The diagram below illustrates the services offered in each country:



*Operations in Switzerland report to the office in Luxembourg
Light gray boxes indicate new segments in 2006

In recent years Kaupthing Bank has been one of the fastest growing financial groups in Europe. The Bank's expansion has been achieved through sound organic growth and a number of strategic acquisitions. The most recent acquisitions are those of FIH Erhvervsbank in Denmark in 2004 and in 2005 the UK bank Singer & Friedlander, now Kaupthing Singer & Friedlander. The aim of this growth is to further enhance the Bank's ability to provide comprehensive services to its client base in the UK, the Nordic countries and elsewhere in northern Europe.

Kaupthing Bank is listed on the stock exchanges in Stockholm and Reykjavík. The Bank focuses on shareholder value, meaning the expansion of the Group has not been achieved at the expense of profitability. The year 2006 proved to be another successful period of solid organic growth, integration and record earnings. From its strong cross-border platform, Kaupthing Bank is in an excellent position to meet clients' local and international needs in financial services.

STRATEGY & STRENGTHS

Kaupthing Bank's goal is to become a leading provider of integrated financial services for small and medium-sized enterprises (SMEs), institutional investors and high net-worth individuals in northern Europe. The Bank intends to achieve this central goal by taking the following measures.

Focusing on Defined Clients, Products and Geographies

The Bank caters to a market niche as an integrated financial services provider for SMEs, institutional investors and high net-worth individuals, which the Bank believes are not adequately served by larger financial institutions. Kaupthing Bank provides these clients with the full range of products offered by larger financial institutions, with investment banking and corporate banking at the core of the strategy, complemented by capital markets, asset management and private banking, products and businesses which are provided at most regional locations.

As a result, income streams are well diversified across all business areas, while the asset base is diversified across countries and industries. Geographically, the Bank's revenues are increasingly spreading across regions. The focus remains on northern Europe, with an emphasis on the Nordic region. However, the Bank recognizes the need to be present in key European financial centers such as the United Kingdom, Luxembourg and Switzerland.

Leveraging Diversification of the Business through Cross-selling

A key advantage of Kaupthing Bank is its ability to provide a wide range of financial services to its clients, including co-investment, financing, advisory and capital markets services, as well as wealth management. The Bank capitalizes on the diversification of its business across product lines and, as appropriate, across regions by cross-selling the full range of products to an existing client base.

For corporate clients, which are primarily SMEs, this includes acting as a partner to help them realize a sustainable growth platform. In addition to providing a full range of banking, investment banking, capital markets, asset management and treasury services, from time to time the Bank also takes equity stakes in its corporate clients to more fully align its economic interests with those of clients. For individual clients this includes offering the full range of banking and brokerage services, as well as "wealth architecture" services to high net-worth individuals for the management, protection and enhancement of their financial assets. The Bank believes that these efforts leave it well positioned to continue its strong record of organic growth.

Balancing Organic Growth with Well-executed Acquisitions

Kaupthing Bank maintains that the recent strategic acquisitions of FIH in 2004 and of Singer & Friedlander in 2005 have contributed to the establishment of a strong operating platform for organic growth. The Bank intends to continue expanding its operations in targeted geographic areas through a combination of organic growth, supported by strong cross-selling, and selected acquisitions that fit the strategic vision.

With respect to acquisitions, the Bank seeks to achieve a return on equity raised in connection with any acquisition of 15% and a return on equity of 15% for the acquired subsidiary within 18 months of closing. In the long term the Bank seeks to achieve a 15% return on the aggregate purchase price. However, increased size is not considered an objective in its own right, as the Bank evaluates both organic growth opportunities and potential acquisitions with a view to maximizing financial performance.

Employing Strong Operational Discipline

Risk management is at the heart of all Kaupthing Bank's operations, as there is a continuous effort to improve the asset quality of the loan portfolio and minimize trading losses. Risk is controlled centrally, with local risk managers reporting from each market area, in addition to supporting a credit approval process. This has manifested in strong credit quality and sustained cost discipline, notwithstanding the rapid growth of the Bank's business. Kaupthing Bank has, in part due to more favorable conditions in the credit cycle in the countries where it operates, been able to decrease the ratio of non-performing loans to loans to customers from 3.7% as of 31 December 2003 down to 1.0% as of 31 December 2006.

KEY BUSINESS OBJECTIVES

In order for Kaupthing Bank to fulfill its potential as a leading provider of financial services in northern Europe, the Bank maintains a number of key business objectives that it believes are necessary stepping stones towards achieving its long-term goals. In recent years these objectives have been demonstrated by Kaupthing Bank's determined strategy of international expansion, both through organic and acquisitive means.

- Maximize the Bank's value and long-term shareholder value
- Achieve at least 15% long-term return on equity
- Maintain a Tier 1 ratio above 8.0% and a equity ratio (CAD) above 11.0%
- Maintain a dividend payout ratio of 10% to 30%
- Sustain solid growth without compromising profitability
- Develop and maintain dependable, long-term relationships with clients

In order to ensure that Kaupthing Bank's clients are provided with exceptional guidance and receive the best possible service, the Bank has organized the tenets of its culture into eleven business principles. These principles are undertaken by all the Bank's operations and are reviewed on a regular basis. A further description of the Bank's principles can be found in the Corporate Culture chapter on page 96.

CORPORATE RESPONSIBILITY

As a multinational company with a substantial presence in a number of national economies, Kaupthing Bank is dedicated to ethical corporate behavior. The Bank supports sustainable development by contributing to economic development and improving the quality of life for its employees, the communities where it operates, and society at large.

Taking responsible and responsive action is an integral part of Kaupthing Bank's corporate culture. Responsible behavior towards clients, our shareholders and employees is an essential element of the Bank's daily business. By the same token, Kaupthing Bank takes the same pride in responsible and responsive action with regard to the communities where it carries out its business.

A flourishing community creates a flourishing business. By supporting charitable causes, educational programs, cultural life and sports, The Bank seeks to help people achieve their goals and, at the same time, make life richer for all of us. While Kaupthing Bank is an international bank, it strives to maintain a local presence in each market. For this reason, the decisions regarding Kaupthing Bank's corporate sponsorship are put in the hands of the members of the Bank's community who are local to the issues and know where the Bank's efforts can make the biggest difference.

Kaupthing Bank is a committed equal opportunity employer, adhering to the highest social standards. The Bank seeks to provide a superior working environment for its staff based on diversity and respect for the importance of the individual. At the same time, the Bank expects its people to engage in the highest ethical standards and show respect for the individual in all their work for the Bank.

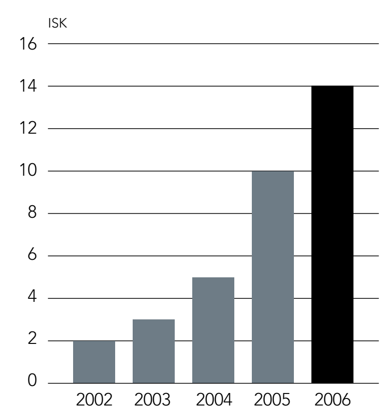
SHARES IN THE BANK

It is the main objective of Kaupthing Bank to create value for its shareholders. The Bank's shares are listed on both the Iceland Stock Exchange and the Stockholm Stock Exchange under the ticker symbol KAUP. At the end of 2006 the Iceland Stock Exchange merged with the OMX Nordic Exchange and is henceforth called the OMX Nordic Exchange in Iceland and will be referred to as such throughout this chapter.

Dividends & Dividend Policy

Kaupthing Bank's current policy is to pay dividends corresponding to about 10-30% of annual profit. The amount of dividends is also subject to the applicable restrictions of Icelandic law and other factors the Board sees fit to take into account. This year Kaupthing Bank's Board of Directors will propose that dividends for 2006 totaling ISK 10,366 million, or ISK 14 per share, be paid out to shareholders, an amount representing 12.2% of net profit. Based on the Bank's share price as of 31 December 2006, ISK 841, the dividends correspond to 1.7% of market capitalization.

Dividend per share*



* Without the extraordinary dividend payment of ISK 27.6 in 2006.

Extraordinary Dividend in Exista

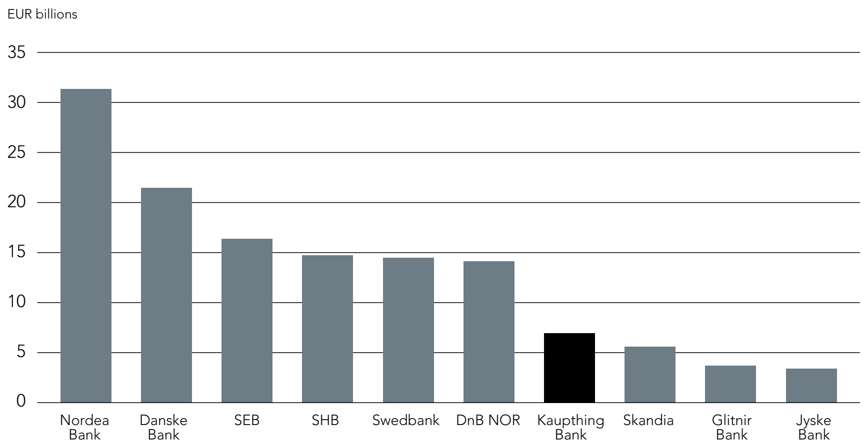
On 16 October 2006 Kaupthing Bank held an extraordinary shareholders' meeting where a proposal for an extraordinary dividend payment was approved. The extraordinary payment consisted in the Bank paying its shareholders dividends in the form of 830,691,316 shares in Exista hf. on 26 October 2006. Shareholders received 1.25 shares in Exista for each share owned in Kaupthing Bank (a 1.25:1 ratio). The total dividend payment represented 7.7% of Exista's total share capital.

This extraordinary payment constitutes the final step in a process meant to reduce Kaupthing Bank's holdings in Exista to an unsubstantial level, as was announced at the Bank's Annual General Meeting in March 2006.

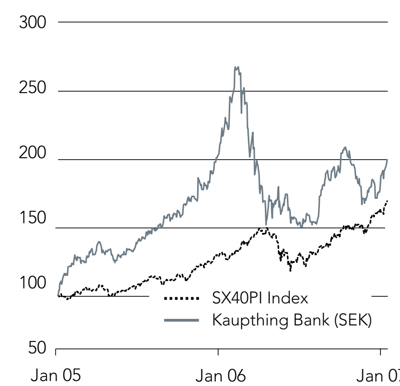
Share Performance

Over the year Kaupthing Bank's share price rose from ISK 746 to ISK 841, an annual increase of 12.7%. Taking into account dividend payments, including extraordinary dividend payments, this growth represents a return for shareholders of 17.8%. As a frame of reference, the Main List of the OMX Nordic Exchange in Iceland rose by 15.8% over the year while the Stockholm Stock Exchange rose by 19.5%. Kaupthing Bank's total market capitalization by the end of 2006 reached ISK 623 billion (€6.6 billion). In terms of market capitalization, Kaupthing Bank is now the 7th largest bank

Largest Nordic banks by market capitalization as of 31 December 2006



Share price performance of Kaupthing Bank in 2005-2006 compared with SX40 Financials on the Stockholm Stock Exchange

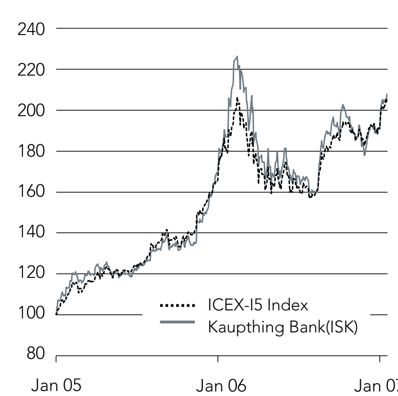


in the Nordic region, as illustrated by the chart above. At the end of 2006 the P/E ratio of Kaupthing Bank was 6.6 and the P/B ratio was 1.9.

Share Capital

Kaupthing Bank's Share capital as of 31 December 2006 amounted to ISK 7,404,530,530 in nominal value, divided into 740,453,053 shares. Each share has a nominal value of ISK 10 and entitles its holder to one vote. All shares are of the same class and hold equal rights. All issued share capital in Kaupthing Bank is listed on the Main List of the OMX Nordic Exchange in Iceland and on the Stockholm Stock Exchange.

Share price performance of Kaupthing Bank in 2005-2006 compared with ICEX-15 on the OMX Nordic Exchange in Iceland



Shareholders

At the end of 2006 Kaupthing Bank's shares were held by a total of 31,730 shareholders, including 6,141 shareholders in Sweden. Of the total Share capital approximately 80% is held by Icelandic entities and 20% by international investors. Ownership is

Shareholdings as of 31 December 2006

Shareholding	Shares	% of total Share capital	Number of shareholders	% of share-holders
1-1,000	6,553,988	0.9%	22,823	71.9%
1,001-10,000	23,391,111	3.2%	7,578	23.9%
10,001-100,000	26,857,759	3.6%	1,065	3.4%
100,001-1,000,000	57,001,036	7.7%	176	0.6%
1,000,001<	626,649,159	84.6%	88	0.3%
Total	**740,453,053**	**100%**	**31,730**	**100%**

20 largest shareholders as of 31 December 2006*

Shareholder	Shares	%
Exista B.V.	140,214,493	18.94%
Kjalar Invest B.V.	71,883,352	9.71%
Vátryggingafélag Íslands hf.	26,806,419	3.62%
Lífeyrissjódur verslunarmanna	21,106,017	2.85%
Lífeyrissjódir Bankastraeti 7	20,791,039	2.81%
Gnúpur fjárfestingafélag hf.	17,142,371	2.32%
Gildi -lífeyrissjódur	16,694,013	2.25%
Kaupthing banki hf.	11,667,649	1.58%
Norvest ehf.	10,800,000	1.46%
Kaldbakur ehf.	8,340,400	1.13%
Sigurdur Einarsson	6,368,423	0.86%
Fjárfestingasjódur Ís-15	6,355,038	0.86%
Everest Equities Ltd.	6,328,927	0.85%
Sund ehf.	5,995,906	0.81%
Holt Holding S.A.	5,506,904	0.74%
Hreidar Már Sigurdsson ehf.	5,423,239	0.73%
Sameinadi lífeyrissjódurinn	5,143,763	0.69%
Samvinnulífeyrissjódurinn	3,862,367	0.52%
AMF Pensionsförsäkrings AB	3,800,000	0.51%
Ingvar Vilhjálmsson	3,658,902	0.49%

*Nominee accounts not included

well distributed, as is clearly demonstrated when shareholders are classified by the size of their holding. At the end of 2006 one shareholder held more than 10.0% in the Bank: Exista B.V. with 18.9% as seen in the list of largest shareholders above. In total Exista holds 23.0%.

Purchase of Own Shares

According to an authorization granted at the Annual General Meeting of Kaupthing Bank in March 2006, the Board can purchase up to 10% in nominal value of its own Share capital. The price paid shall be no lower than 20% below, and no higher than 20% above the rate at which the Bank's shares are priced on the OMX Nordic Exchange in Iceland or the Stockholm Stock Exchange. A net total of approximately 7.6 million shares of the Bank's treasury stock were bought during the year, leaving a remainder of 8.4 million own shares at year end 2006.

Increase in Share Capital

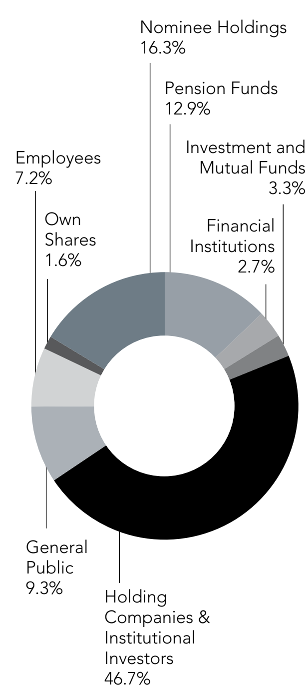
According to an authorization granted at the Annual General Meeting of Kaupthing Bank in March 2006, the Bank can increase its own Share capital by up to ISK 1,250 million in nominal value through a subscription of up to 125 million new shares.

In November 2006, 75.9 million new shares in Kaupthing Bank were offered at a price of ISK 750 or SEK 75 per share. The offering attracted excess demand, and shares were placed with a diverse group of international institutional investors. The offering generated net proceeds of ISK 55.6 billion, which was used to strengthen the Bank's capital base and support the further expansion of operations. The offering successfully achieved the international diversification of the Bank's shareholder base. Citigroup Global Markets Limited and Morgan Stanley & Co. International Limited acted as joint global coordinators and joint bookrunners for the offering. Fox-Pitt, Kelton N.V. acted as a co-lead manager for the offering and Kaupthing Bank acted as a selling agent. After an over-allotment option was exercised, the Share capital of Kaupthing Bank at year end amounted to ISK 7,404,530,530 at nominal value, divided into 740,453,053 shares.

Change in Share capital during 2006

	Share capital (ISK millions)	Number of shares (millions)	Market value (ISK millions)
Shares outstanding as of 1 January	6,638	663.8	495,195
New shares issued	759	75.9	55,558
Purchase and sale of treasury stock	-76	-7.6	-5,730
Change in market value			70,673
Shares outstanding as of 31 December	7,321	732.1	615,696
Own shares at year end	84	8.4	7,064

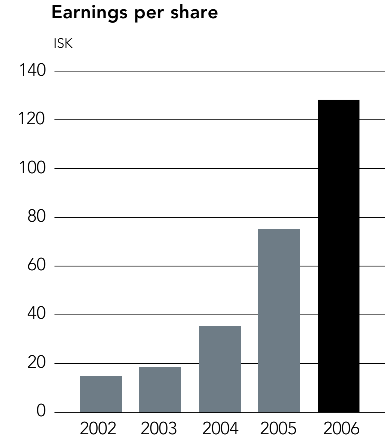
Shareholder structure as of 31 December 2006



Earnings per Share

The Bank reported net shareholders' earnings of ISK 85,302 million in 2006, corresponding to ISK 127.1 per share. The Bank's equity totaled ISK 323,510 million at year end 2006.

Earnings per share



Figures for Kaupthing Bank shares in 2006	
Share price at year end, ISK	841
High/Low, ISK	999/701
Market capitalization, ISK million	622,721
Dividend per share, ISK	37.6
Shareholder's return (adj. for dividend)	17.8%
P/E ratio	6.6
Price-to-book stated	1.9
Number of issued shares	740,453,053
Issued Share capital, ISK	7,404,530,530

Liquidity of Kaupthing Bank Shares

Shares in Kaupthing Bank are highly liquid. Turnover in the Bank's shares averaged approximately ISK 1,936 million, and the average volume was 2.3 million shares per trading day in 2006. The turnover rate was 87% over the year. The majority of trading with the Bank's shares takes place in Iceland, with 86% on the OMX Nordic Exchange in Iceland and 14% on the Stockholm Stock Exchange on average for the whole year. However in the fourth quarter and following the successful offering of Kaupthing Bank shares to international investors, trading on the Stockholm Stock Exchange in the Bank's shares increased substantially. The total turnover in Kaupthing Bank shares on both stock exchanges totaled ISK 483 billion over the year. In terms of market value Kaupthing Bank was the largest company listed on the OMX Nordic Exchange in Iceland. The average spread was 0.5% on the OMX Nordic Exchange in Iceland and 0.6% on the Stockholm Stock Exchange.

Employee Shareholding

Most Kaupthing Bank employees are shareholders or owner of options in the Bank, as the Bank firmly believes that the employees' equity interest in the Bank fosters commitment and personal interest in the success of the Bank as a whole. Kaupthing Bank employees owned approximately 7.2% of the Bank at year end.

The first option agreements were made in 2000, with the number of options varying between employees, as is customary with employee stock option plans. Since then the Bank has entered into further agreements, as can be seen in the table on the next page. Most option agreements are set up so that employees are allocated a fixed number of options, a part of which may be exercised every year at a fixed price. All options that remain unexercised at the end of the period of the relevant agreement are negated. However, options granted in October 2002 can only be exercised on the date of their expiry.

In November 2005 the Board of Directors of Kaupthing Bank decided on the basis of the Bank's stock option scheme to grant approximately 2,300 employees in the Group stock options to buy shares in the Bank, and in December 2006 it was announced that the Board of Directors had decided on the basis of the Bank's stock option scheme to grant further stock options to 564 employees to buy a total of 0.6 million shares, i.e. new full-time employees who began working for the Bank after stock options were granted in November 2005. As of 31 December 2006 the total of allocated employee stock options amounted to 38.0 million shares. Kaupthing Bank will use its own shares or increase Share capital in order to fulfill employee stock options.

Compliance

Strict rules govern securities trading by employees of Kaupthing Bank. The Bank's Compliance Officer ensures that the appropriate rules and regulations are strictly followed by monitoring all such trades. The role of the Compliance Officer is discussed in further detail on page 49.

Stock option plan

Date granted:	Number of shares in thousands	Vesting conditions:	Contractual life of options	Exercise price
October 2002	180	5 years of service. The stock option is exercisable 2007	5 years	120
March 2004	3,248	4 years of service. The stock option is exercisable 2007-2008	4 years	303
December 2002	887	6 years of service. One third of total stock option is exercisable each year 2007-2008	6 years	65.22
November 2005	3,593	3 years of service. One third of total stock option is exercisable each year 2007-2009	3 years	600
November 2005	7,815	3 years of service. One third of total stock option is exercisable each year 2007-2009	3 years	600/630 /660
December 2006	636	3 years of service. One third of total stock option is exercisable each year 2008-2010	3 years	840
December 2006	21,675	5 years of service. One third of total stock option is exercisable each year 2010-2012	5 years	830/872 /916
Total share options	**38,034**			

Investor Relations

Kaupthing Bank aims to provide investors and analysts with clear and detailed information on the activities and operations of the Bank. Great emphasis is placed on developing investor relations. The Bank's website, www.kaupthing.com, provides easy access to the Bank's announcements to stock exchanges, annual reports and quarterly results, as well as other information for market participants, shareholders, and the media. Below are the main channels for investor relations.

Website

The Bank's website is the primary channel for the dissemination of investor information. The investor relations website at www.kaupthing.com/ir provides a wealth of information including live share information, press releases and regulatory announcements to stock exchanges, the latest financial reports and presentations, an event calendar, and an extensive archive of all the Bank's releases with a detailed search interface.

Financial Reports

Kaupthing Bank's Annual Report is published in English only. It is available in PDF and HTML formats on the Bank's investor relations website, www.kaupthing.com/ir. The annual report is also sent to all shareholders with more than 10,000 shares in the Bank and to anyone else specially requesting it. A copy of the annual report can be ordered at www.kaupthing.com/ir.

In addition to the annual report, Kaupthing Bank releases detailed reports and analysis on its quarterly results. These financial reports are available on the investor relations website.

Annual & Interim Presentations

Kaupthing Bank's quarterly and annual results are presented by the Bank's senior management. Analysts and investors are invited to attend these presentations in person via the live webcast or through dial-in facilities. A video of the presentation along with presentation materials are made available on the Bank's website afterwards.

RSS Feed and SMS & E-mail Subscriptions

Kaupthing Bank makes its information available in a number of ways, including RSS feeds, SMS messaging and e-mail alerts. With these tools users can choose to receive press releases, regulatory announcements, as well as financial reports and presentations. Subscriptions to these services can be set up and customized at the Bank's investor relations website.

Press Releases & Regulatory Announcement

Regulatory announcements to stock exchanges and breaking news from the Bank are made available on the investor relations website or through the subscription services above. The website also offers a search option for all such releases.

Investor Relations Contacts

Kaupthing Bank's Investor Relations team is available to investors and analysts to answer all questions and provide information about the Bank and its operations. Contact information for the Investor Relations team can be found at www.kaupthing.com/ir.

Karen Millen

Under the meticulous hands of designer Karen Millen, what began as 100 meters of white cotton unfurled into a global design enterprise spanning three continents. Karen Millen has proven to be an agent of innovation in her field by making designer-wear available to the high-street market. In this same spirit of innovation, Kaupthing Bank makes a broad spectrum of comprehensive financial services available to small and medium-sized enterprises. After Karen Millen experienced considerable growth with the support of our Investment Banking department, we were able to grow alongside her by providing her with private banking and discretionary asset management to make the most of her success. Our integrated approach to financial services fits like a glove when it comes to long-term client relationships, and Karen Millen's ambitious goals and forward thinking have certainly found their match in Kaupthing Bank. Simply put, we like her style.

RISK MANAGEMENT

Kaupthing Bank faces various types of risks related to its business as a financial institution. The Risk Management division is devoted to the management of these risks, the most significant of which are listed below. The mainstays of effective risk management are identifying significant risk, quantifying the Bank's risk exposure, implementing actions to limit risk and constantly monitoring risk.

Kaupthing Bank's Risk Policy

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

The Board of Directors determines Kaupthing Bank's goals in terms of risk by issuing a risk policy. The risk policy both defines acceptable levels of risk for day-to-day operations, as well as the willingness of Kaupthing Bank to incur risk, weighed against the expected rewards. The risk policy is detailed in the Internal Control and Procedural handbook, which is maintained by Risk Management and revised at least once a year. Amendments or minor changes can be made more frequently, but each change needs the approval of Kaupthing Bank's Chief Executive Officer before it comes into effect, and then it must be approved by the Board of Directors at its earliest convenience.

It is incumbent upon the Risk Management division to enforce the risk policy. In order to do so Risk Management constantly monitors risk, with the aim of identifying and quantifying significant risk exposures and acting upon such exposures if deemed necessary. To ensure that the decision-making process within Kaupthing Bank is regulated and that the boundaries set by the Board of Directors and regulatory authorities are not exceeded, Risk Management regularly reports risk exposures, usage of limits and any special concerns to senior management and the Board of Directors. The Risk Management division is divided into six departments: Credit Control, Credit Risk Analysis, Credit Administration, Market Risk, Operational Risk and Research & Design, which is responsible for developing risk models and risk analysis tools for Kaupthing Bank's operations.

Credit Risk

Credit risk is the current or prospective risk to earnings and capital arising from the failure of an obligor of Kaupthing Bank to repay principal or interest at the stipulated time or failure otherwise to perform as agreed. This risk is compounded if the assigned collateral only partly covers the claims made to the borrower, or if its value is variable or uncertain. Credit risk arises anytime the Bank commits its funds with the result that capital or earnings are dependent on a counterparty's, issuer's or borrower's performance. This type of risk is composed of concentration risk, residual risk, credit risk in securitization, cross-border (or transfer) risk and others.

Carefully monitored credit risk serves as a basis for stable profits. Kaupthing Bank's main asset is its loan portfolio. To maintain and further improve a healthy loan portfolio it is imperative to scrutinize all applications and weed out potential problem loans during the application phase, as well as constantly monitor the current loan portfolio. While it is not the Bank's policy to issue credit only for cases of very low risk, it is of the utmost importance that the price of issued credit reflects both the risk and the cost incurred. This means that a detailed assessment of individual customers, their financial positions, and the collateral in question is a prerequisite for granting credit.

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 with 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.

The pricing of each credit granted should reflect the risk taken. The client's interests should 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.

In the long run the credit strategy aims to have write-offs represent less than 5% of interest income. All aspects of the credit process should be designed and implemented with this long-term goal in mind.

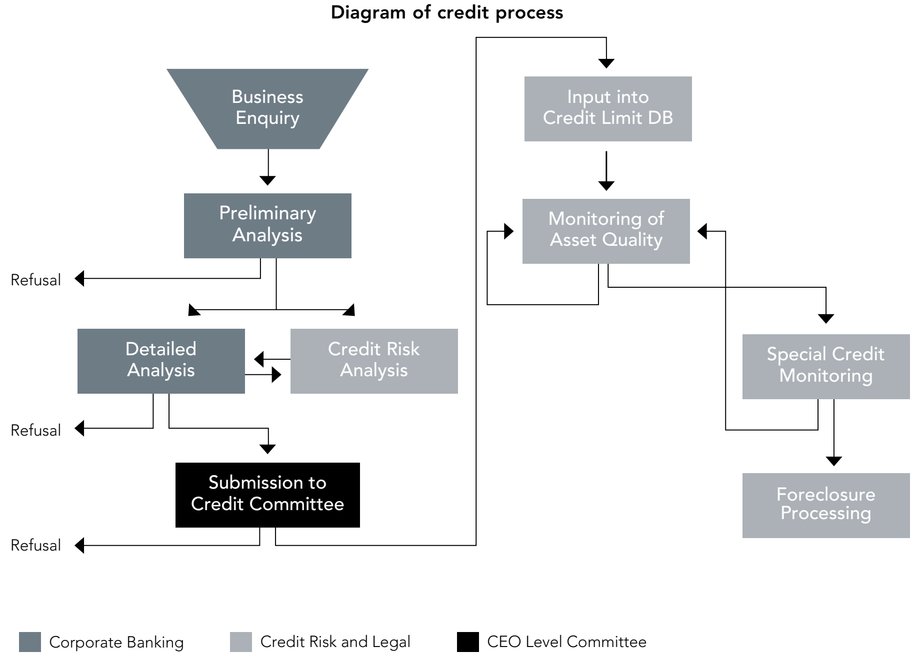
Provisions for losses should reflect the expected loss, both for loans for which specific provisions exist as well as for portfolios of performing loans. The collective assessment of such portfolios should be based on default predictions and loss given default parameters.

Day-to-day credit risk is monitored by Risk Management. Risk Management is responsible for the development and maintenance of credit monitoring and reporting systems. This includes collecting data from all operational systems within the Bank, data verification and unification. The department also performs numerical analysis of the loan portfolio, e.g. estimating expected loss, concentrations within the loan portfolio and mapping defaults in a systematic way. The proprietary credit models employed within the Bank have been developed by Risk Management within the Parent Company and locally within subsidiaries.

Credit Process

The Bank employs a credit decision process incorporated across the Group and within each subsidiary as well. The highest authority in the credit process is the Parent Company's Board Credit Committee. The process structure is based on the hierarchy of the credit committees below the Board Credit Committee, which operate on 2-3 levels and within different bounds depending on the size of the subsidiary. The principle of central management of risk and decision authority is maintained by having the Bank's CEO or his deputy as a member of the Board Credit Committee at each subsidiary.

Diagram of credit process



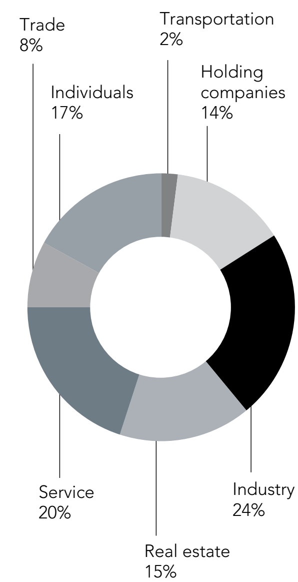
This structure gives Kaupthing Bank the possibility to incorporate much needed local expertise, but at the same time manage risk on a global level. Local credit committees of the Bank's subsidiaries are thus able to grant credits, but the sum total of the exposure of the applicant and financially related counterparties is limited, most commonly by the subsidiary's capital. All applications that would lead to exposures exceeding the set limit are referred to the Board Credit Committee of the Parent Company.

If a preliminary analysis of account manager in Corporate Banking indicate that a business enquiry merits further scrutiny, it is then analyzed in greater detail. If it passes the detailed analysis it is then submitted to the credit committee along with a standard credit risk analysis of the borrower, i.e. a credit rating.

The standard credit evaluation process is based both on quantitative figures from the Financial Statements and on an array of qualitative factors. In this case, factual information on the borrower is collected as well as pertinent macroeconomic data, such as an outlook for the relevant sector, etc. These subjective factors are assessed by answering predetermined questions. Here the analyst cannot rely solely on his quantitative skills, but must also have extensive knowledge of the inner workings of the company in question and be in close contact with its management. Furthermore, a facility rating of the collateral is performed to determine the loss parameter in the case of default

The credit rating of the counterparty plays a fundamental role in the final decision of the committee as well as in the forms being offered in the case of the application being accepted. If the client accepts the terms offered, then the loan becomes part of the loan portfolio, where long-term monitoring takes place with regard to limits and the credit quality of the client. In particular, the client is re-rated using the standard credit rating at least once a year. The loan is placed under special credit monitoring if weakened credit quality or other signs become evident, such as breach of loan covenants or a missed payment. If conditions improve the loan may be removed from the special monitoring, but in some cases the loan may eventually end in foreclosure.

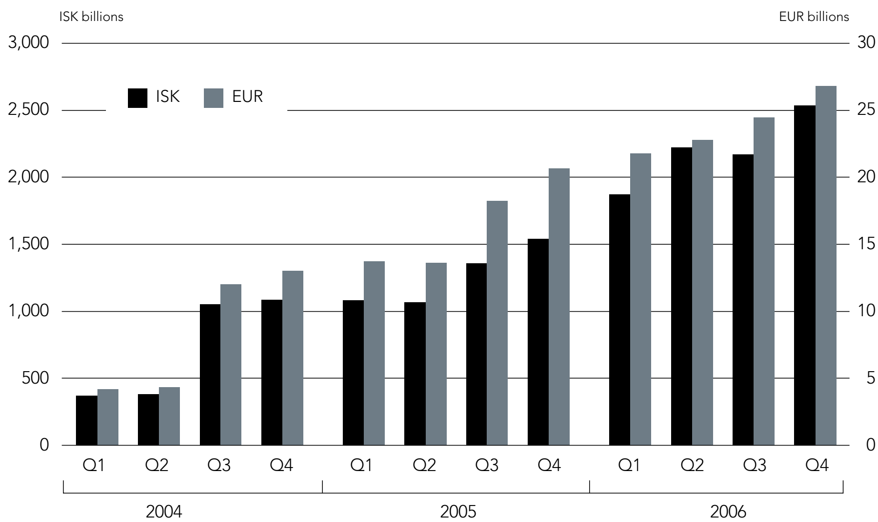
Sector division of loan mass at year end 2006



Credit Exposure

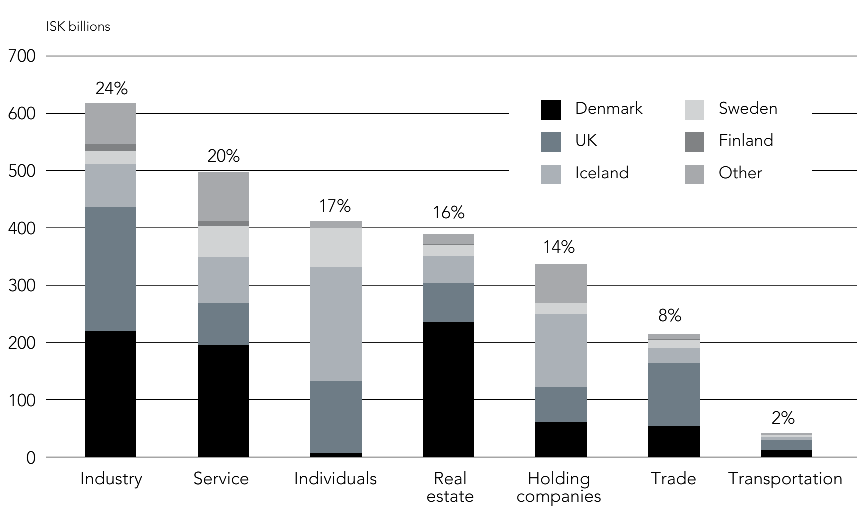
At year end 2006 loans to customers amounted to ISK 2,539 billion. The loan portfolio grew by approximately 64% in 2006 when denominated in ISK. However, only around 14% of loans to customers were denominated in ISK at year end, and around half of this increase can be attributed to the weakening of the ISK in 2006. When measured in EUR, loans to customers increased by around 30% during the year. This is all organic growth as no acquisitions were made during the year.

Portfolio of loans to customers

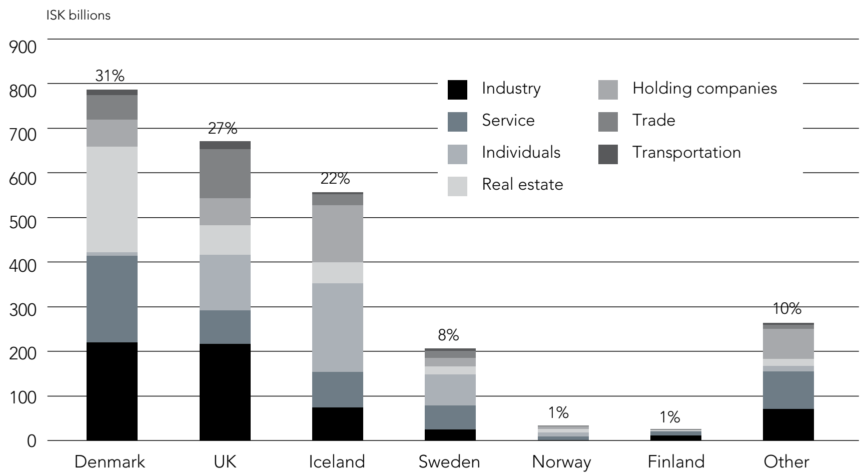


The portfolio is well diversified, with the Bank's largest exposure to companies within the industry sector around 24%, followed by service and individuals with 20% and 17%, respectively. More than two-thirds of these industries and more than half of the services are located in Denmark and the UK. Just under half of exposures to individuals is Icelandic in origin, with mortgage loans representing more than half of that particular exposure. While Danish real estate is most prominent, around 5% of the portfolio has gone to holding companies of Icelandic origin.

Industry & origin of clients



Origin of clients & industry



With respect to geography, the Bank's exposure is highest in Denmark with around 31%, with industry, service and real estate most significant. Around 27% of the exposure is to clients within the UK, where industry and individuals are most prominent. The third highest country concentration is Iceland with around 22% of loans to customers.

Asset Quality

Kaupthing Bank's main asset is its loan portfolio. An informative way of assessing the quality of the loan portfolio and how it has been evolving is to examine loan-loss reserves in relation to the linked quantities: write-offs, non-performing loans and provisions. To make the comparison meaningful over time and between different financial institutions it is most natural to display these quantities as a percentage of the total loan portfolio. In the chart on the next page this is shown for the Bank over the period 1999-2006 (with combined data for Kaupthing Bank and Búnadarbanki up to 2002).

From 1999 to 2003 these measures stayed relatively consistent, but over the last three years they have all improved. Although loan-loss reserves have declined in terms of total loans, the ratio between loan-loss reserves and non-performing loans is still high. Both provisions and impairment have been declining in recent years and the ratio of non-performing loans in relation to total loans to customers has stayed around 1% last two years.

These are all signs of a greatly improved loan portfolio; the tactical changes made with regard to credit over recent years come to fruition and will continue to improve the asset quality in coming years.

Loan-loss reserve as a percentage of total loans

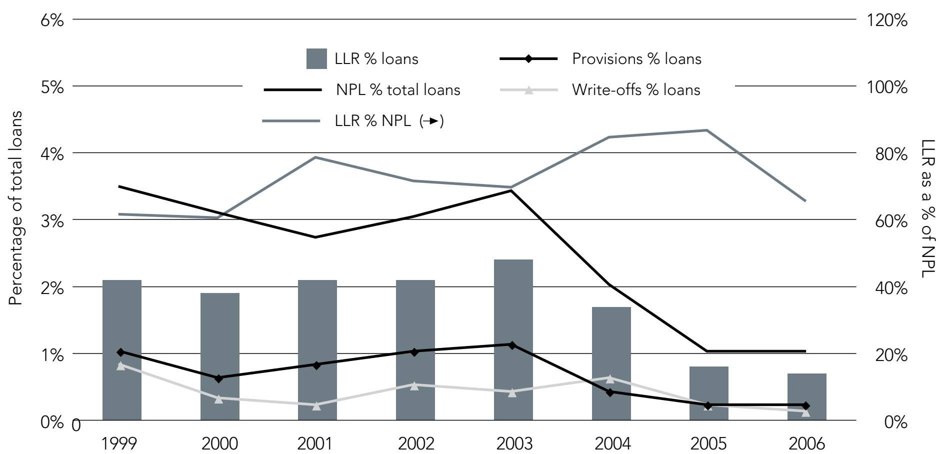


Chart showing the loan-loss reserve (LLR) as a percentage of total loans. It also shows the percentage of total loans which are write-offs, non-performing loans (NPL) and provisions. The dark gray line and the axis to the right show the LLR as a percentage of NPL.

Market Risk

Market risk is the current or prospective risk to earnings and capital arising from adverse movements in market prices and rates. Broadly speaking, the Bank concerns itself with three main components under market risk:

- Equity price risk is the risk loss due to adverse change in equity market prices.
- Interest rate risk is the risk that the value of an interest rate sensitive instrument will fall as a result of a change in market interest rates.
- Foreign exchange risk is the risk of loss due to adverse changes in foreign exchange rates.

Market Risk Policy, Management & Control

Kaupthing 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 the price risk of listed and unlisted securities, both stocks and bonds, interest rate risk, currency risk or other market variables influenced by market forces.

These investments are either taken as a service to clients for example as an underwriting commitment, a co-investment in an acquisition, market making in capital markets etc. – or the investments are made with the strategy of the Bank in mind and then primarily in financial service companies.

The Bank's Risk Management keeps firm track of the market risk embedded in market investments at the Group level and monitors the total estimated market risk against the market risk limits set by the Bank's Board of Directors.

The Board of Directors decides how much market risk exposure the proprietary trading units within the Bank may assume, expressed as a maximum overnight as well as intraday exposure in equities, corporate bonds and government bonds. Exposure caused by derivatives of the items above is included on a gamma-adjusted delta equivalent basis. All derivative positions need prior approval from the Risk Management division.

The Board entrusts the CEO of the Bank and the CEOs and Managing Directors of the subsidiaries with the enforcement of this policy and risk management responsibilities, by monitoring limits and reporting their utilization as well as enforcement.

The Bank's CEO is responsible for approving Specific Position Limits which are used for positions, which are sometimes specific medium-term investment cases and other times strategic (or have the potential of becoming strategic) in the medium term. These positions are typically few in number (5-10) and therefore concentrated in nature. These limits need explicit approval from the Bank's CEO or the Executive Chairman.

Each trading unit within the Bank adheres to the general rules set out by the Board of Directors. Moreover, each trading unit has its own set of working procedures and rules that further specify their targets, limits and scope in trading.

The position limits, or any changes to them, are proposed by the Bank's Head of Trading and then accepted by the Bank's Chief Risk Officer and reviewed by the Bank's Chief Executive Officer who has a say in limit decisions. The size of each position limit is based on, among other factors, underlying liquidity, the Bank's risk appetite as well as legal limitations on individual positions imposed by authorities in Iceland, Denmark, the UK, Sweden, Finland, Switzerland, the US, Luxembourg or other relevant authorities.

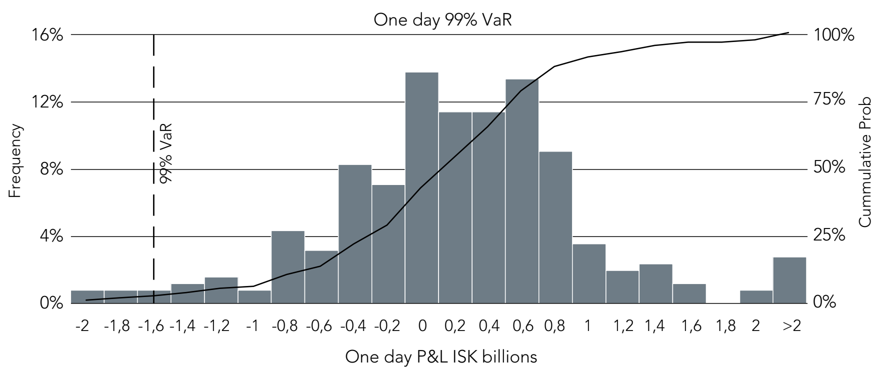
Measurement Methods

Risk measures are generated by proprietary systems that utilize the counterparty, market data and trade databases generated and used by the Bank's trade systems. Additionally, the risk management systems are enhanced by various third party solutions. The models employed in evaluating these measures include position-based models, volatility-based models, i.e. based on the volatility of market variables and their related covariance, and scenario-based models, i.e. the frequency of a severe loss estimated by repeating random scenarios with certain statistical properties that have, in most cases, been estimated from historical data.

All trades and intraday profit or loss are reported continuously to the Chief Risk Officer through a position-monitoring system. Intraday positions in different trading units within the Bank are monitored, and the Chief Risk Officer is alerted if any deviations or exceptions are observed. The Bank's Risk Management division sends a daily report on profit and loss and turnover to the Chief Risk Officer, the Head of Trading and the Bank's Chief Executive Officer.

The Bank's market risk management division sends a monthly risk assessment report to the Head of Trading, the Bank's Chief Executive Officer, and the Bank's Board of Directors, which details volatility-based and scenario-based measures such as Value-at-Risk (VaR) and stress tests based on current exposures.

Daily P&L and VaR



Equity Price Risk

The Bank's total equity exposure should not exceed 35% of risk capital, and thereof the total unlisted exposure or private equity should not exceed 15% of risk capital. Equity exposure totals ISK 159 bn, or 34.5% of risk capital. Thereof, the ratio of unlisted shares was 9.8% of risk capital.

Global equity limit

Equity exposure [ISK billions]		Exposure	VaR (99%/10d) [ISK billions]	VaR (99%/10d) % risk capital	% of risk capital	% of Tier 1 capital	% of Balance Sheet
Total		**159**	**5.5**	**1.2%**	**34.5%**	**49%**	**3.9%**
	Listed	114	5.5	1.2%	24.7%	35%	2.8%
	Unlisted	45			9.8%	14%	1.1%
Icelandic		**53**	**1.0**	**0.2%**	**12%**	**17%**	**1.3%**
	Listed	40	1.0	0.2%	9%	12%	1.0%
	Unlisted	13			3%	4%	0.3%
Other		**106**	**4.4**	**1.0%**	**23%**	**33%**	**2.6%**
	Listed	74	4.4	1.0%	16%	23%	1.8%
	Unlisted	32			7%	10%	0.8%

VaR % of risk capital

	VaR (10d 99%)	% of risk capital	Listed equity exposure % of risk capital
Q4 '05	3,602	1.5%	31%
Q1 '06	2,962	1.1%	26%
Q2 '06	2,594	0.8%	28%
Q3 '06	2,348	0.6%	24%
Q4 '06	5,476	1.2%	25%

The 10-day 99% VaR of the equity positions was 1.2% of risk capital or ISK 5.5 billion at the end of 2006.

Interest Rate Risk

The Bank's operations are subject to the risk of interest rate fluctuations to the extent that interest-earning assets (including investments) and interest-bearing liabilities mature or reprice at different times or in differing amounts. In the case of floating rate assets and liabilities, the Bank is also exposed to basis risk, which is the difference in repricing characteristics of the various floating rate indices, such as the savings rate and six-month LIBOR and different types of interest. Risk management activities are aimed at optimizing 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 tests for each currency.

Yield curve risk and options risk are quantified using a +100bp and +200bp simultaneous shift in all yield curves, and by the measurement of duration gradients.

This table shows interest rate risk by currency and maturity. Trading interest rate risk refers to exposures on the trading book where positions are marked-to-market and profit or loss is recognized immediately, while banking interest rate risk refers to exposure on the banking book where profit or loss is realized over the lifetime of the exposure.

Limit management on interest rate risk in proprietary trading has the same structure as equity price risk. The Bank's total interest rate risk exposure, measured using a +100bp simultaneous shift in all yield curves, should not exceed 8% of risk capital, and thereof the exposure measured on marked-to-market basis should not exceed 3% of risk capital.

Interest rate risk by currency and maturity

Currency:		Within 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
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
CHF	Trading	51	89	-56	3	0	87
	Banking	-2	-40	-92	-21	-37	-192
Other	Trading	-762	196	-44	735	-15	110
	Banking	-9	-68	-113	72	-332	-450
2005							
ISK	Trading	0	-1	-1	-94	-578	-674
	Banking	10	19	2	22	-13,446	-13,393
DKK	Trading	162	43	-106	-865	-768	-1,534
	Banking	-28	-171	-367	-418	-455	-1,439
EUR	Trading	-175	-156	-23	-59	19	-394
	Banking	233	358	-25	261	398	1,225
GBP	Trading	-29	-33	-1	-6	12	-57
	Banking	41	251	-146	-25	-139	-18
USD	Trading	-1	-33	-16	-1	-1	-52
	Banking	39	55	-35	-123	-866	-930
CHF	Trading	7	2	-2	0	0	7
	Banking	4	35	-87	-6	18	-36
Other	Trading	0	-13	-10	-57	29	-51
	Banking	25	26	-27	5	40	69

The table shows interest rate risk by currency and maturity in ISK millions. Risk is measured by assuming a 1% simultaneous shift in all yield curves in the relevant maturity band.

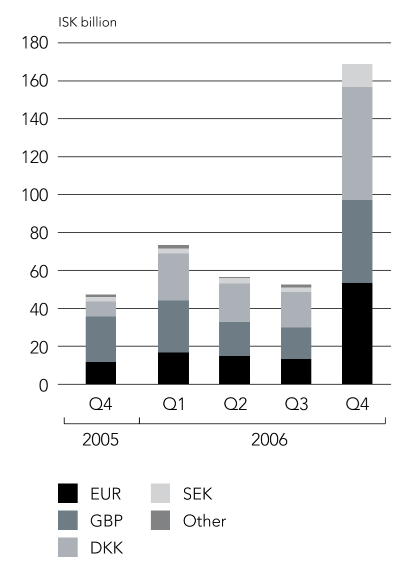
Foreign Exchange Risk

The Bank's foreign exchange risk is considered at a Group level since an effective overview of such risk is a critical element of the Bank's asset/liability risk management. The Board of Directors defines its risk tolerance levels and expectations for foreign exchange risk management and ensures that the risk is maintained at prudent levels.

Foreign exchange risk is quantified using the net balance of assets and liabilities in each currency, and their total sum. The assets and liabilities include current positions, forward positions, commitments, delta positions in FX derivatives, and the market value of derivatives in foreign currency.

The total net position in a single non-ISK currency can never exceed 20% of the capital base as reported in the most recent Financial Statements. The net total currency balance can never exceed 30% of the capital base as reported in the most recent Financial Statements. Positions taken specifically to hedge the capital ratio can be exempt from the limits above, provided a formal permission from the Central Bank of Iceland has been granted.

Net foreign exchange exposure



Liquidity Risk

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.

Quantification

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 securitization 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 subsidiaries quantifies the secured liquidity, and in the same way secured liquidity is then consolidated on the Group level.

At year end there were 427 days covered by the secured liquidity.

Secured liquidity at year end is shown in the table below.

ISK millions	Up to 1 month	1-3 month	3-6 months	6-12 months	12-18 months	18-24 months
Secured liquidity	856,000	573,000	360,000	121,000	(136,000)	(237,000)

Secured liquidity at Kaupthing Bank in excess of 360 days amounted to ISK 121 billion at year end 2007.

In addition to the secured liquidity measurement above, haircuts are applied to each type of asset in the secured assets base in order to account for different stress test scenarios that might occur in the future. In these test scenarios a moderate growth of the Balance Sheet is included.

Limit Management & Monitoring

Active management of liquidity through the framework of limits and controls presented above is only possible with proper monitoring capabilities. The monitoring process focuses on funding portfolios, the forward Balance Sheet and general indicators; where relevant, information and data are compared against limits that have been established.

The Bank's Treasury is responsible for maintaining sufficient liquidity by maintaining a sufficient high ratio of liquid assets and available funding for near-term liabilities.

The secured liquidity measure is calculated and monitored by Risk Management.

Increased withdrawals of short-term funds are monitored through measurements of the deposit base in the Bank. Other general indicators are monitored in the marketplace, including credit spreads, credit default swap spreads, credit rating watch status and market news.

Liquidity risk is reported to the Board of Directors on a monthly basis.

Contingency Funding Plan

Kaupthing Bank monitors its liquidity position and funding strategies on an ongoing basis, but recognizes that unexpected events, economic or market conditions, earnings problems or situations beyond its control could cause either a short or long-term liquidity crisis. To monitor liquidity and funding, the Group Treasury prepares a liquidity worksheet twice a month that projects sources and uses of funds. The worksheet incorporates the impact of moderate risk and crisis situations. The worksheet is an integral component of the contingency funding plan. Although it is unlikely that a funding crisis of any significant degree could materialize, it is important to evaluate this risk and formulate contingency plans should one occur. Both short-term and long-term funding crises are addressed in the contingency funding plan.

Operational Risk

Operational risk is the risk of direct or indirect loss or damage to the Bank's reputation resulting from inadequate or failed internal processes or systems, or from human error or external events that affect the Bank's image, operational earnings and/or have adverse effects on the share price. Strategic risk, reputation risk, legal risk and compliance risk are considered sub-categories of operational risk. Operational risk is therefore inherent in all activities within the Bank.

It is the policy of Kaupthing Bank to reduce the frequency and impact of operational risk events in a cost-effective manner. This is accomplished by fostering a strong culture surrounding operational risk, which entails internal controls and quality management, leadership skills and well educated, qualified staff. Kaupthing Bank's main process for identifying and monitoring operational risk is through the self-assessment of risk and control and through the registration of loss events, near misses and operational incidents. Each business segment regularly assesses its own risk and relevant controls and evaluates the possible impacts. If risk lies outside acceptable limits, then internal controls and the quality and efficiency of the internal processes are reevaluated to bring the risk back within acceptable risk limits.

Kaupthing Bank's operational risk framework sets out the roles and responsibilities for management and supervision, as well as those tools and methods used within the Bank for identifying, measuring, monitoring and controlling operational risk. Sound Practices for the Management and Supervision of Operational Risk, published by the Basel Committee of Banking Supervision, was used in the development of the operational risk framework to ensure rigorous and effective management and supervision.

The implementation of the operational risk framework is divided into five levels:

- Documenting, reviewing and improving upon working processes, policies and internal rules
- Self-assessment of risk and control
- Identifying and then monitoring key risk indicators
- Collecting data regarding loss events and near misses
- Analysis and reporting

Each business segment within the Bank holds the primary responsibility for engaging in and managing its own operational risk. However, the operational risk department is responsible for developing and maintaining the Bank's operational risk framework and providing guidance and support to these business segments during the implementation of this framework. The Operational Risk department acts as a source of information on the development of operational risk. This department also tracks each segments operational risk, and if any segment should overstep the predefined risk boundaries, the head of the relevant segment would be notified as seen fit. The Operational Risk department follows through until the risk has been eliminated or reduced to acceptable levels.

The Operational Risk department works closely with each segment to ensure the successful management, identification, measurement and monitoring of the Bank's operational risk. The Internal Audit department conducts independent reviews of each business segment and provides an overview of the evaluation methods for operational risk.

IT systems and information security are important components of operational risk management. Kaupthing Bank has begun the implementation of ISO/IEC 27001:2005, the international standard for information security management. The Bank maintains this security policy to ensure that its policies, processes, rules and controls concerning information, information systems and communication channels are sound and in keeping with best practices.

Kaupthing Bank has a specially appointed Security Committee responsible for implementing and maintaining this security policy, ensuring the Bank's compliance with the ISO/IEC 27001:2005 standard. The Bank also appoints an Information Security Officer, who is responsible for the day-to-day supervision of matters relating to Kaupthing Bank's security policy, ensuring that IT systems, processes and internal rules comply with ISO/IEC 27001:2005 standards.

In addition, Kaupthing Bank has a crisis management plan to increase the Bank's resilience to disruptions in business arising from internal and/or external events. The crisis management plan seeks to reduce the impact of crises on the Bank's operations, reputation, profitability, clients, shareholders and others who hold a stake in the Bank. Kaupthing Bank also holds various insurance policies to cover major operational risk events.

Operational Risk Analysis

The capital charge due to operational risk is evaluated according to the Standardized Approach outlined in the new Capital Requirements Directive (CRD). However, at a later stage the Bank intends to implement advanced methods for a more risk-sensitive quantification of operational risk. In order to estimate the operational risk capital charge, Kaupthing Bank's business segments are mapped onto six business lines: Investment Banking, Trading and Sales, Retail Banking, Corporate Banking, Agency Services and Asset Management. According to the CRD the remaining two business lines; Payment & Settlement and Retail Brokerage, are included in the Trading & Sales business line.

The total operational risk for all the business lines is currently measured at approximately ISK 26.3 billion using only gross income in Q4 2006, but ISK 15.3 billion using a 3 year average gross income. If the operational risk is accounted for in the equity ratio, without estimating changes to the credit risk charge due to the new CRD, the equity ratio would be approximately 13.8% instead of its current value, 15.0% using only gross income in Q4 2006, but 14.1% using a 3 year average gross income.

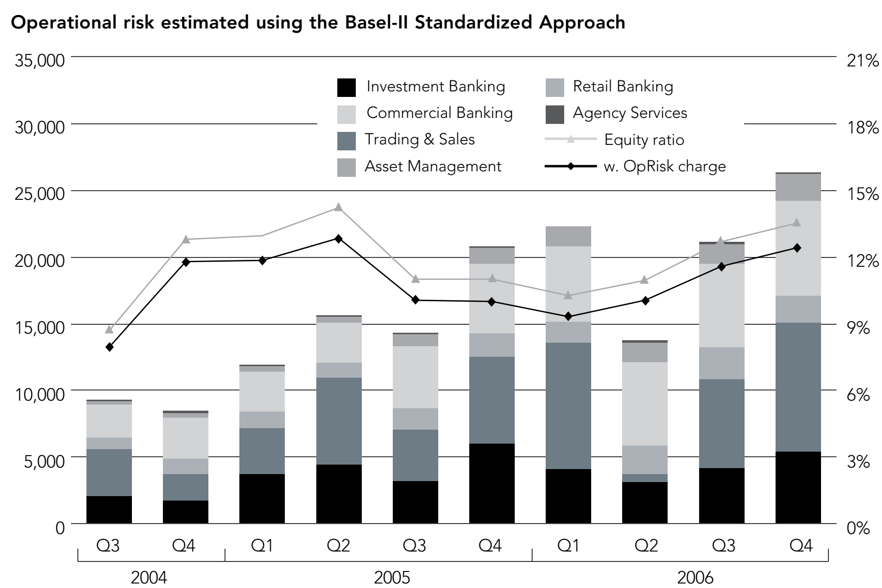


Chart showing operational risk for each business line, according to the Basel II Standardized Approach.

Basel II

The Basel II rules are a set of new, more risk-sensitive rules for capital requirement calculations that came into effect as of 1 January 2007. The Basel II rules define the minimum capital that a financial institution should hold for unexpected events. They also provide sets of minimum qualitative standards and risk management practices that a financial institution should have in place. The current Basel II rules include capital requirements for operational risk in addition to credit risk and market risk, which were already covered in the current rules, Basel I.

The Basel II rules were developed by the Basel Committee for Banking Supervision to replace the Basel I rules. The committee's first proposal for revising the capital adequacy framework was published in June 1999. Since then, the revised framework (International Convergence of Capital Measurement and Capital Standards) was published in November 2005. Based on the recommendations of the revised framework, the Basel II rules were ratified by the EU in Directive 2006/48/EC and Directive 2006/48/EC published in June 2006.

The Basel II rules are represented by three pillars: Pillar I addresses the calculation of minimum regulatory capital requirements for credit, market and operational risk. Pillar II addresses the supervisory review process, the financial institution's capital adequacy assessment including other risk not addressed under Pillar I and the strategy for maintaining capital levels. Finally, Pillar III addresses market discipline and requirements regarding market disclosure of risk-related information.

Under Pillar I financial institutions can choose from three approaches for the calculation of credit risk capital: the Standardized Method (which is similar to the current Basel I rules), Foundation IRB and Advanced IRB (the difference being the sophistication of the capital requirement calculations). Under Foundation IRB and Advanced IRB the Bank uses its own calculation of risk-related variables that serve as the input in the calculation of capital requirement. For operational risk, financial institutions can also choose from three approaches: the Basic Indicator Approach, the Standardized Approach and the Advanced Measurement Approach (the difference being the sophistication of methods and the processes required for operational risk monitoring and quantification).

Kaupthing Bank has applied for permission to use the IRB Foundation Approach to determine its capital requirements for credit risk. The Bank's aim is to start using the IRB Approach for the calculation of risk-weighted assets from 2007 by using its own estimation of probability of default (PD) parameters. Kaupthing Bank will start to use loss given default parameters (LGD) and credit conversion factors (CCF) as stated in the CRD for all exposures except retail, where internal LGD and CCF will be used. Kaupthing Bank aims to implement all necessary internal models for credit risk calculation according to the IRB Advanced Approach in the near future.

Kaupthing Bank has been fully involved in the process of implementing of Basel II rules since late 2004. However the first rating models were introduced into part of the Bank's portfolio in December 2003. The focus this year has been on application to the FSA for the IRB method and fulfilment of Basel II requirements. A great deal of work has been expended on data preparation and collection of historical statistical analysis and model construction. The Bank has also focused on aligning its control environment and risk management processes with Basel II requirements.

With regard to operational risk, Kaupthing Bank intends to initially implement the Standardized approach, which has already been implemented in part within the Bank, and then move towards the Advanced Measurement Approach (AMA).

Stress Testing

Stress testing is a simulation technique used on assets and liabilities to determine their reaction to different financial situations. Their purpose is to determine the size, but not the frequency, of potential losses related to specific scenarios. They form an important diagnostic tool to improve the Bank's understanding of its risk profile. The traditional focus of stress testing relates to exceptional but plausible events.

Various stress tests are performed by Risk Management, including credit and counterparty stress testing and market risk stress testing.

The following scenarios are used for regulatory stress tests at least once a quarter:

Market risk scenarios:

- 35% decrease in the value of all domestic equities
- 25% decrease in the value of all non-domestic equities
- 25% depreciation of the ISK
- 7% decrease in the value of bonds

Credit Risk Scenarios:

- 20% decrease in impaired loans and appropriated assets (net of provisions)
- Increase in default rates of non-mortgage and mortgage loans to their historical highs – 1.8% and 0.2%, respectively

Results of stress test at year end 2006:

Equity ratio (CAD) at year end	15.0%
Result of market risk shock	-2.0%
Result of credit risk shock	-0.3%
Equity ratio (CAD) after shock	12.7%
Minimum required equity ratio (CAD)	8.0%

CORPORATE GOVERNANCE

Corporate Governance at Kaupthing Bank is defined as the framework by which the Bank is directed and controlled and the relationships between the Bank's management, its Board, its shareholders and other stakeholders.

The aim of the Corporate Governance framework at Kaupthing Bank is to ensure disclosure and transparency, to define the responsibilities of the Board and the management, to define the rights and role of shareholders and stakeholders, to ensure the equitable treatment of shareholders and to avoid conflicts of interests.

It is the objective of the management and the Board to have transparent and effective internal controls within Kaupthing Bank. An Internal Control and Procedural Handbook reflects the most recent rules and procedures in effect at Kaupthing Bank. The Internal Control and Procedural Handbook is reviewed annually by the Board of Directors and all changes and updates over the year are presented specially to the Board of Directors for review and approval. The latest version of the ICP handbook was issued in December 2006. The Bank has a special section on its website for Corporate Governance, in accordance with its obligations towards OMX in Sweden. Information provided in this section includes the composition of the Board of Directors, including information about how long each member has served on the Board, each member's principal employment and other significant board assignments. The section also includes information about the Bank's CEO and auditors as well as the Bank's current Articles of Association. No later than in connection with the notification of an Annual General Meeting, the website also includes an account of the work of the Board of Directors during the preceding financial year.

In 2004 the Iceland Chamber of Commerce, the Iceland Stock Exchange and the Confederation of Icelandic Employers issued Guidelines on Corporate Governance, which were later reviewed in 2005. It is the opinion of the Board that Kaupthing Bank is in full compliance with these guidelines.

Statutory Bodies

Shareholders' Meetings

The supreme authority in the affairs of Kaupthing Bank, within the limits established by the Articles of Association and statutory law, rests with legitimate shareholders' meetings. Shareholders' meetings may be attended by shareholders, their proxies and advisors. Furthermore the CEO of Kaupthing Bank has full rights to speak and submit motions at shareholders' meetings. Shareholders' meetings are open to representatives of the press and the stock exchanges. Starting mid-year 2007 the Bank will give shareholders the opportunity to vote on issues being discussed at a shareholders' meeting electronically or via mail.

The Annual General Meeting of Kaupthing Bank is held before the end of April each year. At shareholders' meetings each share carries one vote. Decisions at shareholders' meetings are taken by majority vote unless there are provisions otherwise in the Articles of Association or statutory law.

The Board of Directors

The Board of Directors is the supreme authority in the affairs of the Bank between shareholders' meetings. It handles the affairs of the Bank and ensures that its organization and operation are at all times in correct and appropriate order. The Board ensures adequate supervision of the accounts and disposal of the Bank's property. The Board's responsibilities include setting the Bank's business objectives, strategy and business plan, formulating risk policies, confirming key aspects of the internal organization of the Bank and making decisions on the establishment or closure of foreign branches and foreign subsidiaries and on mergers. The Board is also responsible for making decisions on the Bank's authorized signatures list. The Board of Directors may not involve itself in decisions on individual dealings, unless their scope is substantial in relation to the size of the Bank. Individual Board members must not involve themselves in decisions on individual dealings.

The Board of Directors of Kaupthing Bank is composed of nine members, elected at the Annual General Meeting for a term of one year. Nine alternate members are also elected. The Board elects a Chairman of the Board from among its members and allocates tasks in other respects as required. The Board is authorized to entrust the Chairman of the Board with special activities on behalf of the Bank. The Chairman of the Board (the Executive Chairman) is the public representative of the Board of Directors, unless otherwise decided by the Board of Directors. The Board of Directors appoints the CEO of Kaupthing Bank and decides the terms of the CEO's employment.

The Board of Directors has established working procedures, setting out in further detail the performance of its duties. These procedures discuss, e.g., the area of responsibility of the Board of Directors and Chairman, Board meetings, Board sub-committees, confidentiality, the authorization of the Board to make decisions on individual dealings, the eligibility of Board members, the handling of information on individual customers by the Board and the participation of Board members in the boards of directors of subsidiaries and associated companies.

The working procedures state that in the event of a decision regarding a Board member serving on the board of a subsidiary or an associated company, there shall be detailed discussion on the effect of this on the surveillance role of the relevant Board member and on the necessity of the Board member serving on the relevant board.

The Board has established a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of the Executive Chairman and the CEO. No director is involved in deciding his or her own remuneration. Furthermore, the Annual General Meeting in 2004 adopted a proposal on options for employees and management.

The role of the Executive Chairman is to coordinate the activities of the Bank's subsidiaries, pursue opportunities to increase efficiency by merging with other companies or to seek out potential acquisitions in Iceland and abroad. The Chairman convenes meetings of the Board of Directors and presides at Board meetings. The Chairman ensures that agendas of meetings of the Board of Directors include items which are important to the operations of the Bank and are prerequisites for the supervisory duties of the Board of Directors. The Chairman ensures that all Board members are properly briefed on issues arising at Board meetings. The Chairman has direct access to the Bank's risk management in order to facilitate the supervision of the Bank's activities by the Board of Directors. The Chairman makes proposals on the manner in which the Board of Directors of the Bank supervises the Bank's loan portfolio, securities holdings and operations. This ensures that the Board of Directors will receive regular information on risk in the Bank's operations.

Queries by the Board of Directors or individual Board members shall generally be raised at meetings of the Board of Directors and shall be addressed to the CEO or others present at the meeting. Otherwise, queries shall be sent to the Chairman of the Board. Information may not be requested from nor shall queries be made directly to other employees of the Bank between meetings of the Board of Directors. However these provisions do not apply to the Chairman of the Board if he is an Executive Chairman.

According to the working procedures of the Board of Directors, the Board shall regularly evaluate its activities and procedures, as well as the Bank's progress, with the assistance of outside parties if appropriate.

The working procedures of the Board of Directors state that Board members should familiarize themselves with the provisions of law, the Articles of Association of the Bank, general regulations of the securities market, special regulations of the Bank on the handling of inside information and insider trading and other rules.

The majority of the members of the Board is independent of the Bank, according to an evaluation by the Board of Directors. Also, the majority of the members of the Board is independent of major shareholders (owning 10% of the share capital or more). The criteria for independence are in accordance with the Guidelines on Corporate Governance mentioned above.

Those who wish to stand for election to the Board of Directors must announce their intention with at least seven days' notice, according to the Bank's Articles of Association. Information about Board candidates shall be available at the office of the Bank no later than two days prior to the shareholders' meeting, in accordance with Icelandic law.

Management

The CEO of Kaupthing Bank and the Board of Directors are jointly responsible for the management of the Bank. The CEO is responsible for the day-to-day operations of the Bank, and in this respect the CEO observes the policy and directions of the Board of Directors. The day-to-day operations do not include measures which are unusual or extraordinary. Such measures are only taken by the CEO pursuant to special authorization from the Board of Directors of the Bank unless it is impossible to wait for decisions from the Board of Directors without seriously disadvantaging the operation of the Bank. In such cases the Board of Directors is promptly notified of the measures.

The CEO ensures that the accounts and finances of Kaupthing Bank conform to law and accepted standards and that the disposal of the Bank's assets is secure.

Accounts & Auditing

A state authorised public accountant or accounting firm is elected auditor at each Annual General Meeting of Kaupthing Bank for a term of one year. The auditor examines the Bank's accounts and all relevant account documents for each year of operation, and has access to all the Bank's books and documents for this purpose.

The external auditor's other required duties include reviewing certain transactions of the Bank with related parties and comparing them with comparable transactions with other customers and preparing an opinion with respect to terms, arm's length views, etc. Such reports shall be sent annually to the Financial Supervisory Authority in Iceland.

Auditors are not elected from among the members of the Board of the Bank or the Bank's employees. The qualifications and eligibility of the auditor at elections are in other respects governed by law. Kaupthing Bank's current accounting firm is KPMG hf.

Board Committees

The Board has established four committees: Audit Committee, Compensation Committee, Credit Committee and Underwriting & Investment Committee. Furthermore, the Board exercises its control governance through a number of policies and instructions.

Audit Committee

The Audit Committee maintains regular contact with both external and internal auditors and ensures that complaints and observations from the auditors are acted upon. Furthermore, the Audit Committee discusses accounting principles and any changes to them. The Audit Committee consults and advises the Board on the scope of internal audits. The committee keeps under review the scope and results of the audit and its cost-effectiveness and the independence and objectivity of the auditors. In the event that the auditors also provide a substantial amount of non-audit services to the Bank, the committee shall keep the nature and extent of such services under review. The Audit Committee shall consist of at least three Board members. Executive Board members and employees are not allowed to be members of the Committee. Members of the Audit committee are Hjörleifur Jakobsson (chairman), Bjarnfredur Ólafsson, and Brynja Halldórsdóttir.

Compensation Committee

The Compensation Committee discharges the Board's responsibility in matters relating to executive compensation and the administration of the Bank's incentive compensation and equity-based plans, in accordance with applicable rules and regulations. The principal responsibility in compensating executives is to coordinate the incentives of the executives with actions that will enhance long-term shareholder value. The Compensation Committee shall include at least three Board members. The members of the Compensation Committee are: Ásgeir Thoroddsen (chairman), Finnur Ingólfsson and Tommy Persson.

The Compensation Committee also outlines the policy of the Bank regarding employee stock options. A stock option policy was approved by the Annual General Meeting in 2004.

The Board of Directors is, according to new legislation in Iceland, obliged to approve a remuneration policy regarding salaries and other payments to the CEO and other senior managers as well as to the Board members. The policy shall be published in connection with the Bank's AGM and submitted to the AGM for approval or changes. The first policy according to this legislation will be submitted to the AGM in 2007.

Board Credit Committee

The Board's Credit Committee makes decisions on credits exceeding EUR 165 million, taking into consideration exposure to related parties. Three Board members are members of the Board Credit Committee: Sigurdur Einarsson (chairman), Bjarnfredur Ólafsson, and Gunnar Páll Pálsson, as well as Hreidar Már Sigurdsson, CEO. The Chief Risk Officer also attends these meetings.

Board Underwriting & Investment Committee

The Underwriting & Investment Committee makes all underwriting decisions exceeding certain limits and all investment decisions exceeding certain limits. Three Board members are members of the Board Underwriting & Investment Committee; Sigurdur Einarsson (chairman), Bjarnfredur Ólafsson, and Gunnar Páll Pálsson, as well as Hreidar Már Sigurdsson, CEO. The Chief Risk Officer also attends these meetings.

Internal Committees

The CEO of the Bank consults **the Executive Committee** on matters of special importance to the Bank.

The **Group Credit Committee** is the second highest credit granting body in the Bank. The Group Credit Committee is authorized to approve new loans to parties for a total exposure of EUR 165 million, including exposure to related parties. The CEO chairs the committee.

The **Group Underwriting & Investment Committee** is authorized to make investment decisions up to certain limits and underwriting decisions up to certain limits. The CEO chairs the committee.

The **ALCO Committee** maintains an overview of the Bank's Balance Sheet, proposes policies concerning the structure of assets and liabilities and the co-ordination of risk, capital, funding and liquidity matters.

The CEO consults the **IT Committee** on IT related issues and IT strategy.

Internal Audit, Compliance & Anti-Money Laundering

The Internal Auditor is appointed by the Board of Directors and reports directly to the Board. The mission of the internal audit is to provide independent and objective assurance designed to add value and improve the Bank's operations.

The Board of Directors is furthermore responsible for appointing a Compliance Officer or formally confirming the appointment of a Compliance Officer. The Board shall in the same manner appoint a substitute (or substitutes) to the Compliance Officer. The Compliance Officer reports to the CEO and is independent in his/her duties. The Compliance Officer's responsibilities include enforcing rules on employee securities trading, procedures for the research division, and the separation of operating segments, as well as supervising compliance with rules on the handling of inside information and insider trading.

The Board of Directors is also responsible for appointing (or formally confirming the appointment of) a Money Laundering Reporting Officer (MLRO) and his/her substitute. The MLRO is responsible for ensuring the Bank's compliance with applicable anti-money laundering legislation, best practices and internal rules and procedures on anti-money laundering matters. The MLRO is independent in his/her duties in the same way as the Compliance Officer.

Compliance with laws and regulations and the Bank's internal rules also falls under the responsibility of the Internal Auditor, the Bank's Legal Services, and Risk Management, as applicable.

CREDIT RATING

Kaupthing Bank is rated by two international rating agencies. The Bank's long-term credit ratings are Aaa from Moody's and A from Fitch. The short term ratings are P-1 and F1, respectively.

Moody's Investors Service

In February 2007 Moody's Investors Service announced its latest credit rating of Kaupthing Bank.

Moody's Investor Service

Date	Long-term	Fin. strength	Short-term
February 2007	Aaa	C	P-1
August 2006	A1	C	P-1
April 2006	A1	C+	P-1
May 2005	A1	C+	P-1
November 2004	A1	C+	P-1
December 2003	A2	C+	P-1
May 2003	A3	C	P-1

Moody's rating outlook: stable

Moody's Investors Service announced on 24 February 2007 an upgrade of Kaupthing Bank's credit rating. The Bank's long-term deposits and senior debt ratings in local and foreign currencies was upgraded from A1 to Aaa, the highest possible rating assigned by Moody's. The Bank's ratings for short-term obligations in local and foreign currencies, P-1, which is the highest rating given by Moody's, remains unchanged. The Bank's rating for financial strength, C, also remained unchanged. The upgrade was the result of Moody's implementation of the joint default analysis (JDA) methodology, which takes into account potential sources of external support for banks, and its updated bank financial strength rating (BFSR) methodology.

Moody's has also assigned a long-term rating of Aa3 to FIH Erhvervsbank, Kaupthing Bank's subsidiary in Denmark, as a separate issuing entity.

Fitch Ratings

Fitch Ratings affirmed its credit rating of Kaupthing Bank in August 2006. Its ratings reflect the growing diversification of revenues and asset quality.

Fitch's historic credit ratings

Date	Long-term	Individual	Support	Short-term
August 2006	A	B/C	2	F1
November 2005	A	B/C	2	F1

Fitch's rating outlook: stable

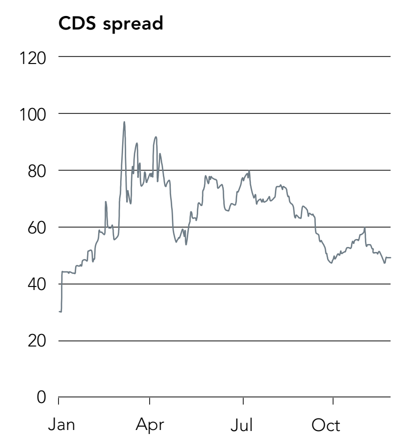
In its announcements Fitch states that these ratings reflect Kaupthing Bank's strong position in the Icelandic market, the growing diversification of its revenues, and its good profitability and asset quality. The Bank is also cited for its recent acquisitions in Denmark and the UK, through which Kaupthing Bank has substantially reduced its reliance on the small Icelandic market. Fitch considers that higher ratings in the future may be rooted in maintaining satisfactory profitability through less favorable financial markets and successfully integrating recently acquired subsidiaries.

Fitch has also assigned a long-term rating of A to Kaupthing Singer & Friedlander, Kaupthing Bank's subsidiary in the UK, as a separate issuing entity.

FUNDING & LIQUIDITY

The diversification of funding sources has been a key strategic priority for Kaupthing Bank. In 2006 the Bank diversified its funding sources by issuing bonds to investors in the United States, Australia and Japan. These markets as well as other markets such as the EMTN market, the Canadian Maple bond market and the local Swiss bond market are important sources of funding for Kaupthing Bank, and the Bank intends to remain a regular issuer in all these markets. At the same time the Bank has concentrated on extending its debt maturity profile and enhancing its liquidity.

Last year was a demanding, but ultimately rewarding year for the Bank's Funding Team. Spreads widened early in the year, mostly due to concerns regarding imbalances in the Icelandic economy and its impact on the Bank as well as the Bank's reliance on wholesale funding. In September Kaupthing Bank finished its refinancing for 2007 redemptions, and since that time there has been a continuous tightening in CDS and cash spreads. Consistent implementation of the Bank's chosen debt strategy and several successful international debt issues were the indisputable highlights of the year for the Funding Team.



Rated Entities in the Group

Kaupthing consists of three rated entities, the Parent Company Kaupthing Bank hf., Kaupthing Singer & Friedlander in the UK, and FIH in Denmark. Most long-term funding is arranged through the Parent Company but FIH, which operates as a self-funded entity, is the only subsidiary that also actively accesses the debt capital markets with public transactions. In 2006 Kaupthing Bank raised €9.3 billion, €6.5 billion of which was raised by the Parent Company and €2.8 billion raised by FIH. In comparison, Kaupthing Bank's refinancing needs stood at €3.2 billion in 2006 and €5.3 billion in 2007. As previously stated the Bank has been aiming to extend its maturity profile. The average maturity of newly issued senior debt was 4.2 years for the Parent Company alone in 2006, compared with 3.2 years in 2005, while for the Group (i.e., including all issuing entities) it was 3.9 years in 2006, compared with 3.4 years in 2005. The average cost of senior long-term funding for the Group was 49.6 basis points in 2006, compared with 11.9 basis points in 2005.

Structured Covered Bonds

In April Kaupthing Bank issued €500 million in ISK structured covered bonds to finance the Bank's residential housing loans in Iceland. The bonds have been assigned a Aaa credit rating by Moody's Investors Service and were sold to a European investor in a block trade.

Issues Placed in the US

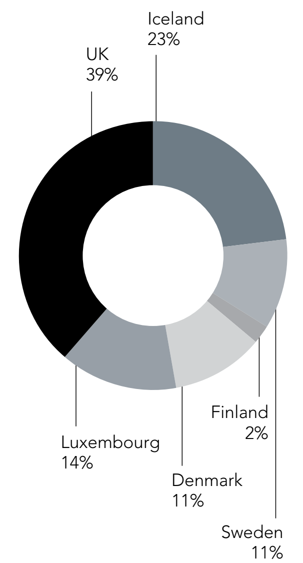
In May Kaupthing Bank printed its only public subordinated issue in 2006. The $1,250 million transaction is classified as Tier 2 capital, paying a coupon of 7.125% and maturing in 2016. The entire issue was sold to institutional investors. The issue was very well received with the order book growing very quickly in excess of $2 billion, and has performed well in the secondary market with the spread tightening by some 50 basis points before year end.

In September 2006 Kaupthing Bank successfully launched a three-tranche offering consisting of $1 billion in 3-year senior floating rate notes, $1.5 billion in 5-year senior fixed rate notes, and $500 million in 10-year senior fixed rate notes under the Bank's US 144A MTN program. This deal represents the largest issue ever offered by any Nordic Bank. With this issue Kaupthing Bank established itself as a repeat and liquid borrower in the US markets. The bonds were sold to more than 200 institutional investors with an order book of over $9.0 billion at close. The 3-year (maturing January 2010) tranche of $1 billion was priced at 3M LIBOR + 70bp, the 5-year tranche of $1.5 billion was priced at US Treasuries + 130bp and bears a coupon of 5.750%, and the 10-year fixed-rate tranche of USD 0.5 billion was priced at US Treasuries + 155bp and bears a coupon of 6.125%. The secondary market responded very well to these issues, and the spread on all three tranches had contracted by 20-30 basis points by year end.

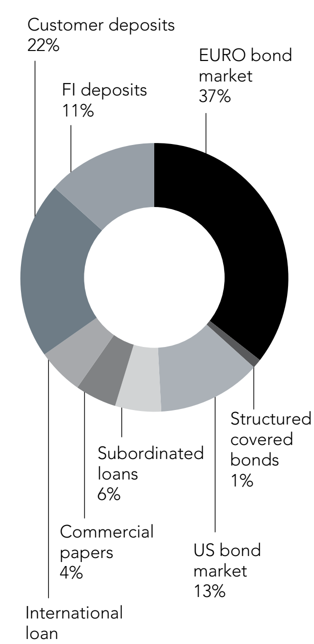
Entering the Domestic Japanese Market

In October Kaupthing Bank took an important step into the domestic Japanese market with its inaugural Samurai transaction. This transaction marks the first Samurai transaction ever by an Icelandic institution and the first Nordic financial institution to enter that market since 2000. The Bank took advantage of the current modest supply in the market to issue a highly successful ¥50 billion in 3-year Samurai bonds. The bond pays a coupon of 1.8%, which translates to the Japanese 3-year swap rate + 75bp. The issue which was initially filed as a ¥20 billion transaction, but following heavy oversubscription with the final order book in excess of ¥75 billion, the decision was made to upsize the transaction to ¥50 billion. The whole issue was successfully placed with a broad range of domestic Japanese institutional investors with 63 separate accounts participating. Due to the buy and hold nature of Samurai investors, the issue has not traded regularly in the secondary market.

Deposits by country



Funding mix



Syndicated Loan Market

Kaupthing Bank was also active on the syndicated loan market in 2006. In March the Bank completed a 3-year and 5-year syndicated dual tranche term loan facility. The terms of the loans are 17.5bp and 23.5bp above EURIBOR for three and five years, respectively. The facility raised a substantial oversubscription with offers for €500 million in total. Due to the oversubscription, the facility was increased from €250 million to €500 million. In December Kaupthing Bank completed a syndicated revolving credit facility of €530 million, a three-year facility with an extension option for a further two years. In total, a group of 26 banks participated in this revolver, which is yet more proof of the long-lasting relationship Kaupthing Bank has with its core relationship banks.

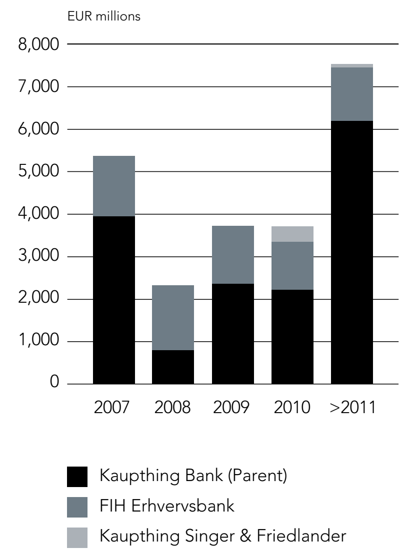
Funding Activities: FIH Erhvervsbank

FIH Erhvervsbank launched two public transactions in 2006, both in Europe. These were the only public issues in euros the Group undertook in 2006, though previously most of the funding of the Group was carried out through the EMTN program. FIH made a €500 million public issue in March. The issue was priced at EURIBOR +20bp. In October FIH launched a €750m bond issue. This was FIH's largest bond issue to date and marks a highly successful return to the European market. The bond has a maturity of three years priced at EURIBOR +35bp. In the third quarter FIH completed a 3-year and 5-year syndicated dual tranche term loan facility. The terms of the loans are 20bp and 25bp above EURIBOR for three and five years, respectively. In total, 25 banks participated in the loan facility.

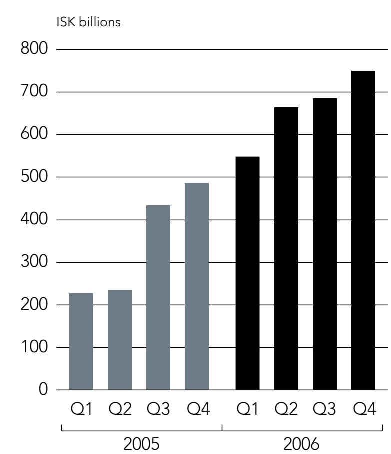
EMTN Private Placement Market

In 2006 the EMTN private placement market (non-syndicated reversed enquires) continued to play a significant role in Kaupthing Bank's long-term funding. The Bank continued to place a strong focus on increasing its presence in the structured private placement market by establishing itself as a flexible and reliable issuer with the capability of issuing a wide range of structured notes. The structured note market gives the Bank access to diversified funding opportunities and provides a more favorable funding cost for the Bank. Although in 2006 the market became highly competitive due to its attractive terms, Kaupthing Bank managed to increase the structured part of its funding significantly since last year. In 2007 the Bank expects the MTN private placement market to play a significant role in its long-term funding. The Bank will continue to issue in the EMTN market, as well as enter into the US MTN market and begin issuing in structured Schuldschein format.

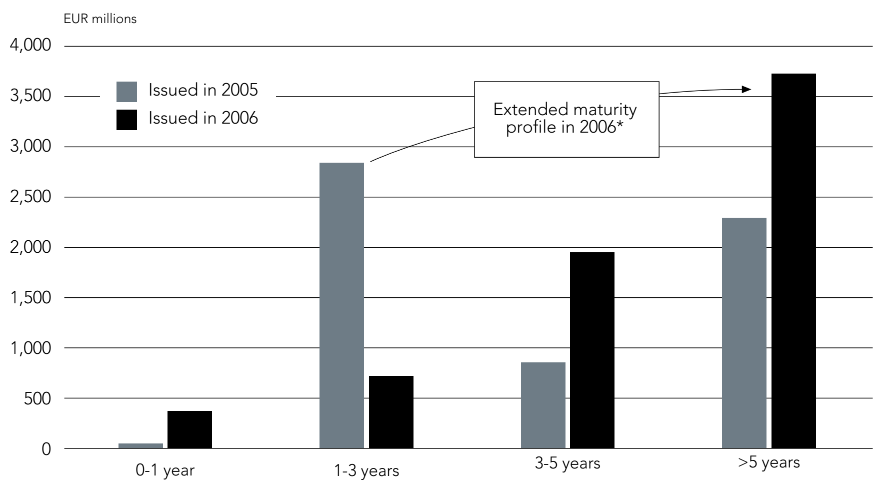
Maturity profile



Customers deposits held by the Bank



Maturity of issued long term debt in 2006 vs 2005



*Parent Company

Increased Deposit Base

In 2006 Kaupthing Bank made a concerted effort to increase its deposit base. Organic growth in deposits was strong in 2006 with a deposit inflow of €1.8 billion, representing a 35% increase in real terms. All the subsidiaries increased their deposit base but the strongest inflow was from Luxembourg, FIH and Kaupthing Singer & Friedlander. Increasing the deposit base will remain the Bank's key strategic priority in 2007, and a growth plan has already been put into place.

Strengthened Bondholder Communications

In 2006 Kaupthing Bank also placed great emphasis on increasing the flow of information to the bond community. In addition to the deal-related road shows, several non-deal road shows were undertaken in numerous countries in Europe, the United States, Japan, Singapore, Hong Kong and most recently in the Middle East. In further support of these efforts Kaupthing Bank has launched a quarterly newsletter for the bondholder community. As part of this plan the Bank has recently improved its debt communications website, increasing the level of detail and streamlining navigation and access to documents. The Bank will carry on with its non-deal road shows to maintain regular communication with its investors.

Strategy Going Forward

Due to this year's successful funding diversification, Kaupthing Bank now has access to a wide range of investors in all the major debt capital markets in the world. In 2007 the Bank will not only enjoy the fruits of its labor from 2006 by revisiting existing markets, but will also continue to diversify its funding sources by exploring new funding markets.

Awards

Top Borrowers as Voted by Investment Bankers

Best Financial Institution Borrower – 3rd place (Euroweek Review of the Year 2006)
Most Impressive Borrower of 2006 – 6th place (Euroweek Review of the Year 2006)

Deal of the Year

Best Samurai Transaction of 2006 – 2nd place (Nikkei Bonds & Financial Weekly)
Best Samurai Transaction of 2006 from a Financial institution - 1st place (Nikkei Bonds & Financial Weekly)

Enhanced Liquidity

In 2006 Kaupthing Bank strengthened its liquidity position significantly by putting into place revolvers, backup facilities and repurchase agreements, all of which are available for drawdown at all times over the lifetime of the agreements. At the beginning of the year the Bank's policy was to hold enough secured liquidity to repay all maturing obligations for the next 180 days. In the middle of the year the Bank introduced a new, more stringent secured liquidity measure. According to this new measure the Bank's policy is to hold enough secured liquidity to meet all maturing obligations for the next 360 days. At year end the Bank was well above that measure with enough secured liquidity to cover the next 427 days (a precise definition of secured liquidity can be found in the Liquidity Risk section of the chapter on Risk Management on page 37. Fulfilling this new, robust liquidity measure helps protect Kaupthing Bank from the volatility in the markets where it operates.

During the fourth quarter FIH also prepared a more diversified funding strategy, finalizing a financial partnership with one of the largest pension funds in Denmark. A wholly owned subsidiary bank was established, FIH Kapital Bank A/S, with DKK 1.8 billion in equity. At the beginning of 2007 the subsidiary bank acquired a loan portfolio of approximately DKK 15 billion from FIH. In return the pension fund will grant a credit facility of DKK 15 billion with a maturity of up to 9 years, though there are no intentions to draw on the facility in the near future. The purpose is to ensure a larger degree of flexibility in FIH's funding and increase the liquidity reserves of the Bank.

Liquidity Management

The Group Treasury manages liquidity on a daily basis in all the countries where the Bank operates. Most subsidiaries are subject to legal and regulatory capital requirements as well as minimum liquidity thresholds. Therefore local Asset Liability Committees (ALCO) in each country are responsible for managing their local liquidity requirements. Each subsidiary quantifies the secured liquidity measure in a consistent manner and reports its liquidity position to the

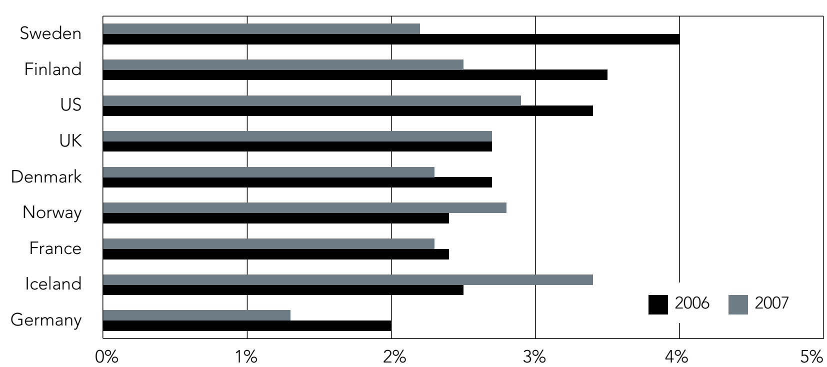
Group Liquidity Management (GLM) within Group Treasury on a monthly basis. The liquidity positions of all subsidiaries are then consolidated by GLM on the Group level. The results are reported to the Board of Directors every month. All local ALCOs are under the supervision of the Group ALCO. The Group ALCO is responsible for balancing the Group-wide needs of resource availability such as capital, liquidity and Balance Sheet limits.

Egill Ágústsson
As one of Iceland's largest importers and entrepreneurs, Egill Ágústsson knows the value of thinking beyond borders and going his own way, which is why he entrusts his personal private banking and investment banking to Kaupthing Bank.

MARKET OVERVIEW

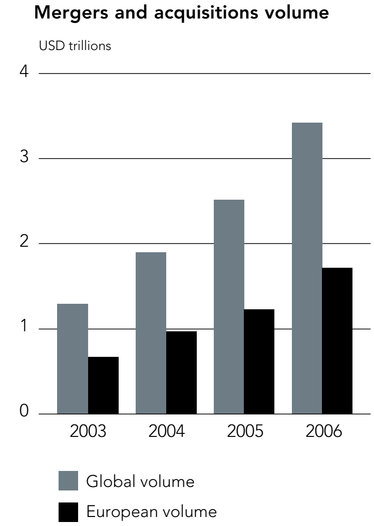
2006 turned out to be a strong year. Global growth was healthy and most economies showed stronger growth than in 2005. After a drastic correction in the equities markets in May and June, global systemic fears were alleviated throughout the second semester as investors globally adopted the outlook of a soft landing for the US economy. Risk appetite increased, and by the end of 2006 emerging markets showed the strongest return on equity markets overall. Corporate activity was greatly supported by strong corporate Balance Sheets with high cash levels, profitability, and continuing accommodative interest rate levels, which have led to the volume of mergers and acquisitions tripling over the last four years.

Real GDP growth forecast for 2006 and 2007



Source: IMF & Kaupthing forecasts

Mergers and acquisitions volume



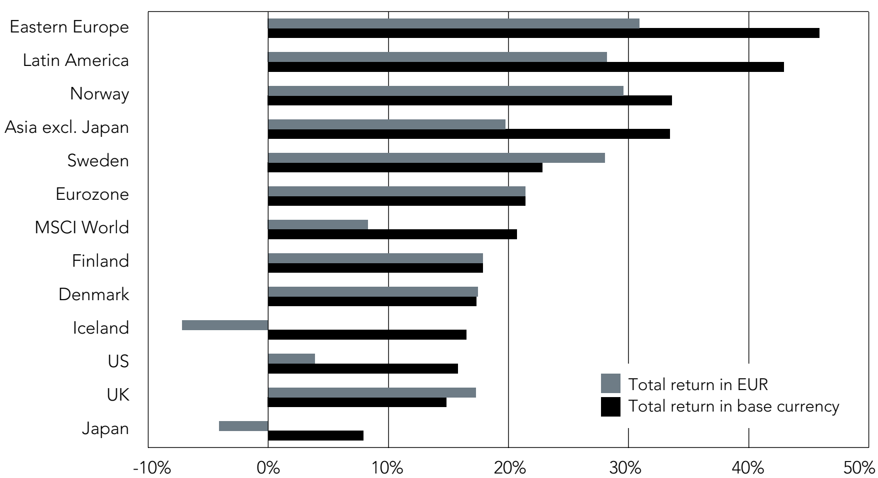
Eurozone

The European corporate landscape was marked by an ongoing boom in mergers and acquisitions across both industries and regions. The high surplus cash levels held by companies combined with low interest rates have both been factors contributing to this surge in the number and size of consolidation deals. Corporate profitability has remained strong across the board, and the global macroeconomic backdrop has continued to shore up earnings expectations. Although the European markets were not immune to the global surge in risk aversion in May and June, equities managed to perform well in 2006.

Favorable valuations, optimistic earnings growth, the high quality of corporate Balance Sheets, and the anticipation of continuing M&A activity all participated in reviving the risk appetite and, naturally, the upwards-moving pricing of risky assets. What's more, the widely held perception of an improving fundamental economic performance in the Eurozone – notably in Germany – provided the fertile ground upon which financial assets pricing could surge again in the second half of the year.

The ECB raised its minimum bid rate on refinancing operations by 125 basis points to 3.5% in 2006, a level still deemed to be accommodative. Over the year, and apparently without impairing the competitive performance of European corporations while favoring the purchasing power of EU consumers for imported goods, the euro has appreciated on a trade-weighted basis.

Equity indices in 2006



Source: Bloomberg

United Kingdom

The UK economy in 2006 was characterized by robust economic growth and rising inflation, a combination that led the Monetary Policy Committee (MPC) to start raising interest rates.

Economic activity was consistently strong throughout the year, with GDP growth rising from 1.9% for 2005 to around 2.7% for 2006. Growth was driven by a surge in investment and a modest pick-up in consumer spending, which in turn was supported by a rise in housing prices of around 10% and strong employment growth of around 0.8%.

CPI inflation rose from 1.9% in January 2006 to 3.0% in December, driven by higher fuel and electricity prices. However, core inflation (such as clothing, furniture and university tuition fees) also rose.

High rates of inflation increased the danger of a substantial pick-up in pay growth during the January 2007 pay round. The rise in money supply growth to a 14-year high represented a further upside risk to inflation, as it could eventually prompt a further rise in asset prices and nominal demand. In response, the MPC raised rates twice, finishing at 5.0% by the end of the year.

United States

After three consecutive years of very good returns, the assets markets – and in particular equities – underwent a drastic correction in May and June. The deterioration of the US current-account deficit sparked a US dollar crisis as the unwinding of global imbalances was feared to produce a global systemic crisis. Inflation and growth forecasts were rescaled to accommodate a scenario of stagflation. But corporate health remained very good throughout the year and the benign liquidity environment remained conducive for a re-rating of risky assets (and in particular of equities and speculative credit). With economic data surprisingly on the upside, the markets rekindled a scenario of a gradual, soft landing for the US economy, thanks to consumer activity and business sentiment indicators holding up reasonably well. Equities registered a very good overall performance in the second half of the year, in spite of reduced economic and earnings growth expectations. The real estate markets remained solid enough not to prompt further fears of a systemic crisis developing. Other external shocks to the financial markets were easily brushed off. The anticipation that the lingering US twin deficits would be dealt with smoothly, and not give rise to significant economic and financial strains, helped in sustaining the world's risk appetite.

EUR/USD Exchange rate

Iceland

After two years of growth above 7% the Icelandic economy is likely to have grown by around 2.5% in 2006. The drop in the growth rate is due to slower growth in private consumption, after a record growth rate in 2005, and a slowdown in investment in the large-scale industrial projects coming to an end this year. Last year the currency fell by around 20%, which had a large effect on economic development with the ISK's volatility characterizing the economy in 2006. Inflation crept up to 8.6% in August due to higher import prices and tension in the labor market, though inflationary pressure did slow down by the end of the year. Inflation stood at 6.8% in 2006 compared to 4.4% in 2005. The Central Bank hiked its policy rate by 400bp in 2006, bringing it up to 14.25% in an effort to lower inflation and cool the economy down. The housing market has started to cool down with turnover dropping and credit growth plummeting. All in all, the economy reached a turning point last year and is expected to slow down this year.

Oil prices in 2006

Iceland is expected to reach some kind of a landing this year with national expenditure levels contracting during last year. The current-account deficit is expected to narrow, which will bolster GDP growth by around 3%. The Central Bank is expected to start lowering rates in Q2 2007, with inflation probably reaching its target around mid year.

Finland

The economy exhibited strong expansion again in 2006 with GDP growth reaching more than 5% above growth in 2005, which was characterized by more subdued growth. Exports and fixed private investments drove this growth, but private consumption continued to expand rapidly as well. Seasonally adjusted unemployment continued to decline down to 7.5% towards the end of 2006, which was probably another factor behind consumer confidence remaining so high both by historical and European standards moving into 2007. Nonetheless, CPI inflation remained subdued at 2.2% in December and at 1.6% on average for 2006.

Denmark

In accordance with the performance in the other Nordic countries, Denmark experienced strong GDP growth in 2006 with growth rates coming in around 4%. This strong growth was not overshadowed by higher inflation of 1.8% YoY. This solid economic development was primarily driven by increases in exports, but both private and public consumption also showed healthy levels. The labor market was strong, with the unemployment rate at around 4%, the lowest level for many years in Denmark. Needless to say that labor costs have started to increase, but on an inflationary level this was offset by an decrease in energy costs. The first signs of a slowdown on the housing market appeared, especially with the metropolitan areas of Copenhagen, Århus and Odense posting slight declines and longer inventory times. The Danish stock market returned a strong performance, with an increase in the order of 15%. This performance was driven to a large extent by earnings growth, share buy-back programs and M&A activity. The Danish Central Bank has followed ECB rate increases during the year, setting the short-dated interest rates at 3.50%.

Norway

The Norwegian economy had another strong year in 2006, with GDP growth at about 4.1%. This strong performance stands out when considering the development of the all-important oil price – from early 2006 until summer 2006 the price of oil increased by c. 20%, after which it plummeted in the months to follow. The drop in the price of oil ended the year at 3.5%. The NOK weakened against the EUR during the year. Inflation in Norway increased in 2006 to approximately 2.1%, which is still quite a low level, especially considering the strong labor market with an unemployment rate of around 2.2%. The Norwegian equity market performed quite strongly in 2006, posting an increase of c. 35%, driven by strong earnings. The Central Bank also increased interest rates during the year, bringing the policy rate up to 3.50%.

Sweden

The Swedish economy is expanding at an exceptionally fast pace, as it seems GDP grew by more than 4% in 2006. Some moderation is expected in 2007 and 2008 with growth rates dropping down to 3%. Nevertheless, given the present momentum of the economy, there is the potential for upwards movement in our estimates. For the most part, labor supply and employment have recovered significantly in 2006, pushing down unemployment and rising household real disposable income, which underpins domestic demand. In addition, global growth remains strong, which continues to boost exports and stimulate investments. Although inflation remains well contained due to high productivity and moderate wage increases, the economy is growing at a pace well above the economy's long-term potential, and consequently the Bank of Sweden is expected to gradually move towards a neutral policy rate during 2007.

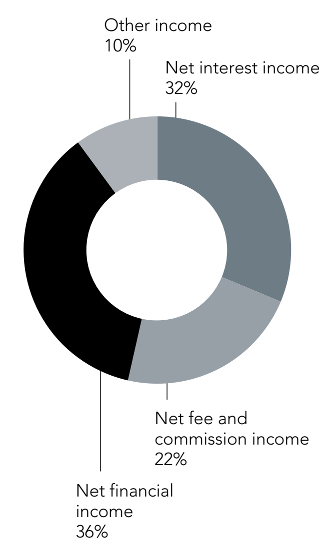
KAUPTHING BANK'S RESULTS

Kaupthing Bank reported a pre-tax profit of ISK 101,083 million in 2006, compared with ISK 62,284 million in 2005. Shareholders' net earnings totaled ISK 85,302 million in 2006, compared with ISK 49,260 million in 2005, an increase of 73.2%. Earnings per share in 2006 were ISK 127.1, compared with ISK 75.2 in 2005.

Income

Operating income in 2006 totaled ISK 167,216 million, an increase of 63.6% compared with 2005. Net interest income in 2006 totaled ISK 52,362 million, an increase of 60.1% compared with 2005. Net fee and commission income in 2006 totaled ISK 37,284 million, an increase of 66.2% compared with 2005. Net financial income, which includes dividend income, net gain on financial assets/liabilities at fair value, net gain on financial assets/liabilities not at fair value and net foreign exchange difference, totaled ISK 60,157 million in 2006, an increase of ISK 22,876 million from 2005. The main reason for this increase is net financial income from the sale of the Bank's holding in Exista in connection to the listing of the company on the Iceland Stock Exchange. Other income totaled ISK 17,413 million in 2006, compared with ISK 9,778 million in 2005. Thereof ISK 7,421 million was generated by the sale of the Bank's entire holding in VÍS during the second quarter.

Income distribution

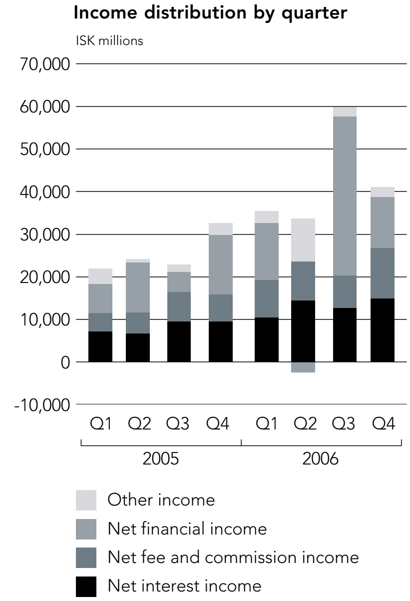


Expenses

Operating expenses totaled ISK 60,006 million in 2006, an increase of 68.9% from 2005. The increase between years is partly due to the inclusion of Kaupthing Singer & Friedlander in the consolidated accounts from the third quarter of 2005. Furthermore, there has been a sharp increase in the number of employees and a general increase in the Bank's activities. The 23.1% depreciation of the ISK during 2006 has also raised operating expenses. The cost-to-income ratio in 2006 was 35.9%, compared with 34.8% in 2005.

Salaries and related expenses in 2006 totaled ISK 33,570 million, increasing by 65.2% from 2005. This increase is primarily due to the consolidation of Kaupthing Singer & Friedlander into the Group from the third quarter of 2005. The increase in salary expenses is also partly explained by a general increase in the number of employees and performance related payments made during the year. The number of full-time equivalent positions at the Bank was 2,719 on 31 December 2006, compared with 2,368 as of 31 December 2005, an increase of 351 or 14.8%. Other operating expenses amounted to ISK 26,437 million in 2006, increasing by ISK 11,230 million from 2005, or 73.8%.

Income distribution by quarter



Income specified by location of markets and customers

ISK millions

	Net interest income		Net fee and commission income		Net financial income		Other income		Operating income		
Iceland	16,592	32%	14,724	39%	34,995	58%	12,233	70%	78,544	47%	37%*
Scandinavia	17,311	33%	5,935	16%	17,181	29%	993	6%	41,420	25%	30%*
UK	12,099	23%	10,543	28%	5,975	10%	4,168	24%	32,785	19%	23%*
Luxembourg	4,882	9%	4,355	12%	1,842	3%	0	0%	11,079	7%	8%*
Other countries	1,478	3%	1,727	5%	164	0%	19	0%	3,388	2%	2%*
Group	52,362	100%	37,284	100%	60,157	100%	17,413	100%	167,216	100%	100%

*Without gain from Exista

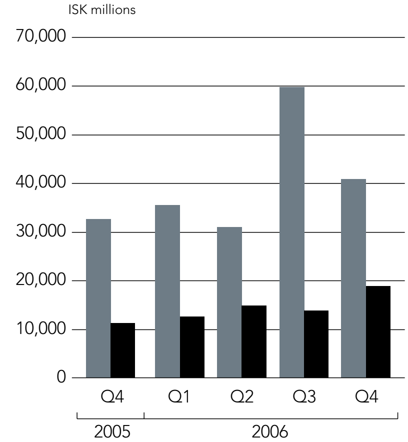
Impairment on loans amounted to ISK 4,857 million in 2006, compared with ISK 2,450 million in 2005. The main reason behind this increase is a rise in loan losses at Kaupthing Singer & Friedlander. Notwithstanding this impairment, impairments have generally remained stable, reflecting the increased quality of the Bank's loan portfolio, despite a 64.4% increase in loans to customers.

Impairment on intangible assets totaled ISK 1,270 million in 2006, all in Kaupthing Singer & Friedlander's asset management business in the UK.

Income tax expense amounted to ISK 14,636 million in 2006, compared with ISK 11,228 million in 2005.

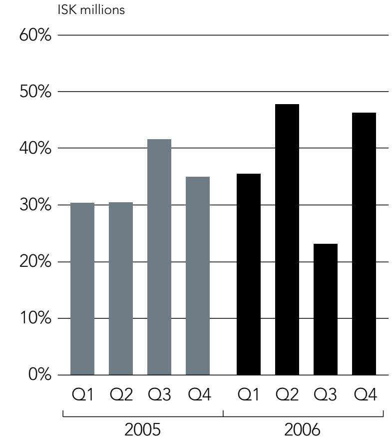
Income and expenses

ISK millions



Cost/Income ratio

ISK millions



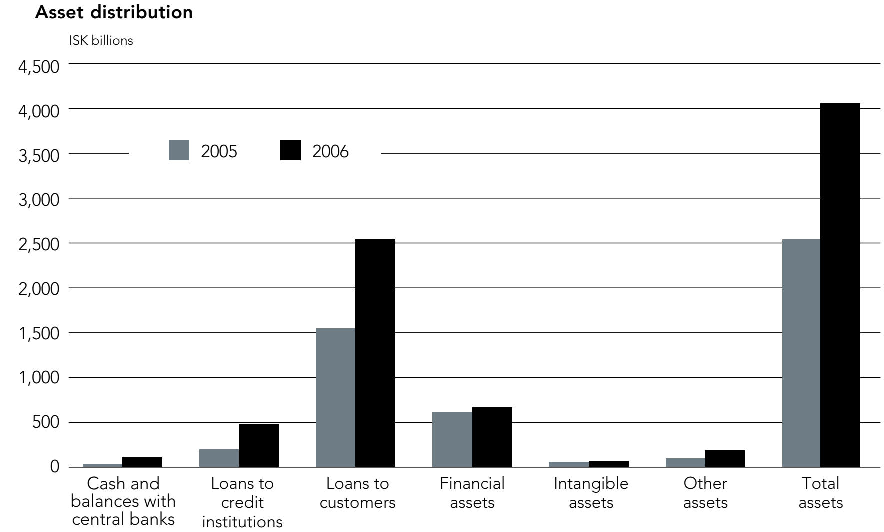
Balance Sheet

Assets

The Bank's total assets as of 31 December amounted to ISK 4,055.4 billion, increasing by ISK 1,514.6 billion or 59.6% since the beginning of the year. Loans to customers increased from ISK 1,543.7 billion to ISK 2,538.6 billion, or by 64.4% in 2006, whilst loans from credit institutions increased from ISK 195.6 billion to ISK 485.3 billion, an increase of 148.1%. The rise in loans from credit institutions is a result of the Bank's decision to increase liquidity.

Financial assets as of 31 December totaled ISK 665.1 billion, increasing by ISK 52.6 billion from the beginning of the year, or 8.6%. Financial assets held for trading amounted to ISK 297.9 billion at year end, decreasing by 11.6% from the beginning of the year. Financial assets designated at fair value totaled ISK 360.6 billion, increasing by 33.2% from the beginning of the year. Derivatives used for hedging amounted to ISK 6.5 billion, compared with ISK 4.5 billion at the beginning of the year. Positions in shares and equity instruments amounted to ISK 159.0 billion on 31 December. Furthermore the Bank holds shares as hedge against derivatives amounting to ISK 49.2 billion. The Bank is furthermore not exposed to market risk of ISK 3.5 billion due to minority interests in the Bank's subsidiary Norvestia in Finland. Listed shares amounted to ISK 113.8 billion or 2.8% of the Bank's total assets as of 31 December 2006. Of this total, ISK 40.1 billion is listed on the OMX Nordic Exchange in Iceland (formerly the Iceland Stock Exchange), or 35.3%. Holdings in unlisted shares totaled ISK 45.2 billion, or 1.1% of the Bank's total assets as of 31 December 2006, compared with 1.6% at the beginning of the year. The Bank's two largest positions in unlisted shares represented approximately 32% of the value of unlisted shares.

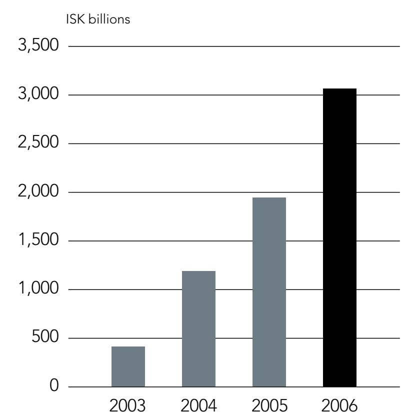
Asset distribution



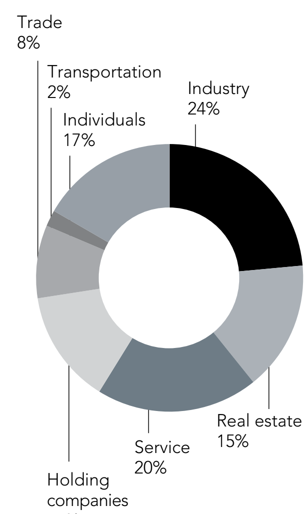
Over the last ten years a feature of the Bank's activities has been to invest in unlisted companies with the aim of selling its holdings within a certain timeframe, for example when a company is listed on a stock market. In connection with these investments Kaupthing Bank has been able to advise companies and has been involved in financial restructuring, mergers and acquisitions in order to facilitate stock market listings for companies. Examples of such cooperation in recent years include Össur hf. (prosthetics manufacturer), Bakkavör Group (food producer) and Mosaic Fashions (fashion retailer). In this way Kaupthing Bank plays an active role in the development of companies which engage Kaupthing Bank's Investment Banking division, and it clearly illustrates that the prosperity of the Bank is closely linked with that of its customers.

Other assets totaled ISK 117.9 billion as of 31 December 2006, increasing by 250.0% from the beginning of the year. This increase is mainly due to unsettled transactions.

Risk weighted assets



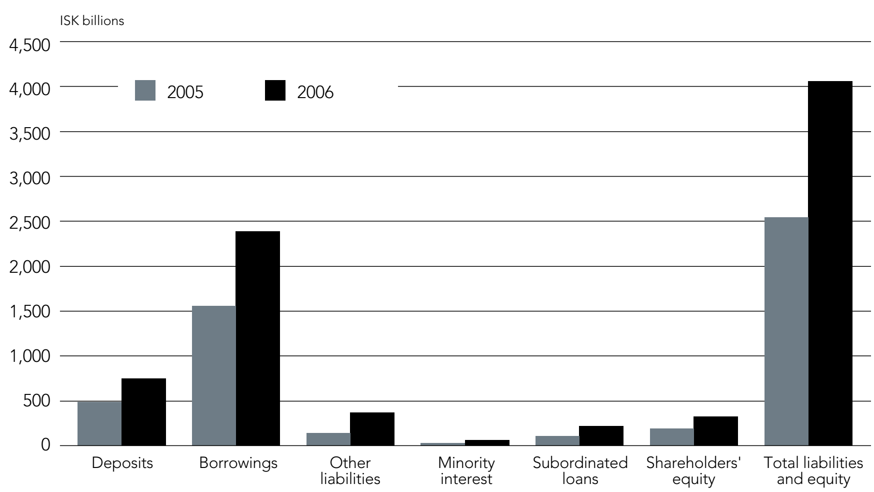
Loans to customers



Liabilities & Equity

Liabilities to credit institutions and central banks totaled ISK 110.5 billion as of 31 December 2006, increasing by ISK 40.8 billion or 58.6% during the year. Deposits amounted to ISK 750.7 billion as of 31 December, increasing by ISK 264.5 billion from the beginning of the year, or by 54.4%. Deposits represented 18.5% of the Bank's total assets as of 31 December 2006, compared with 19.1% at the beginning of the year, but as a ratio of loans to customers they equalled 29.6% at the end of 2006, compared with 31.5% at the end of 2005. Borrowings amounted to ISK 2,399.9 billion as of 31 December 2006, compared with ISK 1,556.6 billion at the beginning of the year, an increase of ISK 843.4 billion or 54.2%.

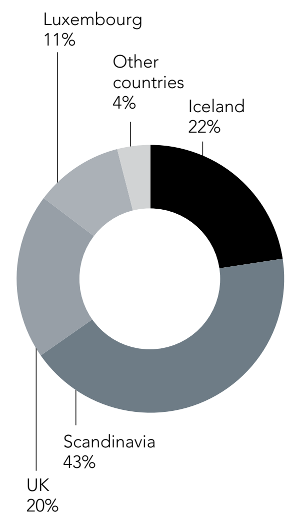
Liabilities and equity



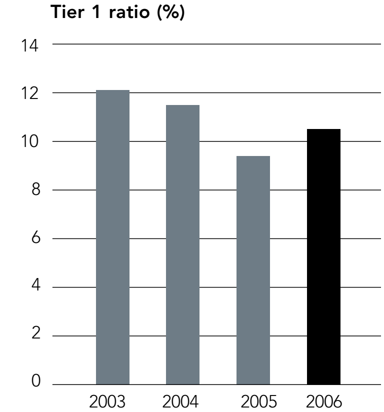
Shareholders' equity amounted to ISK 323.5 billion as of 31 December 2006, compared with ISK 194.2 billion at the beginning of the year, an increase of ISK 129.3 billion or 66.6%. The Bank's risk capital was ISK 460.8 billion as of 31 December 2006. The equity ratio was 15.0% as of 31 December, compared with 12.2% at the beginning of the year. Tier 1 ratio was 10.5%, compared with 9.4% at the beginning of the year. It is the objective of the Bank's management that Tier 1 ratio is at least 8.0% and the equity ratio is at least 11.0%.

As of 31 December the Bank's Share capital was ISK 7,404,530,530 at nominal value, which was divided into 740,453,053 shares. The total number of shareholders as of 31 December was 31,730. One shareholder held more than 10% of Share capital: Exista held 23.0%. As of 31 December 2006 Kaupthing Bank held a 3.2% share in Exista.

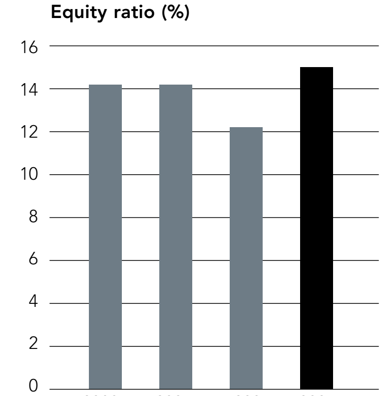
Loans to customers by country



Tier 1 ratio (%)



Equity ratio (%)



FIVE-YEAR SUMMARY

(ISK millions)	2006	2005	2004	2003*	2002*
Income Statement					
Net interest income	52,362	32,710	18,259	10,124	6,998
Net fee and commission income	37,284	22,428	13,308	9,683	6,224
Net financial income	60,157	37,282	16,326	11,145	6,407
Other income	17,413	9,778	2,053	828	1,783
Operating income	**167,216**	**102,198**	**49,946**	**31,780**	**21,412**
Operating expenses	-60,006	-35,525	-23,625	-18,493	-12,455
Impairment	-6,127	-4,389	-3,825	-3,894	-2,794
Income tax	-14,636	-11,228	-4,237	-1,486	-764
Net earnings	86,447	51,056	18,259	7,907	5,399
Attributable to:					
Shareholders of Kaupthing Bank	85,302	49,260	17,707	7,520	5,363
Minority interest	1,145	1,796	552	387	36
Net earnings	86,447	51,056	18,259	7,907	5,399

	2006	2005	2004	2003*	2002*
Balance Sheet					
Assets					
Cash and balances with central banks	106,961	34,877	6,290	3,488	7,397
Loans to credit institutions	485,334	195,594	174,310	47,057	31,122
Loans to customers	2,538,609	1,543,700	980,106	349,033	267,303
Financial assets	665,129	612,534	305,961	131,159	102,180
Intangible assets	68,301	54,943	35,098	5,948	3,002
Other assets	191,062	99,163	52,688	21,884	21,408
Total assets	4,055,396	2,540,811	1,554,453	558,569	432,412
Liabilities and equity					
Deposits	750,658	486,175	202,193	182,497	164,570
Borrowings	2,399,939	1,556,567	968,512	210,645	102,029
Other liabilities	353,877	192,869	167,216	98,192	120,310
Minority interest	11,382	8,329	9,539	10,603	1,114
Subordinated loans	216,030	102,688	57,623	10,704	11,010
Shareholders' equity	323,510	194,183	149,370	45,928	33,379
Total liabilities and equity	**4,055,396**	**2,540,811**	**1,554,453**	**558,569**	**432,412**

*Pro forma figures from Kaupthing Bank and Búnadarbanki Íslands and presented according to Icelandic GAAP

KEY RATIOS

	2006	2005	2004	2003	2002
Cost / income ratio	35.9%	34.8%	47.3%	58.2%	58.2%
Return on shareholders' equity	42.4%	34.0%	25.5%	23.0%	18.7%
Impairment/Loans to customers	0.2%	0.2%	0.4%	1.1%	1.0%
Total credit reserves	0.4%	0.6%	1.7%	2.4%	2.1%
Price / earnings	6.6	9.9	12.4	12.2	8.8
Earnings per share, ISK	127.1	75.2	35.6	18.5	14.8
Earnings per share diluted, ISK	123.4	73.9	35.1	18.4	14.7
Average number of shares outstanding, million	671	655	497	406	362
Average number of shares outstanding diluted, million	691	666	505	411	364
Number of shares at end of year, million	732	664	652	438	409
Number of shares at end of year diluted, million	752	675	660	443	411
Share price at end of year, ISK	841	746	442	225	130

QUARTERLY OVERVIEW OF KAUPTHING BANK

	Q4 2006	Q3 2006	Q2 2006	Q1 2006	Q4 2005	Q3 2005	Q2 2005	Q1 2005
Net interest income	14,806	12,687	14,385	10,484	9,529	9,488	6,647	7,046
Net fee and commission income	11,866	7,632	9,184	8,602	6,203	6,862	4,930	4,433
Net financial income	12,003	37,256	-2,607	13,505	13,960	4,772	11,773	6,777
Other income	2,241	2,210	10,102	2,860	2,867	1,997	846	3,968
Operating income	**40,916**	**59,785**	**31,064**	**35,451**	**32,547**	**22,909**	**24,121**	**21,826**
Operating expenses	-18,846	-13,803	-14,805	-12,552	-11,389	-9,722	-7,411	-7,003
Impairment	-1,637	-2,819	-961	-710	-1,789	-928	-778	-894
Earnings before income tax	**20,433**	**43,163**	**15,298**	**22,189**	**19,481**	**12,469**	**16,007**	**14,327**
Income tax	-1,793	-7,630	-2,618	-2,595	-4,018	-2,428	-1,894	-2,888
Net earnings	**18,640**	**35,533**	**12,680**	**19,594**	**15,463**	**10,041**	**14,113**	**11,439**
Attributable to:								
Shareholders of Kaupthing Bank hf.	18,077	35,393	13,034	18,798	14,786	9,708	13,673	11,093
Minority interest	563	140	-354	796	677	333	440	346
Net earnings	**18,640**	**35,533**	**12,680**	**19,594**	**15,463**	**10,041**	**14,113**	**11,439**

Robert Tchenguiz

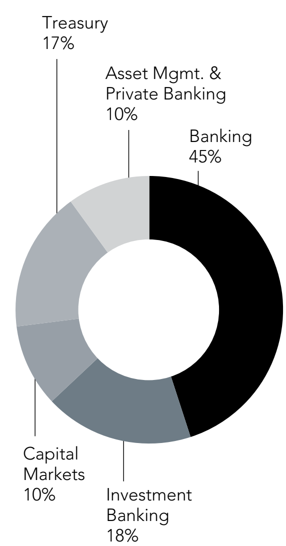
Robert Tchenguiz knows a good deal when he sees one. In fact, it is precisely this business acumen that enabled him to grow an enterprise, which began with rental housing for students and tourists, into one of the most prosperous property groups in the UK. Robert Tchenguiz's relationship with Kaupthing Bank is characteristic of his eye for sustainable performance. The Investment Banking division has repeatedly demonstrated why Robert Tchenguiz calls on Kaupthing Bank, and it is this reliability and capability to deliver on projects that keeps him coming back time and again. Robert Tchenguiz is known among entrepreneurs for his financial savvy, unconventional funding strategies, and ability to realize a good opportunity when it presents itself. Interestingly enough, these are exactly the same qualities that make Kaupthing Bank his investment bank of choice.

OPERATING RESULTS OF BUSINESS SEGMENTS

Kaupthing Bank divides its operations into five business segments plus ancillary units. The Bank's business segments are: Banking, Capital Markets, Treasury, Investment Banking and Asset Management & Private Banking.

All business segments returned a profit in 2006. The highest gross profit was posted by Investment Banking with ISK 45,621 million. Investment Banking provides advice on mergers and acquisitions, arranges acquisitions and leveraged finance, is responsible for assisting companies with stock offering and also makes long-term equity investments. Banking posted the next largest gross profit with ISK 39,208 million. Banking provides general banking services to individuals and corporations in countries where Kaupthing Bank has a banking license, i.e. Denmark, Iceland, Sweden, Luxembourg, Finland and the UK. Treasury returned a gross profit of ISK 19,773 million during the year. Treasury is responsible for inter-bank trading, derivatives and FX trading and the funding of the Bank. Capital Markets returned a gross profit of ISK 7,467 million. Capital Markets is responsible for securities brokerage for institutional investors and proprietary trading. Asset Management & Private Banking returned a gross profit of ISK 5,023 million during the year. It is responsible for managing and investing assets for individuals and institutional investors and operates a number of mutual and pension funds.

Operating income by business segments*



*without gain from Exista

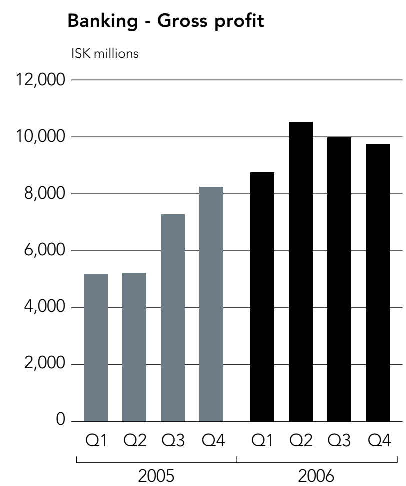
Gross profit of the business segments

ISK millions	Capital Markets	Investment Banking	Treasury	Banking	Asset Mgmt & PB
Net interest income	-1,513	-3,349	11,492	45,903	817
Net fee and commission income	7,396	9,577	2,927	5,744	11,231
Net financial income	7,913	42,984	8,411	750	531
Other income	-1	44	26	6,631	962
Operating income	13,795	49,256	22,856	59,028	13,541
Operating expenses	-6,205	-3,636	-3,078	-14,969	-7,380
Impairment	-123	1	-5	-4,851	-1,138
Total expenses	-6,328	-3,635	-3,083	-19,820	-8,518
Gross profit	7,467	45,621	19,773	39,208	5,023

BANKING

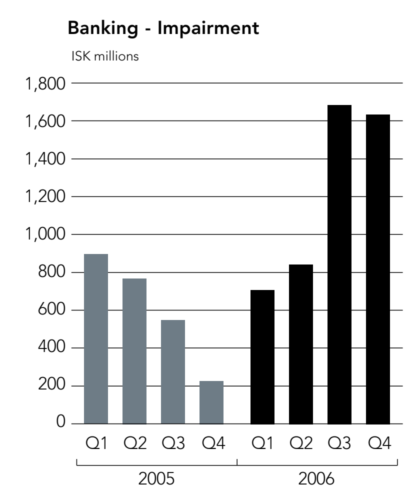
- Record earnings in Banking
- Net interest income up 43% from 2005
- Strong growth in net fee and commission income

Banking posted a record gross profit of ISK 39,208 million, compared with ISK 25,917 million the previous year, representing an increase of 51.3%. Net interest income was ISK 45,903 million, increasing by 43.1% from the previous year. The interest margin decreased from 1.86% in 2005 to 1.77% in 2006. Net fee and commission income totaled ISK 5,744 million, up 81.5% from 2005. Other income in Banking amounted to ISK 6,631 million. Loan impairment increased from ISK 2,395 million in 2005 to ISK 4,851 million in 2006



Banking

ISK millions	2006	2005	Q4 2006	Q3 2006	Q2 2006	Q1 2006
Net interest income	45,903	32,076	12,471	11,959	11,264	10,209
Net fee and commission income	5,744	3,165	1,662	1,560	1,389	1,133
Net financial income	750	232	320	63	164	203
Other income	6,631	3,419	1,712	1,722	1,977	1,220
Operating income	59,028	38,892	16,165	15,304	14,794	12,765
Operating expenses	-14,969	-10,580	-4,602	-3,630	-3,433	-3,304
Impairment	-4,851	-2,395	-1,621	-1,684	-841	-705
Total expenses	-19,820	-12,975	-6,223	-5,314	-4,274	-4,009
Gross profit	39,208	25,917	9,942	9,990	10,520	8,756



Banking is divided into two distinct units, Corporate Banking and Retail Banking. Though these units are treated as a single business segments, their activities are operated as separate units. Kaupthing Bank has banking licenses in six countries but engages in retail banking mainly in Iceland where it operates a high street branch network. The Banking division provides general banking services to individuals and corporations, such as advisory and assistance in financing to small, medium-sized and large corporates. Activities are focused on Iceland, Sweden, the United Kingdom and Denmark, particularly on the segment consisting of small to medium-sized enterprises.

The Banking segment also provides banking services to Private Banking customers, primarily through the offices in Luxembourg, Iceland and the UK. The Bank has a well diversified corporate banking portfolio between markets, sectors and products, and a strong retail foothold in Iceland. The Banking division provides 95.5% of the Bank's loans to customers. Kaupthing Bank is one of the leading lenders in

Iceland, for retail as well as corporates, while the Bank's subsidiary FIH is one of the top three corporate banks in Denmark, with a market share of 13% based on the December 2006 MFI statistics.

Diversified Loan Portfolio

The Bank's loan portfolio is well diversified. Loans to customers represented 62.6% of the Bank's total assets as of 31 December 2006. The industry sector contributes the most to the loan portfolio with 24% of the total portfolio, while service contributes the second largest with 20% of the total portfolio. Loans to individuals represented 17% of the total portfolio. Further information on the credit process and credit exposure can be found in the chapter Risk Management on page 26.

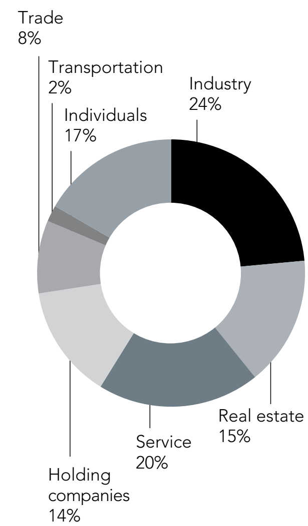
Corporate Banking

Corporate Banking offers a range of financing services and products for its corporate clients, from smaller businesses to larger companies operating in complex international environments. The Bank is focused on developing long-term relationships with its clients and gaining a thorough understanding of their businesses and the competitive environment in which they operate, in order to tailor the Bank's products to their needs.

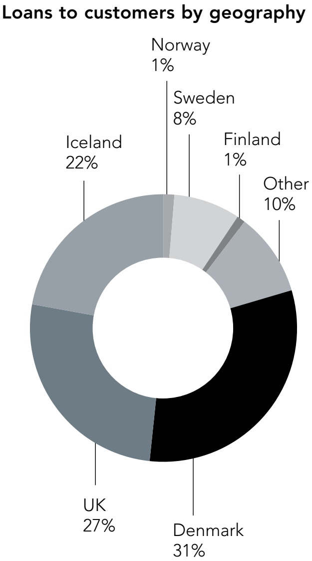
Corporate Banking provides a wide range of services, including term loans, bridge financing, credit lines, revolvers and other kinds of working capital facilities, structured finance, mezzanine financing, property and asset finance and investment financing. Corporate Banking also provides comprehensive cash management and other add-on products and services, such as cash pooling, cash sweeping and comprehensive internet banking from its operations in Iceland. Corporate Banking employed 281 people at year end 2006.

A number of large financing projects were undertaken by Corporate Banking in 2006, such as the DKK 210 million acquisition and working capital facility provided in relation to Iceland Telecom's acquisition of Sirius IT Partner, a leading software provider to the governmental sector in Denmark, Norway and Sweden; a working capital and acquisition facility granted in relation to the acquisition of Dustin AB, the leading internet reseller of IT products in Sweden. Corporate Banking also acted as an advisor on the financing and provided a bridge loan facility for Össur's €101 million acquisition of the French orthopedics company Gibaud. Earlier in the year, Kaupthing also provided $40 million funding in connection with the company's $38 million acquisition of the US based developer and manufacturer of ligament braces, Innovation Sports, Inc.

Loans to customers



Loans to customers by geography



Corporate Banking also provided debt facilities following underwritings by Investment Banking in a number of transactions, including the £430 million merger of the UK fashion retail companies Mosaic and Rubicon, the £86 million recapitalization of the cosmetics wholesaler Lornamead, and the £29 million underwriting for Nature Way Foods Limited to support its expansion into the US. Kaupthing Bank also provided a €350 million commitment to the pharmaceutical company Nycomed as a joint lead arranger for its acquisition of Altana Pharma AG.

Property projects completed by Corporate Banking in 2006 included the £365 million refinancing of Laurel Propco in the United Kingdom in which Kaupthing Bank acted as the joint lead arranger with RBS; the financing of Propinvest's NOK 670 million acquisition of a portfolio of 17 properties in Germany, Sweden, and Norway; the PMS Holding's SEK 720 million financing of a 130,000 sq. m. portfolio consisting of seven offices and four industrial properties in Sweden, six of which are located in and around Stockholm; and development projects such as the £175 million financing of Candy & Candy's acquisition of Middlesex Hospital in London; as well as the financing, in a club deal with Nationwide Building Society, of a £198 million site purchase and scheme enhancement prior to construction of a prominent mixed-use development project in the City of London, which will be a 72-storey building known as the Shard of Glass located at London Bridge Station.

Other projects include Heimsferdir´s acquisition of Matka Vekka, Finland´s largest chain of travel agencies for which Kaupthing acted as a financial adviser and sole mandated lead arranger of senior and subordinated debt facilities; the financing of Fram Food's acquisition of a substantial stake in Fjord King in France, and an acquisition facility provided for UK Fisheries, a joint venture undertaken by Samherji and Parlevliet & Van der Plas to acquire and refinance the harvesting company J. Marr Ltd. in the UK.

Retail Banking

Kaupthing Bank operates retail banking activities in two countries, Iceland and by small extent in Sweden, with the vast majority of activity taking place in Iceland. The Retail Banking unit is responsible for traditional retail banking activities, with a focus on individual customers and smaller businesses. Larger businesses, such as medium-sized and large companies, are clients of the Corporate Banking unit. Retail Banking offers comprehensive banking services such as mortgage lending, overdrafts, deposits, credit card issuing, cash management and clearing. As of December 31 2006 Retail Banking operated a network of 33 branches and service points in Iceland, including 13 branches in the Reykjavík area. Kaupthing Bank's Retail Banking market share in Iceland for private customers is estimated to be approximately 25%, which is an increase of over 2% from the beginning of 2005. Retail Banking employed 431 people at year end 2006.

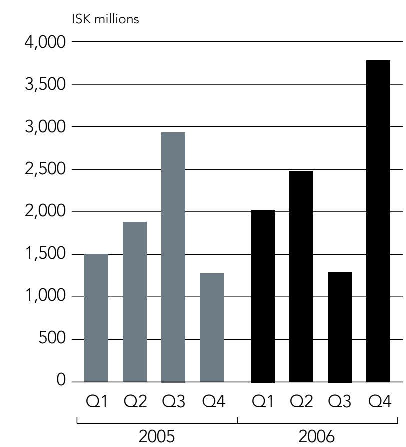
Retail banking activities in Iceland have undergone considerable changes, transforming from a traditional lending institution into a modern bank, offering comprehensive financial solutions for its customers. The Bank places great importance on continuous product development and innovation. Services through the branch network have been continually updated over the last ten years. The role played by financial advisers has grown significantly, while traditional clearing has become less important as automation and self-service on the internet are replacing traditional teller services to a large degree. Retail Banking has also increased its range of services by selling and advising on personal insurance and pension products. The objective of the Retail Banking unit is to advise the Bank's customers on a set of comprehensive financial services tailored to their personal requirements.

INVESTMENT BANKING

- Record year for Investment Banking - gross profits up by 107%
- Strong performance by the Acquisition and Leveraged Finance team - total debt underwritten up by 110% in GBP
- Operations reinforced - strategic recruitment of senior positions

Investment Banking generated a gross profit of ISK 45,621 million in 2006, compared with ISK 22,019 in 2005, representing a 107.2% increase. Net financial income amounted to ISK 42,984 million, including ISK 26,084 million in capital gain from the sale of the Bank's holding in Exista in connection to the listing of Exista. Net fee and commission income amounted to ISK 9,577 milllion, representing an increase of 26.1% from 2006.

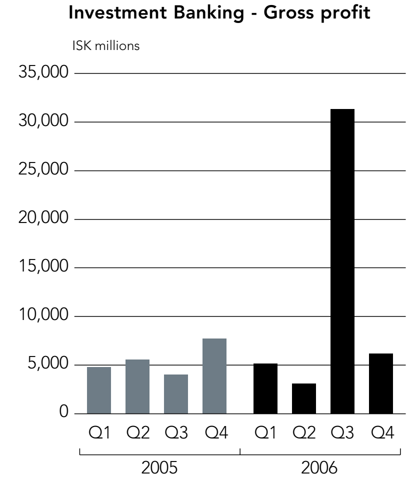
Net fee and commission income



Investment Banking

ISK millions	2006	2005	Q4 2006	Q3 2006	Q2 2006	Q1 2006
Net interest income	-3,349	-2,322	-914	-961	-624	-850
Net fee and commission income	9,577	7,592	3,792	1,295	2,471	2,019
Net financial income	42,984	18,416	4,592	31,652	2,505	4,235
Other income	44	163	7	-142	-84	263
Operating income	49,256	23,849	7,477	31,844	4,268	5,667
Operating expenses	-3,636	-1,808	-1,310	-562	-1,208	-556
Impairment	1	-22	4	0	-2	-1
Total expenses	-3,635	-1,830	-1,306	-562	-1,210	-557
Gross profit	45,621	22,019	6,171	31,282	3,058	5,110

Investment Banking - Gross profit



Investment Banking maintains a significant presence in the northern European investment banking market, offering clients a full range of financial services, including M&A advisory, capital markets advisory, acquisition and leveraged finance, and principal investments. The Bank maintains investment banking operations in the UK, Iceland, Norway, Sweden, Denmark, Finland and the Faroe Islands. At the end of 2006 the Investment Banking division employed 94 people.

A key characteristic of the Investment Banking division is its unique ability to combine the Bank's financing capabilities with its collaborative, cross-border product offerings. This arrangement enables the Bank to provide clients with comprehensive financing solutions coupled with an extensive, locally focused advisory business.

During 2006 the Investment Banking division underwent a period of further development. The London office has been expanded with a new Equity Capital Markets team as well as a Real Estate Advisory team. The Bank's Investment Banking operations in Denmark and Norway have also been strengthened by M&A advisory teams. Both of these teams are already returning results above expectations. Within the Norwegian team's first six months of operation, five equity placements had been executed, in addition to advising Apax on its acquisition of Telenor Satellite Services for $400 million and Schibsted on the sale of its TV assets for approximately NOK 2.5 billion.

M&A Advisory

Investment Banking's M&A Advisory team structures and executes transactions involving all aspects of mergers, acquisitions, divestitures, spin-offs, leveraged buy-outs and recapitalizations. The total value of all transactions in which Investment Banking provided M&A advisory services during 2006 was approximately ISK 420 billion.[1]

Historically a large part of the Bank's M&A advisory services has been provided for Icelandic clients undertaking domestic or cross-border acquisitions. This has changed in recent years with a significant and increasing proportion of transactions originating outside Iceland and involving non-Icelandic clients.

The key M&A deals for the Bank in 2006 include:
- Missouri Bidco's successful £817 million public offer for low-price retailer Matalan
- Apax Partners France's $400 million acquisition of Telenor Satellite Services
- FL Group's €480 million acquisition of private label soft drink manufacturer Refresco
- A private investor's trade sale of Dustin
- An investor group's acquisition of a 9.5% stake in Ventelo
- Mosaic Fashions' £320 million acquisition of Rubicon Retail
- Exista's ISK 53 billion acquisition of VÍS
- £98 million management buyout of Costcutter
- Schibsted's sale of its stakes in media companies TV2 and TV4
- A/S Atlantis Vest's NOK 2.2 billion mandatory offer for Rieber & Son

Capital Markets Advisory

The Bank's Capital Markets advisory team typically advises on and executes IPOs, rights issues, convertible debentures and private placements. In 2006 the most sizeable capital markets transaction was the Bank's role as the sole manager in connection with Exista's IPO in September 2006. Exista's market capitalization amounted to ISK 233 billion at the time of the IPO.

Acquisition and Leveraged Finance

The Acquisition and Leveraged Finance team supplies asset and commercial backed debt, often in conjunction with Principal Investments or advisory services from the M&A Advisory team. The division's primary work includes structuring, arranging and underwriting senior, mezzanine and

[1] Based on transaction completion dates.

equity-related products. The division has an underwriting capacity of ISK 115 billion, targeting mid-market transactions.

The Acquisition and Leveraged Finance division's performance in 2006 was very strong, underwriting a total of £1.8 billion, a 110% increase from 2005.

Acquisition and Leveraged Finance's portfolio, amounting to ISK 458.3 billion as of 31 December 2006, represents approximately 18% of the Bank's total loan portfolio. The division's portfolio is well diversified, with no industry segment accounting for more than 10% of the total portfolio apart from manufacturing with 21.5% and retail with 21.4%. Based on loan origination, the largest geographical exposures were in the UK with 29% and in Scandinavia with 17%.

Key transactions in Acquisition & Leveraged Finance in 2006 include:
- €430 million senior and subordinated credit facilities used to fund FL Group's acquisition of Refresco
- £508 million senior and subordinated credit facilities used in the management buyout of Matalan
- £430 million senior and subordinated credit facilities used to fund Mosaic Fashions' acquisition of Rubicon Retail Group
- £55 million senior and subordinated credit facilities used in the management buyout of Costcutter
- €125 million senior and subordinated credit facilities used to finance Gilde's acquisition of the pet food producer Arovit
- The financing of A/S Atlantis Vest's NOK 2,200 million mandatory offer for Rieber & Son
- £85 million senior credit facilities used to refinance personal care brands group Lornamead

Principal Investments

Kaupthing's Principal Investments team invests equity in listed and unlisted mid-sized companies with a strong cash flow and high growth potential. Investments are often related to advisory work or debt financing where clients have shown interest in having Kaupthing Bank co-invest alongside them. The objective is to take minority stakes along with our clients in connection with management buy-outs, mergers, restructurings or acquisitions; hence the Bank shares risk with its clients and further establishes long-term relationships. Principal Investment activities substantiate an important element in the Bank's integrated offering of investment banking products and provide a unique solution in the Nordic and UK mid-cap market environment.

In 2006 principal investments were made in companies such as Refresco, Costcutter, and Ventelo, while investments in Baugur Group and Bakkavör Group were sold.

At the end of 2006 the Bank's total holdings in unlisted companies represented about 1.1% of total assets. As investments in unlisted companies have provided excellent returns, the Bank's objective is that these sort of investments correspond to a maximum of 15% of the Bank's risk capital.

MAJOR TRANSACTIONS COMPLETED BY INVESTMENT BANKING

Adviser to FL Group
on the acquisition of
Refresco
€480,000,000
April 2006
KAUPTHING BANK

Lead Arranger and Underwriter
of Senior and Mezzanine Debt
Facilities
Refresco
€430,000,000
April 2006
KAUPTHING BANK

Adviser to Mosaic Fashions
on its acquisition of
Rubicon
£320,000,000
October 2006
KAUPTHING BANK

Lead Arranger and Underwriter
of Senior and Mezzanine Debt
Facilities
Rubicon
£430,000,000
October 2006
KAUPTHING BANK

Adviser to Exista
on its acquisition of
ISK 53,000,000,000
May 2006
KAUPTHING BANK

Adviser to Exista
on its flotation on
ICEX
ISK 233,000,000,000
September 2006
KAUPTHING BANK

Adviser to Apax
on its acquisition of
telenor
Satellite Services
$400,000,000
October 2006
KAUPTHING BANK

Adviser to Schibsted
on its sale of a 33.4% stake in
NOK 1,150,000,000
October 2006
KAUPTHING BANK

A/S Atlantis Vest
Advising on and financing of
mandatory offer for
Rieber & Søn
NOK 2,200,000,000
November 2006
KAUPTHING BANK

Gilde

Sole Mandated Lead Arranger of Senior and Mezzanine Debt Facilities

AROVIT PETFOOD

€125,000,000

October 2006

KAUPTHING BANK

MidOcean Partners | LA fitness

Acquisition bridge facilities

crownsports

£49,000,000

February 2006

KAUPTHING BANK

Missouri BidCo Ltd

Sole Mandated Lead Arranger and Underwriter of Senior and Subordinated Debt Facilities

MATALAN

£508,000,000

October 2006

KAUPTHING BANK

Missouri BidCo Ltd

Adviser to Missouri BidCo on its public offer for

MATALAN

£817,000,000

October 2006

KAUPTHING BANK

KAUPTHING BANK

Co-investor and Sole Mandated Lead Arranger of Senior and Mezzanine Facilities

Costcutter

£55,000,000

March 2006

KAUPTHING BANK

KAUPTHING BANK

Adviser on the management buy-out of

Costcutter

£98,000,000

March 2006

KAUPTHING BANK

Schibsted

Adviser to Schibsted on its sale of a 26.9% stake in

4

SEK 1,455,000,000

November 2006

KAUPTHING BANK

DUSTIN

Adviser on the trade sale of Dustin

Sole Mandated Lead Arranger of Mezzanine Facilities

SEK: not disclosed

August 2006

KAUPTHING BANK

R2O | KAUPTHING BANK

Adviser to Kaupthing and R20 on the acquisition of a 9.5% stake in

ventelo

SEK: not disclosed

October 2006

KAUPTHING BANK

CAPITAL MARKETS

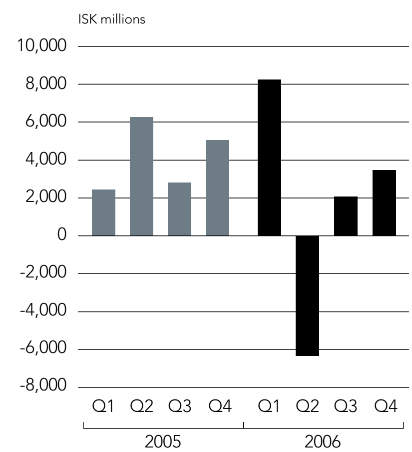
- Substantial increase in net fee and commission income
- Capital Markets divisions set up in Denmark and the UK
- Number of employees nearly doubled in 2006

Capital Markets posted a gross profit of ISK 7,467 million in 2006, compared with ISK 16,540 million in 2005, representing a decrease of 54.9%. Net fee and commission income amounted to ISK 7,396 million, representing an increase of 56.4%. There was a decrease in net financial income over the year from ISK 16,008 million in 2005 to ISK 7,913 million in 2006.

Capital Markets

ISK millions	2006	2005	Q4 2006	Q3 2006	Q2 2006	Q1 2006
Net interest income	-1,513	-1,120	-610	-528	16	-391
Net fee and commission income	7,396	4,730	2,244	1,686	1,594	1,872
Net financial income	7,913	16,008	4,407	2,269	-6,515	7,752
Other income	-1	35	0	-1	0	0
Operating income	13,795	19,653	6,041	3,426	-4,905	9,233
Operating expenses	-6,205	-3,113	-2,513	-1,377	-1,329	-986
Impairment	-123	0	0	0	-123	0
Total expenses	-6,328	-3,113	-2,513	-1,377	-1,452	-986
Gross profit	7,467	16,540	3,528	2,049	-6,357	8,247

Capital Markets - Gross profit



Capital Markets activities are broadly divided into three parts: Institutional Sales, Trading, and Research. Institutional Sales offers a full-service product for institutional investors, with superior knowledge of the Nordic and UK market, based on close collaboration with Research. Trading has two main functions, Proprietary Trading and Client Facilitation. Proprietary Trading trades for the Bank's own accounts in bonds and equities on the international securities markets as well as managing a portfolio of diversified international positions. Client Facilitation makes markets in a number of bonds and equities in the Bank's main regions. The main purpose of this activity is to enable clients to conduct large and complex transactions smoothly and with efficiency. At year end there were 226 full-time positions in Capital Markets.

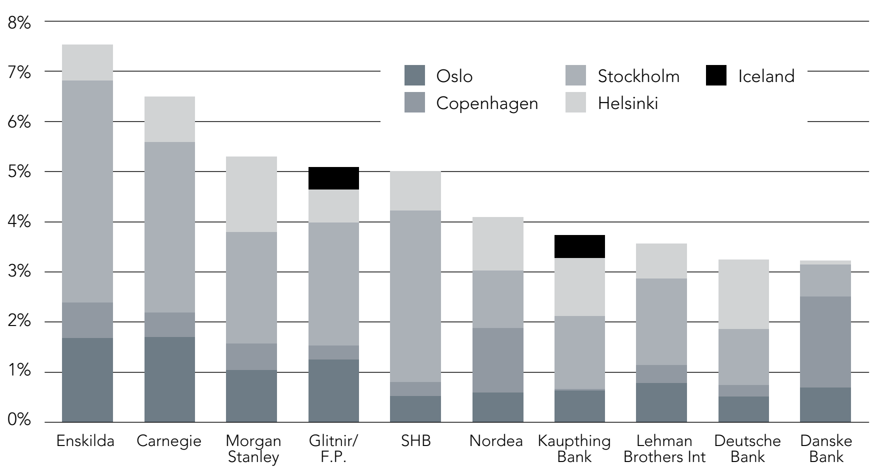
Kaupthing Bank has a substantial market share of debt and equity trading in the Nordic region, with a 3.7% market share in terms of turnover in equities trading on the Nordic stock exchanges, making the Bank the seventh largest participant in the market for 2006. In Stockholm, Oslo and Helsinki, the three largest Nordic equities markets, the Bank's market share for 2006 was 3.3%, 2.9% and 5.5%, respectively.

The Bank was the largest participant on the Iceland Stock Exchange both in equities and bond trading with a market share of 27.5% and 28.2%, respectively, for 2006.

New Capital Markets activities were established at the Bank's two largest subsidiaries in 2006. Kaupthing Singer & Friedlander Capital Markets in the UK commenced trading in September 2006 and FIH Capital Markets in Denmark began their operations in August. For more detailed information on these new divisions see the description of KSF's operations on page 101 and the description of FIH's activities on page 99.

The Bank has decided to integrate Capital Markets activities within equities even further, creating a sector-based research platform focusing across all the Nordic countries as well as the UK. This product is also marketed in other territories, including the US. The new position of Global Head of Equities was established to oversee these efforts and maintain the development of these activities in the right direction.

Market share in equities trading of individual stock market members on Nordic stock exchanges in 2006

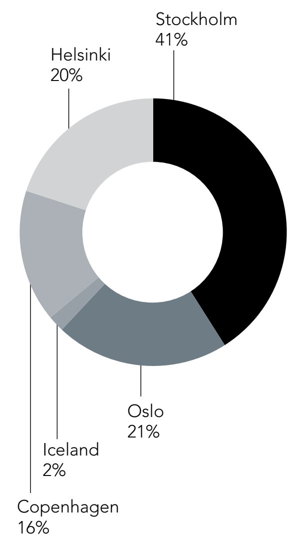


Institutional Sales

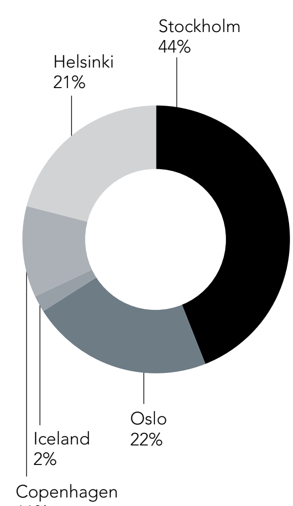
Institutional Sales offers a full-service product, with local know-how and expertise coupled with the strengths inherent in a larger group. Our client base consists primarily of financial institutions such as mutual funds, pension funds, investment companies and insurance companies as well as hedge funds and, in certain markets, high net-worth individuals.

The Institutional Sales team consists of experienced and dedicated professionals with a superior knowledge of the Nordic and UK markets. The objective of

Market capitalization in equities on the Nordic stock exchanges



Turnover in equities on the Nordic stock exchanges



Institutional Sales is to establish itself as a trusted partner for its clients by building long-term relationships with them.

In cooperation with Kaupthing's Investment Banking division, Institutional Sales participates in share buy-back programs, IPO's and block deals as well as new issues of equities and bonds and other corporate-finance related transactions.

Kaupthing Bank Capital Markets is a member of the London Stock Exchange, all the Nordic Exchanges and the Tallinn Stock Exchange through the Bank's subsidiary in Helsinki. Through our subsidiary Kaupthing Securities Inc., the Bank is also a member of the National Association of Securities Dealers (NASD) in the United States, enabling trade directly on NASDAQ. In addition, the Bank is a listing agent authorized by the Luxembourg Stock Exchange to list securities, such as bonds, shares, and other instruments.

Research

Kaupthing Bank Research operates as an independent unit within Capital Markets but maintains close collaboration with the other units in the segment. The unit functions as a network of approximately 81 research analysts located in the United Kingdom, Sweden, Finland, Norway, Denmark and Iceland, engaging in equity analysis and fixed income research as well as macroeconomic and strategy research.

The Equity Research Department offers a full-service product, with local, in-depth, idea-driven research on companies listed on the Nordic stock exchanges, making us a true gateway to the Nordic markets. The Bank is also building a strong presence in the UK with research on selected mid and small cap corporations, incorporating UK companies into the scope of analysis when appropriate.

Research analysts work in sector teams across the Nordic and UK region to serve international and domestic clients to present the best investment research available in the markets covered. The Bank is also increasingly taking a global approach, in which analysts operating in the same sector but different regions pool their knowledge.

The Bank's position in analysis rankings has risen sharply since beginning in 2003. Kaupthing Research is currently the top-ranked department in equity strategy and macro research as well as in the category of mid and small cap research. With regard to forecasting skills, Kaupthing Research tops the quantitative charts from AQ Research, which takes into account all the local and international research entities active in the Bank's local markets.

Trading

Kaupthing Bank engages in proprietary trading and market making in a number of instruments and markets. This involves managing positions for the Bank's own account.

Proprietary Trading

Some of the positions taken for the Bank's own account are strategic with a medium-term horizon, while others are short-term positions aimed at taking advantage of price discrepancies or spreads in different markets. However, all positions fall within a clearly defined risk framework based on various factors such as liquidity, legal framework and the Bank's risk policy.

In October 2006, as part of the ordinary course of proprietary trading, the Bank's investment in Storebrand, a Norwegian insurance company, was increased to a 7.8% interest in the company's share capital. Kaupthing Bank's holding in Storebrand was valued at approximately €165 million at the time the investment in the company was increased, which is the largest holding on the Balance Sheet in any one entity within the proprietary trading portfolio.

The proprietary trading units within the Group have a complimentary focus on different instruments and markets. The different units also vary in terms of strategy and timeframe. Each unit is awarded a risk budget based upon past performance and its current business case.

An organizational change was introduced on 1 January 2007 whereby Proprietary Trading was moved into Treasury. From that date onwards the results of Proprietary Trading will be included with those of Treasury. The purpose of these changes was to further demarcate securities brokerage for clients and proprietary trading for the Bank's own account.

Client Facilitation

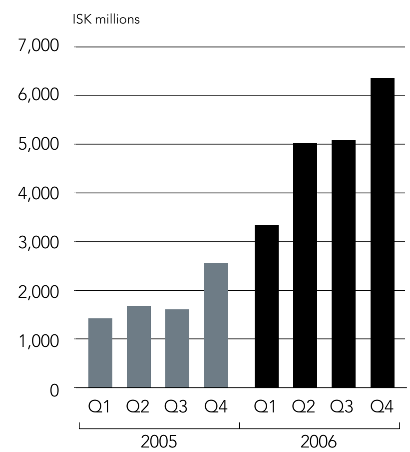
Market making involves the Bank's committing to buy and sell certain classes of securities in accordance with pre-determined rules, to ensure a liquid market in those securities. Market making activities include trading with numerous companies and institutions, especially in Iceland. The Bank is an active market maker in both equities and bonds, particularly for Icelandic issuers. The most extensive market making is currently in benchmark bonds for the National Debt Management Agency of Iceland and the Icelandic Housing Financing Fund.

TREASURY

- Record profits for Treasury
- Net interest income up 143%
- Strong postion in derivatives and foreign exchange trading

Treasury posted a gross profit of ISK 19,773 million in 2006 compared with ISK 7,259 million in 2005, representing an increase of 172.4%. Treasury's strong results are attributed to the Bank's solid position in derivatives and foreign exchange trading and its own position taking in foreign exchange. Net interest income amounted to ISK 11,492 million reflecting a 142.8% increase from 2005. Net fee and commission income totaled ISK 2,927 million, considerably higher than 2005. Net financial income increased significantly to ISK 8,411 million, primarily reflecting financial gain from a proprietary position in swaps, FX options and equity options used for hedging equity-linked products.

Treasury - Gross profit



Treasury

ISK millions	2006	2005	Q4 2006	Q3 2006	Q2 2006	Q1 2006
Net interest income	11,492	4,733	3,652	2,343	3,861	1,636
Net fee and commission income	2,927	1,364	825	464	791	847
Net financial income	8,411	2,637	2,828	3,072	1,109	1,402
Other income	26	0	23	1	2	0
Operating income	22,856	8,734	7,328	5,880	5,763	3,885
Operating expenses	-3,078	-1,481	-983	-799	-742	-554
Impairment	-5	6	0	-1	2	-6
Total expenses	-3,083	-1,475	-983	-800	-740	-560
Gross profit	19,773	7,259	6,345	5,080	5,023	3,325

Treasury is responsible for Group funding, including management of liquidity and foreign exchange exposure as well as providing exchange, interest rate and other risk management products to third parties and inter-bank trading. In addition, increases or decreases in the Bank's net interest income resulting from the impact of fluctuations in inflation on our Icelandic inflation-linked mortgage portfolio are reflected in Treasury. Within Treasury operations are divided into Inter-bank Trading, Derivatives Trading, Foreign Exchange (FX) & Derivatives Sales, and Funding. Treasury's largest operations are in Iceland but activities are also undertaken in Luxembourg, Denmark, the UK, Sweden and Finland. In 2006 new local heads of Treasury were recruited in the UK and Sweden where the Bank sees strong growth potential. At the end of 2006 Treasury employed 74 people.

Inter-bank Trading

The Inter-bank Trading division manages the Bank's currency exposure, interest-rate exposure, including the entire Bank's trading with other banks on the Icelandic market, the international money market, and the currency market. Kaupthing Bank is one of three banks in Iceland acting as a market maker for the Icelandic currency and money markets and one of the leading players in these markets.

Derivatives Trading

The Derivatives Trading desk is responsible for trading all derivatives. Kaupthing Bank is a leading market maker for equity derivatives, interest rate derivatives and foreign exchange derivatives related to the ISK. The Bank is also active in the area of structured products, in which customized solutions are made available for a wide variety of investors. Among those products are equity-linked, commodity-linked and credit-linked bonds issued or arranged by Kaupthing Bank.

Foreign Exchange & Derivatives Sales

Foreign Exchange (FX) & Derivatives Sales offers companies and institutional investors foreign exchange services and a range of interest rate and currency derivatives for position taking and risk management. The Bank's greatest strength in this area is its innovation when it comes to customizing these services for the client's needs. The team helps them manage their risks and offers a comprehensive array of derivative products. In addition this division offers a variety of structured products to institutional investors and private banking clients. Kaupthing Bank Treasury also provides its clients with monitoring and advisory services on currency and interest rate risk management.

An organizational change was introduced on 1 January whereby the foreign exchange and derivatives sales were transferred from Treasury to Capital Markets and will be included in the results of Capital Markets from 1 January 2007.

Funding & the Group Treasury

The Group Treasury is the central coordination unit responsible for the overall treasury strategy of the Bank. Operations in the Group Treasury comprise three teams: a funding team focusing on the Bank's funding activities; a financial institution team responsible for building relationships with other financial institutions, investors, and credit analysts; and finally an asset liability management team focusing on liquidity and capital management for the Group in cooperation with risk management and finance. This team also handles securitization projects for the Bank, liquidity investments and internal funding to subsidiaries. Group Treasury also maintains an ongoing dialogue with rating agencies. For full details on the Bank's funding activities in 2006 see the chapter on Funding & Liquidity on page 52.

ASSET MANAGEMENT & PRIVATE BANKING

- Strong year for Asset Management & Private Banking
- 179% increase in gross profit from 2005
- 114% increase in net fee and commission income in 2006

Asset Management & Private Banking posted a gross profit of ISK 5,023 million in 2006, compared with ISK 1,802 million the previous year, which represents an increase of 178.7%. Net interest income amounted to ISK 817 million compared with ISK 632 million in 2005. The largest part of operating income in Asset Management & Private Banking is constituted by net fees and commission income. Net fee and commission income totaled ISK 11,231 million, representing a 113.7% increase from 2005. Operating expenses amounted to ISK 7,380 million or 54.5% of revenues, compared with 69.9% in 2005.

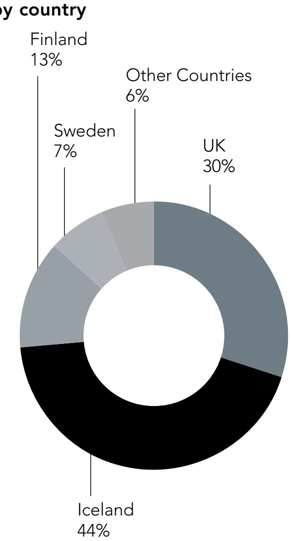
Asset Management

ISK millions	2006	2005	Q4 2006	Q3 2006	Q2 2006	Q1 2006
Net interest income	817	632	254	167	234	162
Net fee and commission income	11,231	5,256	3,221	2,544	2,837	2,629
Net financial income	531	100	110	91	134	196
Other income	962	0	605	357	0	0
Operating income	13,541	5,988	4,190	3,159	3,205	2,987
Operating expenses	-7,380	-4,186	-2,037	-1,660	-1,745	-1,938
Impairment	-1,138	0	0	-1,138	0	0
Total expenses	-8,518	-4,186	-2,037	-2,798	-1,745	-1,938
Gross profit	5,023	1,802	2,153	361	1,460	1,049

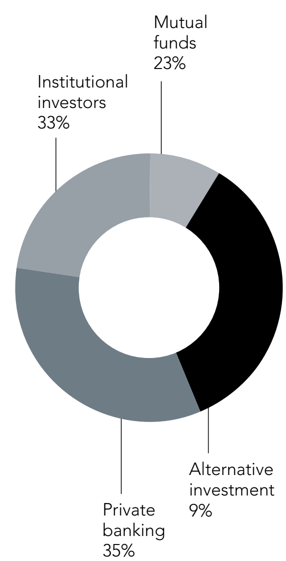
Asset Management & Private Banking manages financial assets for institutional, corporate and private clients. Asset Management is organized into five units: mutual fund management, alternative investments, asset management for institutional investors, services for institutional investors, and consultants. Private Banking consists of two units: customer relations and portfolio management.

Asset Management & Private Banking services are offered in eight different countries within the Kaupthing Bank Group: the Faroe Islands, Norway, Finland, Luxembourg, Sweden, Switzerland, the UK and Iceland. As of 31 December 2006 assets under management (AuM) amounted to ISK 1,403 billion. The Bank's asset and fund management activities are primarily based in the United Kingdom and Iceland, while main private banking activities are concentrated in Iceland, Luxembourg, the United Kingdom and Sweden. At the end of 2006 Asset Management & Private Banking employed 380 people.

Assets under management by country



Assets under management

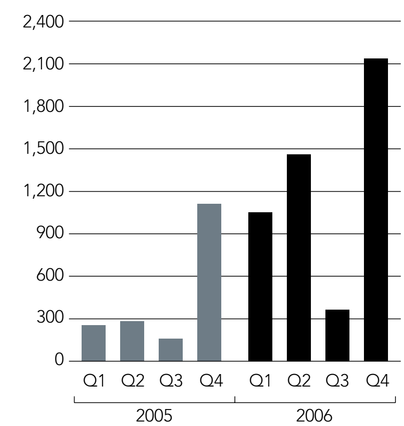


Asset Management

The Asset Management division offers a comprehensive range of mutual funds, as well as alternative investment vehicles. In addition, it offers customized asset allocation strategies and managed accounts, designed to meet the diverse needs of corporate, institutional and private clients. Special emphasis is placed on asset and liability management of pension funds and professional services in identifying client needs, structuring portfolios accordingly, managing risk and monitoring processes. The Asset Management division employs its market experience and proprietary tools in asset allocation, security selection, portfolio risk management and related services. In an international, competitive environment, the focus is on developing competent staff, efficient IT processes and highly effective teamwork between our international asset managers, researchers and analysts. This emphasis is aimed at obtaining the best results for clients and ensuring that they are offered comparable services and return on investments. The Asset Management division has signed mandates with a wide range of institutional clients, located mainly in Finland, Sweden and Iceland. These include mandates for local bonds, equities and balanced mandates, and also a wide range of global and specialized mandates.

AM & PB - Gross profit

ISK millions



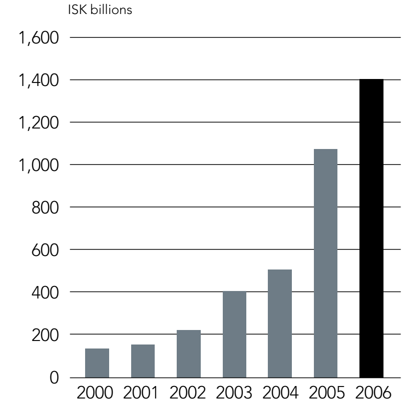
At the end of 2006 AuM of the Asset Management division amounted to ISK 912 billion.

Private Banking

Private Banking provides its individual clients with a range of investments and portfolios to match their requirements. Account managers focus on customer relations with the aim of maintaining high quality service and financial advice to clients. The Bank's policy of employing only experienced account managers is reflected in the service quality it is able to provide. Account managers also play a role in managing their clients' assets through close collaboration with the Asset Management team. Each client has his or her own dedicated account manager who is selected to match the individual client's needs and service expectations. The Bank recognizes that clients and their families often require more than short-term solutions; focus is placed on nurturing long-term relationships in order to provide comprehensive financial services across a broad range of client needs. The services offering ranges from the custody of shares or deposits to complex and tailor-made investments, as well as certain tax and legal services for high net-worth individuals. By identifying the current and future financial requirements of clients, the Kaupthing Bank Private Banking team is able to offer guidance and advice on how best to achieve these goals. Private banking services are offered from the offices in Iceland, Sweden, Luxembourg, Switzerland, the Faroe Islands, Finland, and the UK. The offices cooperate closely in the development of new products and services to match the demanding and changing requirements of the client base.

Asset under management

ISK billions



At the end of 2006 AuM of Private Banking at Kaupthing Bank amounted to ISK 491 billion.

Nick and Chris Candy
Nick and Chris Candy know the meaning of potential when it comes to residential real estate. The two brothers have built their reputation on outfitting luxury homes from floor to ceiling that suit their clients in every way. This sort of comprehensive approach to turning vision into reality is why Kaupthing Bank finds Nick and Chris Candy such kindred spirits, as we too are focused on bringing possibilities within our clients' reach. From property finance to personal private banking, Kaupthing Bank is where Nick and Chris Candy come to fund their visions and put their assets to work. They have an unparalleled passion for designing your homes. We have an unparalleled passion for building your business.

EMPLOYEES

Kaupthing Bank's dynamism, which has served to propel its rapid growth, is rooted in the individuals who make up the Bank. Their diverse vantage points and unique abilities create a broad range of skills and knowledge that underpin the Bank's work.

Over the year the Bank focused on unifying its operations throughout the Group, including the integration of its workforce in the UK. The new Kaupthing Singer & Friedlander represents a significant portion of the Bank's employees with a quarter of the Bank's total personnel at year end. In support of this unification a number of projects have been under way to assist the new employees as they come together to form the new Kaupthing Singer & Friedlander.

An essential part of this unification process consists in the relocation of all UK central activities to one location. Kaupthing Singer & Friedlander is now situated under one roof on Hanover Street, in the heart of London's West End. Additionally, Kaupthing Bank in Luxembourg has moved into new, larger housing in Kirchberg. Kaupthing Bank in the Faroe Islands has also relocated to a larger building near the Torshavn city center. Lastly, the expansion of the Bank's headquarters in Reykjavik is slated for completion by mid 2007.

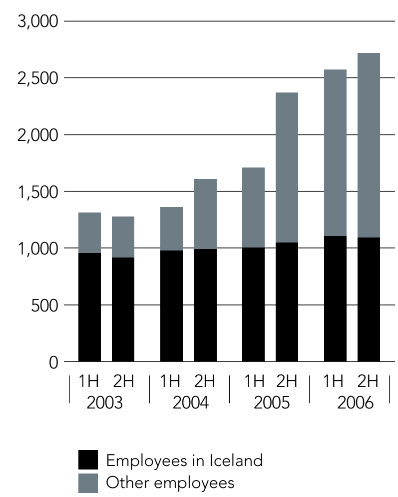
Recruitment

A career at Kaupthing Bank demands a high level of diligence and dedication. The work of Kaupthing Bank requires individuals of uncommon ability, and to this end great efforts have been made in creating the Bank's current ensemble.

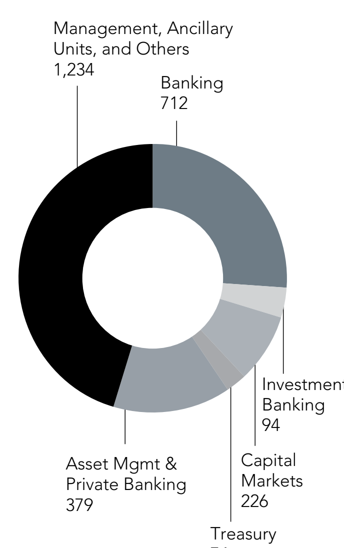
Operating in global capital markets, the Bank's personnel form a community that revolves around the unique backgrounds, individual perspectives and diverse skills of its people. The Bank consistently seeks to recruit those who can strengthen this diversity, but still support its core values. Likewise, as the Bank has grown and expanded its operations in recent years, the number of applications from highly qualified people has increased significantly, indicative of interest from people who are attracted by the Bank's distinct position and ideology.

Kaupthing Bank's recruitment strategy is based on attracting these highly qualified candidates through employee networks, selective head-hunting, advertisements and a high-profile presence at universities. To meet the requirements of the Bank's expanding operations and the many demanding projects last year, a substantial increase in recruitment was necessary. In all, around 750 people were brought into

Full-time equivalent positions at year end



Employees by division at year end



the Bank throughout all its segments, with the greatest rise in the UK, Denmark and Sweden.

Careers & Development

Kaupthing Bank comprises a league of enterprising women and men who are distinguished by their diligence, imagination, and ambition. The Bank's work is driven by a sense of teamwork and solidarity that transcends both international borders and the Bank's hierarchy. The people of Kaupthing Bank are part of a culture of integrity and leadership they themselves have a hand in creating, and for this reason they form a community in which people's potential and talent are cultivated and realized with the aim of establishing lifelong careers.

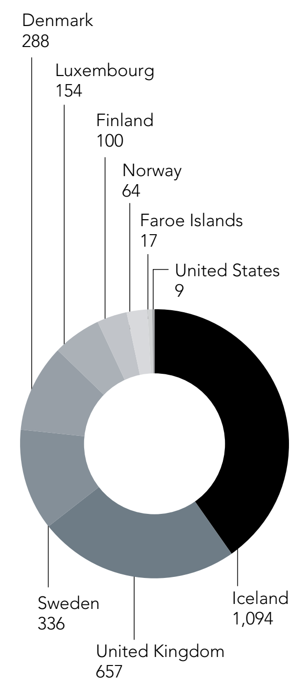
Leadership is certainly among the strongest elements fostered by the Bank's community, seeking to demonstrate leadership both in the industry and in the societies where it operates. In order to sustain this element of leadership, strong emphasis is placed on developing employees through training programs in-house as well as by supporting and organizing educational opportunities outside the Bank. The culture of Kaupthing Bank cultivates the desire to keep abreast of the latest developments. As a forward-looking enterprise, the Bank strives to continually stimulate its employees to uphold the state of the art in their respective fields. Last year the Bank placed great emphasis on training its managers and developing their leadership qualities.

Job Satisfaction & Retention

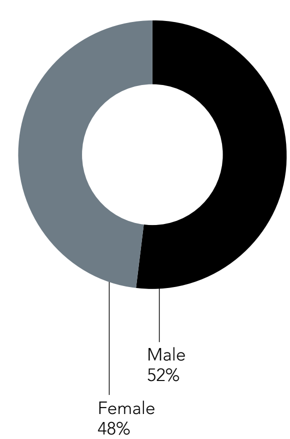
The Bank seeks not only to attract the most qualified personnel, but to retain them by creating a superior work environment and attending to their needs. Great emphasis is placed on maintaining employees' knowledge and skills through training, development and informative feedback. To ensure success for the Bank as a unit, employees are encouraged to engage in synergetic teamwork, and every effort is made to facilitate communication and the flow of information. Employee initiative and responsibility are promoted through challenging assignments where rewards are determined by results.

In spite of the extensive changes Kaupthing Bank faced last year, personnel turnover was at a level comparable to the previous year – well within the standard parameters for a bank of its type. The total turnover rate for the Bank was around 15%, which is to no small degree dependent on external factors such as the local unemployment rate. The real challenge is to keep unwanted turnovers (resignations) at a minimum, and as they constitute less than half of the turnover rate, it may be said that this challenge has been met with success.

Number of employees by country at year end



Employees by gender



To maintain this level of retention the Bank conducts an extensive annual workplace survey. The main purpose of the survey is to evaluate workplace issues such as cooperation, job development, job training, management, and employee services. A good workplace environment leads to greater job satisfaction, which works to everyone's benefit. The results of the survey are compared against the Bank's historical results as well as results from other companies conducting similar surveys. The overall results for the last survey in 2006 were very positive. This type of survey encourages management and employees to constantly improve their working relationships and make adjustments when necessary based on feedback. This valuable feedback is also often gleaned from performance appraisals for individual employees, who are encouraged to set their own goals for job development within the Bank.

Incentives

By rewarding good results Kaupthing Bank encourages its people to fulfill their potential, and in this way support optimal performance of the Bank. The system of profit-sharing exemplifies how the Bank works as a community and, by the same token, shares the spoils of success as a community. By aligning the interests of employees and shareholders Kaupthing Bank enables its people to take a still more active role in instituting the success of their own community. The employee stock-option plan serves as a representation of the stake that Kaupthing Bank employees already have in the future of their bank.

Salaries & Benefits

When competing aggressively for qualified personnel it is important to be able to offer wages that are comparable to or superior to those offered by the competition. Though the compensation package weighs heavily in overall job satisfaction, it is certainly not the most important factor. In addition to monthly salary, employees receive a bonus payment when the Bank's performance goals are achieved. On top of this separate bonus payments are made to management, key employees and front-line employees directly affecting the Bank's performance. At the end of 2005, a stock-option scheme was put in place, which enables all regular employees to buy shares in the Bank at a given price. New employees have the opportunity to enter into such a scheme after a given period of time.

At the end of 2006, Kaupthing Bank's employees owned approximately 7.2% of the Bank's shares. Further information about employee stock-option programs can be found in the chapter Shares in the Bank on page 21.

Communication

The open flow of information through the Bank is important in maintaining efficient operations. Employee engagement is facilitated through a number of channels, the largest of these being the corporate intranet for the Bank and a number of other local intranets within the different subsidiaries. Internal communication is also supported through Group-wide employee publications and an annual CEO tour which opens face-to-face dialogue between employees and senior management. Through these channels the Bank supports the flat organizational structure and encourages collaboration throughout the Bank.

Human Resources Strategy

- Attract qualified personnel by creating a motivated workplace.
- Always hire the best candidate for the position.
- Retain competent employees by creating a superior workplace.
- Provide new employees with appropriate training from the outset.
- Encourage employees to maintain professional skills and give them the opportunity to develop and grow.
- Keep staff up to date with the most current information.
- Ensure maximum employee success – empower the individual, provide an opportunity to show initiative, and commend independent initiative.
- Maintain a spirit of ambition, efficient decision-making, flexibility and quick responses to changes.
- Create a strong international team.
- Sustain an environment that supports a balance between work and life.
- Ensure equal opportunities, with regard to employment, work facilities, assignments, training, job development and wages.
- Align the interests of employees with the interests of the organization.

CORPORATE CULTURE

Kaupthing Bank's corporate culture centers on the common interests of the Bank and its clients by seeking to establish strong, long-term relationships between the two.

The corporate culture places a premium on the Bank's human resources, through knowledge acquisition, job development, training and communication, leading to job satisfaction and a real sense of community. In this environment emphasis is placed on effective management, a clear definition of responsibility, straightforward work processes and a minimum of bureaucracy. In this way the Bank is able to serve its clients as well as possible and by helping them achieve their goals.

In order to ensure that its clients are provided with exceptional guidance and receive the best possible service, the Bank has organized the tenets of its culture into eleven business principles. These principles are undertaken by all the Bank's operations and are reviewed on a regular basis. Those that apply for a position with the Bank are evaluated with these criteria in mind, and as careers unfold within the Bank these are lines along which the Bank encourages its employees to grow.

Long-term Relationships

Kaupthing Bank's main objective is to develop and maintain long-term relationship with its clients. Their needs and interests are made a priority, as their success creates the Bank's success, thus establishing a common goal.

Teamwork

The best results are achieved when the Bank and its clients work together as a team. Effective cooperation and communication ensure fast and professional service and provides the basis for efficient teamwork.

Fun & Flair

Business becomes a pleasure when the Bank can take part in celebrating its clients' successes. Maintaining a positive morale supports a sense of community and an ambitious approach to working. Providing effective advice and achieving excellent results leads to shared enjoyment, underscoring the Bank's commitment to its clients.

Trumping Bureaucracy

Cutting bureaucracy enables the Bank to respond swiftly to its clients' needs. Short and straight lines of communication, a clear definition of responsibility and the devolution of power provides the Bank's clients with sharp, swift and effective advice.

Efficient Decisions

Effective service to the Bank's clients is based on swift and efficient decision-making, achieved through a flat hierarchy, the devolution of power and open communication. This also makes for an exciting and highly motivating work environment that attracts highly educated, top-quality candidates.

Welcoming Change

The business environment is constantly undergoing changes, bringing the Bank up against new challenges as a leading financial company and adviser to ambitious clients. In order to assist its clients in gaining a competitive advantage, the Bank keeps abreast of changing business practices and seeks to implement changes ahead of the competition.

Identifying Opportunities

By identifying opportunities where others see business as usual the Bank is able to advise its clients effectively and provide them with exceptional choices. The Bank ensures its employees are able to perform this task by providing them with training and education, building their confidence and encouraging their initiative.

Embracing Competition

Both the Bank and its clients face intense competition, as is par for the course in a rapidly changing business environment. However, the Bank views competition as a powerful motivator, as a spur to keep the Bank's business ahead of the times and providing its clients with the best possible service in the industry.

Taking Intelligent Risks

The Bank uses its expertise to advise its clients on the risks they face and enable them to make informed decisions. Powerful information systems and highly qualified personnel, with the interests of the Bank and its clients at heart, ensure intelligent risk assessment and decision-making.

Building Businesses

The Bank is determined to build its clients' businesses, for the benefit of both parties. Through a strong and committed team of Bank personnel and clients working in unison, focusing on the task at hand, the best possible business results can be achieved.

Rewarding Talent

To ensure that its clients receive superior advice and services, the Bank rewards those employees who perform most successfully. The Bank's greatest resource is its personnel, and it places great emphasis on retaining good employees, that is, those who provide the greatest benefits to the Bank's clients.

INFORMATION TECHNOLOGY

While the human element is clearly the Bank's strongest resource, a concerted effort is made to equip employees with the newest, most effective, and most powerful technology available in the industry.

Kaupthing Bank's Information Technology unit is dedicated to the tasks of identifying, implementing, and maintaining technology and information systems across a wide range of applications. Another important aspect of these activities is ensuring that the integrity of the Bank's systems is never compromised. High standards of security are maintained to protect sensitive information and access to the Bank's networks and systems. Additionally, in 2006 there was a concerted effort in response to the EU's new directive on the prevention of money laundering and terrorist financing with the implementation of new technology into the Bank's transaction and compliance risk systems.

Overall the Information Technology unit seeks to sustain a flexible architecture especially designed to support the Bank's international expansion by enabling groups to collaborate and communicate information across borders. IT is Kaupthing Bank's primary tool to knock down internal walls and create an open environment that facilitates the free flow of information, though never in a way that would jeopardize the security of the Bank's network or place sensitive information in a vulnerable position.

IT Consolidation Project

As Kaupthing Bank has continued to establish its presence internationally, the need to unify computer systems and various other aspects of information technology has become an important activity for the Bank. In January 2004 these efforts were organized into a special project team. This IT consolidation project, headed by the Bank's Chief Information Officer, aims to work with the various entities functioning within the Kaupthing Bank Group to bring all systems and processes under a unified structure. The project's working goals include realizing consistency, facility, and synergy. The long-term objective of the project, however, is to establish an enhanced data and information infrastructure operating with uniform components across the Group. As the IT consolidation project progresses, benefits include increased efficiency and smoother implementations of new modules and eventually complete systems.

PRINCIPAL SUBSIDIARY:
FIH ERHVERVSBANK

Kaupthing Bank acquired FIH Erhvervsbank in July 2004 as part of its strategy to grow its corporate banking capabilities and expand its presence in the Nordic region. The acquisition doubled the size of the Balance Sheet at the time and provided a leading position in the Danish corporate banking sector. Since the acquisition, the Bank has focused on realizing revenue through expanding into new business areas and cross-selling products.

CEO: Lars Johansen
Year founded: 1958
Year established as subsidiary: 2004
Number of full-time positions: 288

Market Position

FIH Erhvervsbank is one of the leading commercial banks in Denmark specializing in corporate lending, providing Danish companies with a broad range of financing services. In 2006 it had approximately 4,000 clients, including approximately 60% of Denmark's 200 largest industrial companies and a number of municipalities, giving it a corporate banking market share of approximately 13%.

Three Principal Business Segments

Banking

Corporate Banking provides a wide range of banking services to approximately 250 of the largest companies in Denmark, as well as to other large companies in Sweden and Norway. This division comprises three units.

Small and Medium-sized Enterprise (SME) **Banking** is a principal lender to smaller and medium-sized companies.

Structured Finance provides solutions for various types of financings in the Nordic region, including equity-related financings, such as acquisition finance to private equity funds, management buy-outs, management buy-ins, refinancings and delisting transactions. The financing solutions are tailored to meet the requirements of the individual transaction, with pricing to match the risk and terms of the financing. FIH Structured Finance cooperates with leading private equity funds in the Nordic region.

Property Finance handles all transactions regarding major real estate investments in the Nordic region.

Investment Banking

Investment Banking provides advisory services as well as funding in connection with mergers and acquisitions. During 2006, advisory services for a number of successful transactions were provided, including the provision of financial advice to the owner of Sterling Airways in connection with the acquisition of the passenger airline activities of Maersk Air and in connection with the subsequent sale of Sterling to the Icelandic FL Group. Financial advice was also provided to Swedish telecommunications company Ventelo in connection with its acquisition of the Danish company Webpartner. In early 2006, FIH hired a number of senior investment bankers from Carnegie with the intention of increasing its investment banking activities going forward.

Capital Markets

Capital Markets was established at FIH in 2006 and provides sales, trading and brokerage services for Nordic equities. The establishment of FIH Capital Markets is expected to strengthen other business segments' positions. For example, Investment Banking will now be able to provide advice in connection with initial public offerings and other capital market issuances.

Annual Accounts

FIH Erhvervsbank's annual accounts and other financial reports are available as separate documents on the Bank's website (www.fih.dk for reports in Danish and www.fih.com for reports in English).

PRINCIPAL SUBSIDIARY:
KAUPTHING SINGER & FRIEDLANDER

Kaupthing Bank acquired Singer & Friedlander in July 2005 at a time when operations in the UK consisted mainly of an investment banking business through Kaupthing Ltd. The acquisition formed part of the Bank's strategy to expand the product offering in the UK in order to be able to provide small and medium-sized enterprises (SMEs) and high net-worth individuals with an integrated and wide range of banking services.

Managing Director: Ármann Thorvaldsson
Year founded: 1907
Year established as subsidiary: 2005
Number of full-time positions: 634

Market Position

The former Singer & Friedlander specialized in banking, asset finance and investment management, which made it a good fit with Kaupthing's operations in the UK. The banking business focused on corporate banking, private banking and property finance, constituting more than half of Singer & Friedlander's revenues in 2004. As of 31 December 2006 the Investment Management business had approximately £3.3 billion in funds under management (including non-discretionary), of which approximately £2.1 billion was owned by private clients.

Integration & Restructuring

Following the acquisition of Singer & Friedlander, Kaupthing Bank has engaged in a concerted effort to integrate and restructure operations with those of Kaupthing Ltd. to form the new Kaupthing Singer & Friedlander. The process was executed with the following objectives in mind:

- More efficient use of capital
- Reduced bureaucracy with shorter communication lines and faster decision-making
- Increased transparency in operations and reduced inter-company transactions
- Increased focus on business and income generation through cross-selling
- Increased economies of scale in support functions

Expanded Activities

To further expand the product offering a new Capital Markets division has been established at Kaupthing Singer & Friedlander in addition to a greatly enhanced Treasury division. This expansion of the product offerings in the United Kingdom is expected to realize revenue synergies, from cross-selling products. Today Kaupthing Singer & Friedlander provides corporate banking services to SMEs as well as a full range of investment banking services, including Treasury, Asset Management and Capital Markets services, in addition to a wide range of wealth management services for high net-worth individuals. Kaupthing Singer & Friedlander is headquartered in central London, with three branch offices in Glasgow, Manchester and Dorking, and six satellite sales offices in Leicester, Truro, West Malling, Leeds, Wisbech and Staverton. International private banking services are offered from an office in the Isle of Man.

Six Principal Business Segments

Banking

Kaupthing Singer & Friedlander's banking operations are divided into five principal areas. Corporate Banking includes corporate banking, structured and leveraged finance, bill discounting and trade finance. Property Lending comprises lending for investment properties, residential development, student accommodation and overseas properties. Private Banking oversees domestic mortgages, international mortgages, yacht mortgages, aircraft finance, stock lending and unsecured lending. Isle of Man Banking predominantly provides property lending for onshore and offshore properties. Finally, Commodity Trade Finance provides transactional finance to metal trades.

Asset Finance, which is part of Banking, covers four broad product categories. Equipment Finance provides leasing and hire-purchase facilities to SMEs, partnerships, sole traders and individuals. Health Care provides operating lease facilities to NHS Trusts and Foundation Trusts. Premium Finance provides short-term lending for the payment of insurance policy premiums. Block Discounting provides wholesale finance to smaller finance companies for onward lending into markets similar to those in which equipment finance companies operate.

Asset Management

Kaupthing Singer & Friedlander operates its asset management activities through Singer & Friedlander Investment Management Ltd. (SFIM), one of the United Kingdom's longest established investment managers. SFIM is a discretionary and non-discretionary asset manager focusing on long-only UK equity investments and fund management for private clients and UK and international charities. Services for private clients and professional intermediaries include a range of discretionary portfolio management services, tax-efficient investment services, investment funds, multi asset portfolios, pension management, and portfolios of funds. Charities services include the management of segregated portfolios to meet the individual investment needs of each charity, as well as pooled funds to enable participation in a full range of asset classes where segregated investments are not appropriate. Singer & Friedlander Investment Management Ltd. had, including non-discretionary, £3.3 billion of assets under management at year end 2006.

Investment Banking

Kaupthing Singer & Friedlander's investment banking operations provide a mix of services comprising M&A advisory services, acquisition and leveraged finance, debt syndication and principal investments. Acquisition & Leveraged Finance provides both senior and a range of subordinated debt instruments to support both M&A driven transactions and refinancings/ recapitalizations. This division has a long tradition of co-investing with its clients to support the expansion of growth businesses. Kaupthing Singer & Friedlander's Principal Investments invests alongside clients, and is able to underwrite the full debt and equity requirement of any transaction with an enterprise valuation ranging from €30 million to €500 million through the Parent Company's Balance Sheet, and can participate in even larger deals through partnership arrangements.

Capital Markets

The recently established Capital Markets business offers a range of brokerage services to mid and small capital companies in the UK. All of the Bank's UK brokerage activities are conducted through KSFCM. The business comprises Corporate Finance, including tax-efficient products, corporate finance and pre-IPO funding; Corporate Broking including IPOs, secondary offerings and investor relations services; Sales, both to institutions and hedge funds; and Equity Research, and Trading including sales trading, market making and proprietary trading and finally the business provides a Contract for Difference product to complement the sales and trading service. The business commenced trading in September 2006.

Treasury

Treasury services in the UK have undergone considerable expansion to offer Kaupthing Singer & Friedlander's clients the widest access to professional financial markets solutions. Until recently, Treasury had been limited to overseeing the funding of Kaupthing Singer & Friedlander. The Bank is currently broadening the function to include full trading activities, including a wide range of interest rate, foreign exchange and liquidity management solutions.

OTHER SUBSIDIARIES

Kaupthing Bank operates in ten countries. The following is a brief overview of the Bank's major subsidiaries other than FIH Erhvervsbank and Kaupthing Singer & Friedlander, which are described in greater detail on the preceding pages.

Kaupthing Bank Luxembourg SA

Year established as subsidiary: 1998
Managing Directors: Magnús Gudmundsson & Johnie W. Brøgger

In early 1998 Kaupthing Bank set up a securities brokerage office in Luxembourg. At the beginning of 2000 it was granted a commercial banking licence, and its name was established as Kaupthing Bank Luxembourg SA. As this company has shown strong growth, the range of services it offers has increased significantly. Operations moved into larger, new premises at the beginning of 2006 to accommodate this growth. The main activities of Kaupthing Bank Luxembourg S.A. are private banking and specialized corporate services. In addition to providing general deposit accounts and loans to customers, the private banking services of Kaupthing Bank Luxembourg SA include asset management, securities brokerage, and the establishment of holding companies. Kaupthing Bank Luxembourg SA also specializes in debt-syndication. There were 154 full-time positions at Kaupthing Bank Luxembourg at year end.

Kaupthing Bank Sverige AB (Sweden)

Year established as subsidiary: 2002
Managing Director: Robert Charpentier

Kaupthing Bank Sverige AB operates in three cities in Sweden: Stockholm, Gothenburg and Malmö. It offers a wide range of financial services with special emphasis on securities brokerage, advisory services and asset management and private banking. Corporate banking and Structured Products also substantiate part of its activities. Services are aimed towards institutions as well as individuals. There were 336 full-time positions at Kaupthing Bank Sverige at year end.

Kaupthing Bank Oyj (Finland)

Year established as subsidiary: 2001
Managing Director: Tommi Salunen

Kaupthing acquired a Finnish security company Sofi Oyj located in Helsinki in 2001 in efforts to establish its presence in the Nordic region. In December 2004 the company was granted a banking license and changed its name to Kaupthing Bank Oyj. Current operations center on investment banking services, securities brokerage, and asset management for corporations, institutional investors and high net-worth individuals. Kaupthing Bank Oyj is also the fourth largest broker on OMX Helsinki with a market share of 5.5% at year end 2006. There were 100 full-time positions at Kaupthing Bank Oyj at year end.

Norvestia Oyj (Finland)

Year established as subsidiary: 2003
Managing Director: Juha Kasanen

At the end of 2003 Kaupthing Bank acquired a majority holding in Norvestia Oyj, a Finnish investment company based in Helsinki, whose Series B shares are listed on the main list of OMX Helsinki. Norvestia's objective is to make long-term investments in listed Nordic equities and funds. Investments are made primarily in Nordic equities, equity funds, hedge funds, in the money market and in other securities. As a new investment strategy Norvestia will begin to seek long-term industrial investments in 2007. Kaupthing Bank owns 900,000 unlisted A-shares and 3,785,869 listed B-shares, representing 54.6 % of the votes and 30.6 % of the share capital in Norvestia plc. The company is fully consolidated with Kaupthing Bank with the shares not owned by the Bank reported as a minority interest. There were 5 full-time positions at Norvestia Oyj at year end.

Kaupthing Føroyar Virdisbrævameklarafelag P/F (Faroe Islands)

Year established as subsidiary: 2000
Managing Director: Peter Holm

Kaupthing Føroyar Virdisbrævameklarafelag P/F is a leader in asset management for institutional and private investors in the Faroe Islands, where it operates two securities funds. It was the first securities firm in the Faroe Islands where Kaupthing Bank intends to participate in the establishment and development of a Faroese stock exchange. The company offers traditional banking services as well as investment services. There were 17 full-time positions at Kaupthing Føroyar at year end.

Kaupthing New York Inc. (US)

Year established as subsidiary: 2000
Managing Director: Magnus C. Lejdström

In 2000 Kaupthing Bank began its operations in the US under the name Kaupthing New York, Inc. The Investment Banking operation engages in various assignments for US and Nordic companies, while Capital Markets related activities take place through the wholly owned subsidiary Kaupthing Securities, Inc., which obtained its National Association of Securities Dealers license in April 2001. Kaupthing Securities, Inc. executes securities across Europe for institutions as well as through US exchanges, including the New York Stock Exchange and NASDAQ. There were 9 full-time positions at Kaupthing New York at year end.

Kaupthing Norge AS (Norway)

Year established as subsidiary: 2003
Managing Director: Jan Petter Sissener

Kaupthing Norge AS was established in 2003, following the acquisition of Tyren Holding AS, an asset management company. In 2004, Kaupthing Bank further strengthened its Norwegian operations by acquiring A. Sundvall ASA, a securities broker and research house. In 2006 Kaupthing Bank increased its presence in Norway considerably, providing companies, institutional investors and private clients with comprehensive financial services, including asset management, investment banking and capital markets services. There were 64 full-time positions at Kaupthing Norge at year end.

Kaupthing Bank Asset Management Company hf. (Iceland)

Year established as subsidiary: 1996
Managing Director: Hildur Nielsen

Kaupthing Bank Asset Management Company hf. is a subsidiary maintained in addition to Kaupthing Bank's other activities in Iceland. The company manages a large selection of Icelandic mutual funds that cater to the needs of both private and institutional investors. The funds and their investment strategies differ according to their focus on institutional or private investors. There were 31 full-time positions at Kaupthing Bank Asset Management Company at year end.

NEW BOND STREET ASSET MANAGEMENT

Kaupthing Bank entered into a limited liability partnership under English law with eight individual partners in May 2004 to form a specialized credit management business called New Bond Street Asset Management LLP (NBSAM).

NBSAM is regulated by the UK FSA to provide independent advice, asset management services and fund products. The company specializes in investment grade credit and features three product platforms: private managed accounts, public open-end funds and closed-end funds (CDO management).

NBSAM has a managed account for its strategic partner, Kaupthing Bank, with assets under management (AuM) in excess of €5 billion covering sovereign, financial institution and asset-backed securities with an average credit quality of Aa3. NBSAM also has significant expertise in CDO management and has arranged eight synthetic corporate CDOs with AuM exceeding €2.8 billion* the most recent of which (Piccadilly 1) was lead managed by Barclays Capital. NBSAM also arranged its first $1 billion public CDO of ABS – NBSCDO1 and launched the 'New Bond Street Diversified Strategies Plc', a Dublin-based open-end whose first fund ('Diversified Credit') is an investment company with a multi-asset class long/short investment strategy in the investment grade space.

NBSAM's success in generating alpha is based on the long track record of the individual partners in the above asset classes and more specifically the following expertise: (i) fundamental credit analysis and portfolio management theory, (ii) knowledge of credit derivatives/securitization/CDO technology and, (iii) experience in many forms of structured and vanilla financing and (iv) managing credit trading. NBSAM employs 22 people.

*Delta-weighted equivalent

HISTORY

The roots of Kaupthing Bank hf. were conceived in 1982 at the dawn of great change: the emergence of the free capital market in Iceland. Through solid organic growth and a series of strategic acquisitions the Bank has become a vibrant and forward-looking provider of comprehensive financial services throughout northern Europe.

Kaupthing hf. was originally established as a small agency for financial advisory and securities brokerage. After the initial restrictions on the Icelandic financial market were lifted, other legislation controlling financial activities in Iceland began to open up rapidly and encourage a more active market. Kaupthing was at the forefront of these changes as the first to offer managed funds and one of the five founding partners in the Iceland Stock Exchange. This pioneering spirit has remained a central force as the Bank continues to chart out new frontiers in the global financial market.

In the mid 90s Kaupthing began to flourish in securities brokerage and asset management. At the same time it widened its focus to include opportunities abroad. Kaupthing established the first global mutual fund in Iceland and was the first Icelandic financial institution to launch a company abroad (in Luxembourg). Kaupthing Bank became licensed as an investment bank in 1997 and was granted a commercial banking license in January 2002 (when the word "Bank" was added to its name). In October 2000 Kaupthing was listed on the Iceland Stock Exchange (now the OMX Nordic Exchange in Iceland), at which point the owners of the Bank, the savings banks, reduced their holdings, and individuals and institutional investors replaced them as shareholders.

Kaupthing Bank has continued to strengthen its international operations through acquisitions and the establishment of subsidiaries, expanding beyond the Nordic region's borders and defining its presence in northern Europe, which the Bank now considers its home market. Initial developments include the acquisitions of the brokerage house Sofi Oyj in Finland in 2001 (now Kaupthing Bank Oyj) as well as the Swedish bank JP Nordiska AB (now Kaupthing Bank Sverige AB) in 2002. In 2003 Kaupthing Bank and Búnadarbanki merged under the name Kaupthing Bank. This move constituted a considerable expansion of the Bank's activities, as Kaupthing Bank was an investment bank while Búnadarbanki was a corporate and retail bank.

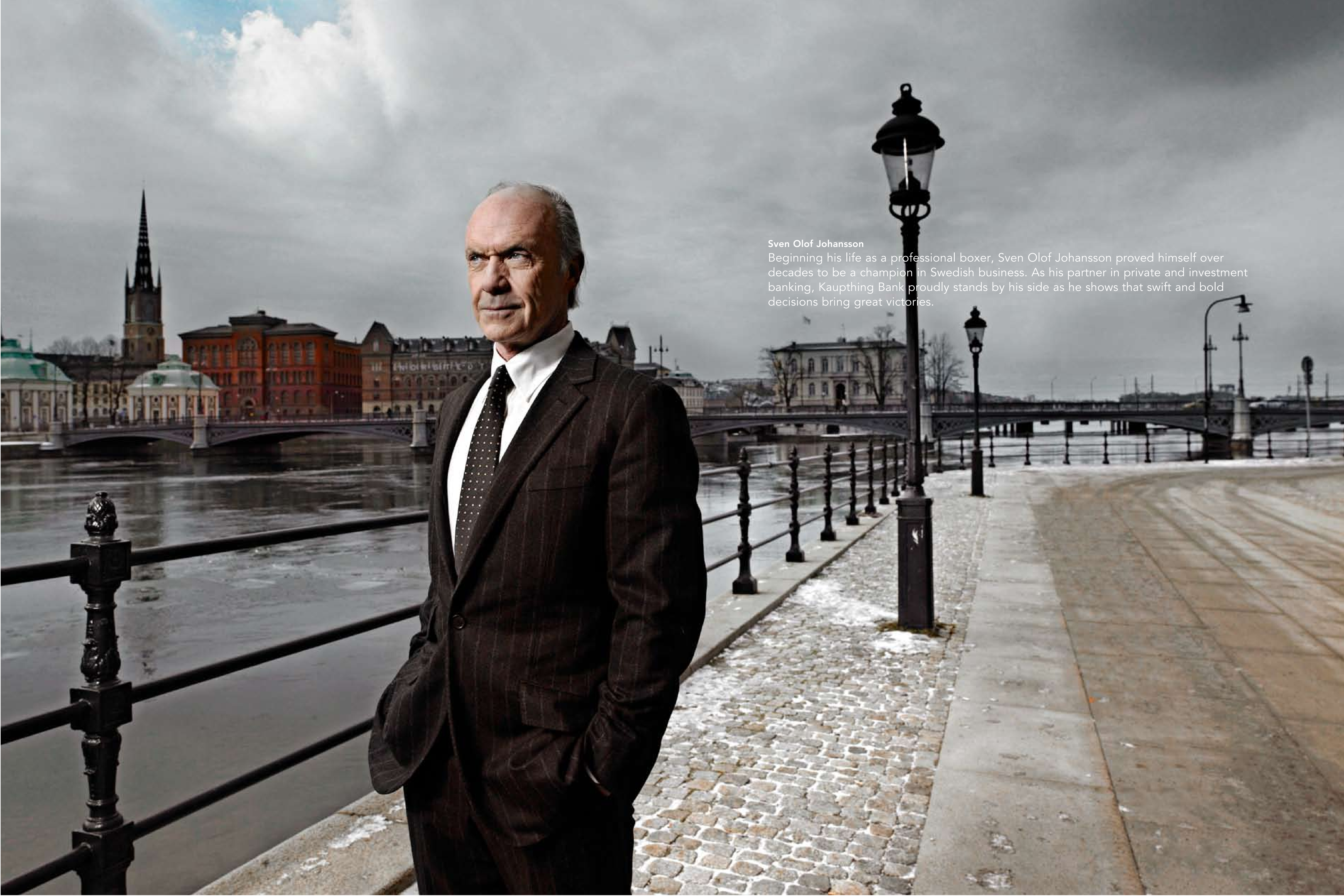
However, the two most significant acquisitions are the two most recent, as they strategically position Kaupthing Bank in major markets overseas. The Danish bank FIH Erhversbank A/S was acquired in 2004, securing a firm foothold for the Bank in the Danish corporate lending market. Subsequently the UK's Singer & Friedlander Group plc. was acquired in 2005 and merged with the Bank's other operations in the UK to form Kaupthing Singer & Friedlander. This new operation, now the largest of the Bank's subsidiaries (based on the number of employees), substantiates a solid platform for growth in the UK.

As Iceland's largest bank, Kaupthing Bank retains a key position in the country's economy. The Bank is both a catalyst for evolution in the domestic market, ushering in the highest standards of trade and new business, and a powerful business partner for national operations seeking far-reaching channels into international markets. However, as the majority of the Bank's operations take place outside Iceland with over 63% of revenue for 2006 (excluding financial gain from Exista) generated abroad, the Bank's reliance on Iceland has been greatly decreased. In this respect Kaupthing Bank has established itself, in the truest sense, as a northern European bank. But geography aside, the Bank has grown into an agent of innovation and advancement across borders and oceans, bringing people with ideas together with the capital and expertise they need to realize their potential.

Chronology of Kaupthing Bank's Expansion and International Growth

- In 1982 Kaupthing hf. was establised.
- In 1998 Kaupthing Luxembourg S.A. was established. In early 2000 the company was granted license to operate as a bank and accordingly its name was changed to Kaupthing Bank Luxembourg SA.
- In March 2000 a New York office was opened, Kaupthing New York.
- In March 2000 Kaupthing Føroyar in the Faroe Islands, in which Kaupthing hf. owned 51% and the Faroese Savings banks 49%, also began operation in Thorshavn, now owned 100% by Kaupthing Bank.
- In September 2000 Kaupthing formally opened a branch in Stockholm, Kaupthing Stockholm. Later on Kaupthing's operations in Stockholm merged with Aragon, which was acquired in May 2002.
- In June 2001 Kaupthing Denmark began operation in Copenhagen.
- In early 2002 Kaupthing acquired Handsal Asset Management (now Kaupthing Asset Management SA), based in Geneva.
- In January 2002, Kaupthing Bank finalized its acquisition of the Finnish securities firm Sofi Oyj, now Kaupthing Bank Oyj.
- In May 2002 Kaupthing signed an acquisition agreement for the Swedish securities firm Aragon.
- In June 2002 Kaupthing Bank became the main shareholder, with 28%, in JP Nordiska Bank in Sweden. Kaupthing Bank financed its share with the entire shareholdings in its subsidiary Aragon Holding AB.
- In December 2002 Kaupthing Bank acquired JP Nordiska, now Kaupthing Bank Sverige AB.
- On 20 December 2002 trading in Kaupthing Bank shares commenced on the Stockholm Stock Exchange.

- In February 2003 Kaupthing Bank commenced operations in London under the name Kaupthing Limited, now included in Kaupthing Singer & Friedlander.
- On 27 May 2003 Kaupthing Bank merged with the newly privatized Búnadarbanki Íslands, the Icelandic corporate and retail bank.
- In September 2003 Kaupthing Búnadarbanki, now Kaupthing Bank, acquired Norwegian asset management company, Tyren Holding AS.
- Early in 2004 the Bank further strengthened its Norwegian operation by acquiring the securities company A. Sundvall ASA, now Kaupthing Norway.
- In July 2004 the Danish corporate bank FIH Erhvervsbank was acquired.
- In July 2005 the British bank Singer & Friedlander was acquired and the name later changed to Kaupthing Singer & Friedlander after merging with the Bank's other operations in the UK (i.e., the former Kaupthing Limited).



Sven Olof Johansson

Beginning his life as a professional boxer, Sven Olof Johansson proved himself over decades to be a champion in Swedish business. As his partner in private and investment banking, Kaupthing Bank proudly stands by his side as he shows that swift and bold decisions bring great victories.

ANNUAL ACCOUNTS 2006

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KAUPTHING BANK

ENDORSEMENT AND SIGNATURES OF THE BOARD OF DIRECTORS AND THE CEO

The Consolidated Financial Statements of Kaupthing Bank hf. for the year ended 31 December 2006 have been prepared in accordance with International Financial Reporting Standards (IFRS). The Consolidated Financial Statements 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 86,447 million for the year ended 31 December 2006. The Board of Directors proposes a payment of dividend, ISK 14 per share, which equals 12% of net earnings for the year. An extraordinary shareholders' meeting held on 16 October 2006 approved that shareholders should be paid a dividend amounting to ISK 18,205 million in the form of 830,691,316 shares in Exista hf. The total dividend paid during the year 2006 amounted to ISK 37.6 per share. Shareholders equity, according to the Balance Sheet, amounted to ISK 323,510 million at the end of the year, including Share capital amounting to ISK 7,321 million. The equity ratio of the Bank, calculated according to the Act on Financial Undertakings, was 15.0%. This ratio may not be lower than 8.0%.

Kaupthing Bank hf.'s Share capital amounted to ISK 7,321 million at yearend. Share capital was increased by ISK 759 million during the year 2006. The increase net selling price was ISK 55,558 million. Registered shareholders at year end 2006 numbered 31,730 compared to 33,027 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, which owned 23.0% of the shares.

The Board of Directors and the CEO of Kaupthing Bank hf. hereby confirm the Consolidated Financial Statements for the year ended 31 December 2006.

Reykjavík, 29 January 2007

Board of Directors

Sigurdur Einarsson
Chairman

Ásgeir Thoroddsen

Brynja Halldórsdóttir

Hjörleifur Thór Jakobsson

Niels de Coninck-Smith

Bjarnfredur Ólafsson

Gunnar Páll Pálsson

María Sólbergsdóttir

Tommy Persson

Hreidar Már Sigurdsson
CEO

INDEPENDENT AUDITORS' REPORT

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

Report on the Consolidated Financial Statements

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 2006, and the Consolidated Income Statement, Consolidated Statement of changes in Equity and Consolidated Cash Flow Statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Managements 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 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.

Auditors' 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 our judgement, including the assessment of the risks of material misstatement of the Financial Statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entitys 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 entitys internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the Financial Statements.

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

Opinion

In our opinion, the Consolidated Financial Statements give a true and fair view of the consolidated financial position of Kaupthing Bank hf. as at 31 December 2006, and 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 EU.

Reykjavík, 29 January 2007

KPMG hf.

Saemundur Valdimarsson

Reynir Stefán Gylfason

CONSOLIDATED INCOME STATEMENT FOR THE YEAR 2006

	Notes	2006	2005
Interest income		187,451	100,009
Interest expense		(135,089)	(67,299)
Net interest income	42	52,362	32,710
Fee and commission income		40,904	23,508
Fee and commission expense		(3,620)	(1,080)
Net fee and commission income	43	37,284	22,428
Net financial income	44-49	60,157	37,282
Share of profit of associates	69	1,194	1,396
Other operating income	50	16,219	8,382
Operating income		167,216	102,198
Salaries and related expenses	52-53	(33,570)	(20,317)
Administration expenses		(19,800)	(11,594)
Depreciation and amortisation	75	(5,976)	(2,818)
Other operating expenses		(660)	(796)
Impairment on loans	55	(4,857)	(2,450)
Impairment on other assets	55	(1,270)	(1,939)
Earnings before income tax		101,083	62,284
Income tax expense	56	(14,636)	(11,228)
Net earnings		86,447	51,056
Attributable to:			
Shareholders of Kaupthing Bank hf.		85,302	49,260
Minority interest		1,145	1,796
Net earnings		86,447	51,056
Earnings per share			
Basic earnings per share	57	127.1	75.2
Diluted earnings per share	57	123.4	73.9

Amounts are in ISK millions

CONSOLIDATED BALANCE SHEET AS OF 31 DECEMBER 2006

	Notes	2006	2005
Assets			
Cash and balances with central banks	58	106,961	34,877
Loans to credit institutions	59	485,334	195,594
Loans to customers	60-64	2,538,609	1,543,700
Bonds and debt instruments	65	318,264	390,575
Shares and equity instruments	65	159,020	114,355
Derivatives	65,93	65,454	21,047
Derivatives used for hedging	65,93	6,453	4,459
Securities used for hedging	65	115,938	82,098
Investments in associates	69	5,304	13,888
Intangible assets	70-71	68,301	54,943
Investment property	72-73	31,584	24,156
Property and equipment	74-77	30,466	22,433
Tax assets	84	5,834	5,004
Other assets	78	117,874	33,682
Total Assets		4,055,396	2,540,811
Liabilities			
Due to credit institutions and central banks		110,456	69,643
Deposits		750,658	486,175
Borrowings	79	2,399,939	1,556,567
Subordinated loans	80	216,030	102,688
Financial liabilities measured at fair value	81-83	71,264	60,273
Tax liabilities	84	23,209	18,458
Other liabilities	87-88	148,948	44,495
Total Liabilities		3,720,504	2,338,299
Equity			
Share capital		7,321	6,638
Share premium		164,028	114,606
Reserves		17,220	(1,540)
Retained earnings		134,941	74,479
Total Shareholders' Equity	89-91	323,510	194,183
Minority interest		11,382	8,329
Total Equity		334,892	202,512
Total Liabilities and Equity		4,055,396	2,540,811

Amounts are in ISK millions

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR 2006

	Share capital and premium	Reserves	Retained earnings	Total Share-holders' equity	Minority interest	Total equity
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 AFS financial assets		(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 equity holders, 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
2005						
Equity 1 January 2005	117,080	(670)	32,960	149,370	9,539	158,909
Translation difference		(388)		(388)	(77)	(465)
Fair value changes in AFS financial assets		(2)		(2)		(2)
Deferred pension reserve		(480)		(480)		(480)
Net earnings recognised directly in equity		(870)		(870)	(77)	(947)
Net earnings according to the Income Statement			49,260	49,260	1,796	51,056
Total recognised earnings for the year		(870)	49,260	48,390	1,719	50,109
Dividends paid to equity holders, ISK 10 per share			(3,298)	(3,298)		(3,298)
Issued new share capital	416			416		416
Restating the initial investments in shares			(4,886)	(4,886)		(4,886)
Purchases and sales of treasury stock	3,706			3,706		3,706
Exercised stock options	42			42		42
Other changes			443	443	(2,929)	(2,486)
Equity 31 December 2005	121,244	(1,540)	74,479	194,183	8,329	202,512

Amounts are in ISK millions

CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR 2006

	2006	2005
Cash flows from operating activities:		
Earnings before income tax	101,083	62,284
Adjustments to reconcile Net earnings to cash flow (used in) from operating activities:		
Non-cash items included in Net earnings and other adjustments	1,481	4,936
Operating assets and liabilities, changes	(144,389)	23,234
Income taxes paid	(8,115)	(1,455)
Net cash (used in) from operating activities	(49,940)	88,999
Cash flows from investing activities:		
Investment in associated companies	(5,400)	(1,805)
Disposal of associated companies	20,266	6,111
Dividend received from subsidiaries	4,103	102
Payment for acquisition of subsidiaries (less cash acquired)	0	(60,356)
Purchase of Intangible assets	(1,810)	(2,884)
Purchase of Investment property	(3,475)	(4,839)
Proceeds from sale of Investment property	5,367	208
Purchase of Property and equipment	(13,818)	(4,965)
Proceeds from sale of Property and equipment	3,283	1,452
Other changes	221	(4,855)
Net cash from (used in) investing activities	8,737	(71,831)
Cash flows from financing activities:		
Subordinated loan capital issued	111,336	42,731
Subordinated loan capital repaid	(2,601)	(3,524)
(Purchases) sales of own shares to meet share awards and share option awards	(5,800)	3,706
Proceeds from the issue of shares	55,558	0
Dividends paid	(24,814)	(3,298)
Net cash from financing activities	133,679	39,615
Net increase in Cash and cash equivalents	92,476	56,783
Cash and cash equivalents at beginning of the year	81,758	26,985
Effect of exchange rate changes on cash held	28,555	(2,010)
Cash and cash equivalents at year end	202,789	81,758
Additional information:		
Paid and total purchase price of subsidiaries	0	63,708
Received and total sale price of subsidiaries	0	6,111

Amounts are in ISK millions

CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR 2006 - NOTES

	2006	2005
Non-cash items in the Income Statement and other adjustments		
Impairment on loans	4,857	2,450
Depreciation and amortisation	5,976	2,818
Impairment on other assets	1,270	1,939
Net earnings of associated companies	(1,194)	(1,396)
Investment property, fair value change	(96)	(365)
Net gain on disposal of Investment property	(3,020)	0
Indexation and exchange rate difference	2,689	2,458
Net gain on disposal on Property and equipment	(303)	(248)
Net gain on a disposal of a subsidiary	0	(3,093)
Net gain on a disposal of associated companies	(8,398)	0
Share based payment expenses	571	42
Changes in other non cash items	(871)	331
	1,481	4,936
Changes in operating assets and liabilities		
Loans, change	(1,253,947)	(394,644)
Financial assets measured at fair value, change	(51,147)	(68,042)
Financial assets available for sale, change	(2,016)	(118,012)
Tax assets, change	(3,060)	(1,276)
Other assets, change	(82,894)	(10,096)
Deposits, change	301,998	233,892
Borrowings, change	834,270	421,593
Financial liabilities, measured at fair value, change	10,872	(14,988)
Provisions, change	1,378	3,271
Tax liabilities, change	(1,788)	(1,422)
Other liabilities, change	101,945	(27,042)
	(144,389)	23,234
Cash and cash equivalents at year end		
Cash in hand and demand deposits	95,828	16,828
Due from credit institutions	106,961	64,930
Cash and cash equivalents at year end	202,789	81,758

Amounts are in ISK millions

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

General Information

1. Reporting entity

Kaupthing Bank hf. is a company incorporated and domiciled in Iceland. The address of the Bank´s registered office is Borgartún 19, Reykjavík. The Consolidated Financial Statements for the year 2006 comprise Kaupthing Bank hf. (the Parent Company) 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.

Certain comparative information have been restated.

The Financial Statements were approved and authorised for issue by the Board of Directors of Kaupthing Bank hf. on 29 January 2007.

b) Basis of measurement

The Consolidated Financial Statements are prepared on the historical cost basis except the following assets and liabilities that are stated at their fair value: derivative financial instruments, financial instruments held for trading, financial instruments designated at fair value through profit and loss, financial instruments classified as available-for-sale and investment properties.

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 shall be used.

c) Functional and presentation currency

The Consolidated Financial Statements are presented in Icelandic krona (ISK), which is the Bank´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 Consolidated 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 Consolidated Financial Statement presented. Actual results may differ from the estimates and the assumptions 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 Consolidated Financial Statements and estimates with a significant risk of material adjustment in the next year are discussed in note 37.

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's 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.

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 securitisation is set out in note 67.

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 associates and jointly controlled 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 translated 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 a financial liability designated as a hedge of the net investment in a foreign operation.

c) Foreign operations

The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on aquisition, 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.

5. con'd

Foreign exchange difference 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, 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 as it accrues, taking into account the effective yield of the asset or an applicable floating rate. Interest income and expense includes the amortisation of any discount or premium or other differences between the initial carrying amount of an interest bearing instrument and its amount at maturity calculated on an effective interest rate basis.

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

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

b) Fee and commission

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.

c) Net financial income

Net financial income comprises of Dividend income, Net trading income and Net income from other fincancial instruments at fair value.

Dividend income is recognised in the Income Statement on the date the dividend is declared.

Net trading income comprises gains less losses related to trading assets and liabilities, and includes all realised and unrealised fair value changes, interest, dividends and foreign exchange differences.

Net income from other financial instruments at fair value relates to non-qualifying derivatives held for risk management purposes and financial assets and liabilities designated at fair value through profit or loss, and includes all realised and unrealised fair value changes, interest, dividends and foreign exchange differences.

6. con'd

d) Lease payments made

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 calculated 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 reviwed 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.

a) Impairment on loans

The Bank recognises losses for impaired loans promptly where 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.

7. con'd

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 installments or on interest or principal payments;

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

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

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

vi) observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of 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 Bank, including:

- adverse changes in the payment status of borrowers in the Bank; or
- general national or local economic conditions connected with the assets in the Bank.

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.

7. con'd

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; and
- future cash flows in a group of loans evaluated for impairment are estimated on the basis of the contractual cash
- 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 loss occurring and its identification is determined for each identified portfolio.

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 (and the related impairment allowance accounts) 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 assets acquired are 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 assets 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.

7. con'd

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.

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 largely are independent from 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 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. 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 i) interest income, ii) foreign exchange differences and other gains and losses. Interest income is recognised on accrual basis. Derivatives with positive fair values are recognised as trading assets and derivatives with negative fair values are recognised as trading liabilities.

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 non-derivative financial instruments to manage the potential earnings impact of these risks.

Several types of derivatives are used for this purpose, including interest rate swaps and 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.

The Bank's risk management activities concentrates 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.

10. con'd

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 Net financial 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.

c) 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.

d) 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 Translations 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 the Income Statement. They are recycled and recognised in Income Statement 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 income is included in the carrying amount of 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; or

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.

13. con'd

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 as Other operating income. 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 simple 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 in fair value, usually an increase, indicated by valuation techniques is recognised in the Income Statement 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.

16. con'd

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 setoff 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 - lessor

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.

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.

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 are stated at fair value. The Bank uses internal real estate experts 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) Owned assets

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 residual value is 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 80. 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 Subordinated loans 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/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.

28. con'd

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

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, and inital fair value 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 gurantees 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 vast.

32. con’d

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.

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 Bank’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 not yet adopted

A number of new standards, amendments to standards and interpretations are not yet effective for the year ended 31 December 2006, and have not been applied in preparing these Consolidated Financial Statements. The Bank will apply the following new standards, amendments and interpretations when effective:

- IFRS 7 Financial Instruments: Disclosures requires entities to provide disclosures in their Financial Statements that enable users to evaluate the significance of financial instruments for the entity´s financial position and performance; and the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the reporting date, and how the entity manages those risks. IFRS 7 which becomes mandatory for the Bank´s 2007 Financial Statements, is expected to have impact on additional disclosures.

35. con'd

- IFRIC 7 Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies addresses the application of IAS 29 when an economy first becomes hyperinflationary and in particular the accounting for deferred tax. IFRIC 7, which becomes mandatory for the Bank´s 2007 Financial Statements, is not expected to have impact on the Consolidated Financial Statements. The main impact will be on additional disclosures.

- IFRIC 8 Scope of IFRS 2 Share-based Payment addresses the accounting for share-based payment transactions in which some or all of goods or services received cannot be specifically identified. IFRIC 8 will become mandatory for the Bank´s 2007 Financial Statements, with retrospective application required. The Bank has not yet determined the potential effect of the interpretation.

- IFRIC 9 Reassessment of Embedded Derivatives requires that a reassessment of whether embedded derivative should be separated from the underlying host contract should be made only when there are changes to the contract. IFRIC 9, which becomes mandatory for the Bank´s 2007 Financial Statements, is not expected to have any impact on the Consolidated Financial Statements.

- IFRIC 10 Interim Financial Reporting and Impairment prohibits the reversal of an impairment loss recognised in a previous interim period in respect of goodwill, an investment in an equity instrument or a financial asset carried at cost. IFRIC 10 will become mandatory for the Bank´s 2007 Financial Statements, and will apply to goodwill, investments in equity instruments, and financial assets carried at cost prospectively from the date that the Bank first applied the measurement criteria of IAS 36 and IAS 39 respectively (i.e., 1 January 2004).

36. 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.

37. 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.

a) 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.

37. con'd

b) Fair value of derivatives

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.

c) 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.

d) 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:

i) 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.

ii) 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.

iii) 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.

Segment Reporting

38. 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 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 market transactions, acquisition and leverage finance and principle investment.

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- Treasury is responsible for inter-bank trading, the Bank's funding, derivatives and foreign exchange trading and brokerage.
- 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 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 centers are: Overhead, Back office, Risk Management, Finance, Legal department, Information Technology, Human Resources and Sales and Marketing.

Geographical segments

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

39. Summary of the Bank's business segments:

	Capital Markets	Investment Banking	Treasury	Banking	Asset Management and Private Banking	Elimination and cost centers	Total
2006							
Net interest income	(1,513)	(3,349)	11,492	45,903	817	(988)	52,362
Net fee and commission income	7,396	9,577	2,927	5,744	11,231	409	37,284
Net financial income	7,913	42,984	8,411	750	531	(432)	60,157
Other income	(1)	44	26	6,631	962	9,751	17,413
Operating income	13,795	49,256	22,856	59,028	13,541	8,740	167,216
Operating expense	(6,205)	(3,636)	(3,078)	(14,969)	(7,380)	(24,738)	(60,006)
Impairment	(123)	1	(5)	(4,851)	(1,138)	(11)	(6,127)
Total expense	(6,328)	(3,635)	(3,083)	(19,820)	(8,518)	(24,749)	(66,133)
Earnings before cost allocation	7,467	45,621	19,773	39,208	5,023	(16,009)	101,083
Allocated cost	(3,206)	(888)	(2,015)	(8,744)	(3,426)	18,279	0
Earnings before income tax	4,261	44,733	17,758	30,464	1,597	2,270	101,083
Net segment revenue from external customers	20,697	53,425	(52,166)	135,108	9,516	636	167,216
Net segment revenue from other segments	(6,902)	(4,169)	75,022	(76,080)	4,025	8,104	0
Operating income	13,795	49,256	22,856	59,028	13,541	8,740	167,216
Depreciation and amortisation	9	8	11	3,512	21	2,415	5,976
Total assets	214,433	108,946	1,649,940	2,597,032	12,386	(527,341)	4,055,396
Total liabilites	183,637	47,998	1,600,859	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 liabilites and equity	214,433	108,946	1,649,940	2,597,032	12,386	(527,341)	4,055,396
Capital expenditure	259	38	285	6,957	705	7,384	15,628

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	Capital Markets	Investment Banking	Treasury	Banking	Asset Management and Private Banking	Elimination and cost centers	Total
2005							
Net interest income	(1,120)	(2,322)	4,733	32,076	632	(1,289)	32,710
Net fee and commission income	4,730	7,592	1,364	3,165	5,256	321	22,428
Net financial income	16,008	18,416	2,637	232	100	(111)	37,282
Other income	35	163	0	3,419	0	6,161	9,778
Operating income	19,653	23,849	8,734	38,892	5,988	5,082	102,198
Operating expense	(3,113)	(1,808)	(1,481)	(10,580)	(4,186)	(14,357)	(35,525)
Impairment	0	(22)	6	(2,395)	0	(1,978)	(4,389)
Total expense	(3,113)	(1,830)	(1,475)	(12,975)	(4,186)	(16,335)	(39,914)
Earnings before cost allocation	16,540	22,019	7,259	25,917	1,802	(11,253)	62,284
Allocated cost	(1,751)	(706)	(877)	(5,356)	(1,758)	10,448	0
Earnings before income tax	14,789	21,313	6,382	20,561	44	(805)	62,284
Net segment revenue from external customers	22,830	25,620	(33,915)	78,481	4,482	4,700	102,198
Net segment revenue from other segments	(3,177)	(1,771)	42,649	(39,589)	1,506	382	0
Operating income	19,653	23,849	8,734	38,892	5,988	5,082	102,198
Depreciation and amortisation	19	22	4	1,475	15	1,283	2,818

Geographic analysis

40. 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.

	Iceland	Scandi-navia	UK	Luxem-bourg	Other	Total
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	0	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., amounting to ISK 26,084 million, is included in Net financial income in Iceland. Financial gains relating to the sale of VÍS hf., amounting to ISK 7,421 million, is included in Other income in Iceland.

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	Iceland	Scandi-navia	UK	Luxem-bourg	Other	Total
2005						
Net interest income	10,224	10,642	7,698	3,715	431	32,710
Net fee and commission income	8,859	3,814	6,364	2,896	495	22,428
Net financial income	6,217	10,218	18,015	1,907	925	37,282
Other income	6,048	1,742	1,986	2	0	9,778
Operating income	31,348	26,416	34,063	8,520	1,851	102,198

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

	Iceland	Scandi-navia	UK	Luxem-bourg	Other	Total
2006						
Cash and cash 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	111,685	66,316	4,899	314	259,363
Assets	1,071,516	1,626,247	807,878	363,250	186,505	4,055,396
2005						
Cash and cash balances with central banks	811	32,078	59	1,929	0	34,877
Loans to credit institutions and customers	531,743	776,470	297,642	70,693	62,746	1,739,294
Financial assets measured at fair value	247,761	185,399	160,956	5,492	12,926	612,534
Other assets	69,362	36,809	45,389	2,165	381	154,106
Assets	849,677	1,030,756	504,046	80,279	76,053	2,540,811

Notes to the Income Statement

Net interest income

42. Interest income and expense is specified as follows:

	Interest income	Interest expense	Net interest income
2006			
Cash and balances with central banks	911	0	911
Loans, receivables and deposits	150,405	(43,470)	106,935
Borrowings	0	(77,613)	(77,613)
Subordinated loans	0	(10,665)	(10,665)
Securities	28,191	(2,372)	25,819
Financial lease	5,359	0	5,359
Other	2,585	(969)	1,616
Interest income and expense	187,451	(135,089)	52,362

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2005	Interest income	Interest expense	Net interest income
Cash and balances with central banks	367	0	367
Loans, receivables and deposits	79,297	(18,855)	60,442
Borrowings	0	(37,776)	(37,776)
Subordinated loans	0	(3,646)	(3,646)
Securities	15,356	(6,862)	8,494
Financial lease	3,375	(94)	3,281
Other	1,614	(66)	1,548
Interest income and expense	100,009	(67,299)	32,710

Net fee and commission income

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

	2006	2005
Fee and commission income		
Securities trading	11,413	8,263
Derivatives	3,582	1,680
Lending	2,901	1,665
Other fee and commission income	23,008	11,900
Fee and commission income	40,904	23,508
Fee and commission expense		
Received guarantees	(139)	(61)
Securities trading	(2,052)	(937)
Other fee and commission expense	(1,429)	(82)
Fee and commission expense	(3,620)	(1,080)
Net fee and commission income	37,284	22,428

Net financial income

44. Net financial income is specified as follows:

Dividend income	5,074	1,808
Net gain on financial assets and liabilities not at fair value	142	147
Net gain on financial assets and liabilities at fair value	52,023	33,920
Net foreign exchange gain	2,918	1,407
Net financial income	60,157	37,282

Dividend income

	2006	2005
45. Dividend income is specified as follows:		
Dividend income on available-for-sale financial assets	54	50
Dividend income on trading assets	3,703	1,723
Dividend income on assets at fair value through profit and loss	1,317	35
Dividend income	5,074	1,808

Net gain on financial assets and liabilities not at fair value

	2006	2005
46. Net gain on financial assets and liabilities not at fair value are specified as follows:		
Net realised gain on loans and finance leases	103	3
Net realised gain on available-for-sale assets	32	138
Net realised gain on financial liabilities measured at amortised cost	0	6
Other net realised gain	7	0
Net gain on financial assets and liabilities not at fair value	142	147

Net gain on financial assets and liabilities at fair value

	2006	2005
47. Net gain on financial assets and liabilities at fair value are specified as follows:		
Net gain on trading portfolio	12,997	14,223
Net gain on assets designated at fair value through profit and loss	38,668	19,226
Fair value adjustments on hedge accounting	358	471
Net gain on financial assets and liabilities at fair value	52,023	33,920
48. Net gain on trading portfolio are specified as follows:		
Loss on interest rate instruments and related derivatives	(3,643)	(1,720)
Gain on equity instruments and related derivatives	11,226	12,961
Gain on foreign exchange trading	463	751
Gain on other derivatives	4,951	2,231
Net gain on trading portfolio	12,997	14,223
49. Net gain on assets designated at fair value through profit and loss are specified as follows:		
(Loss) gain on interest rate instruments designated at fair value	(2,623)	13
Gain on equity instruments designated at fair value	41,291	19,213
Net gain on assets designated at fair value through profit and loss	38,668	19,226

Other operating income

50. Other operating income is specified as follows:

	2006	2005
Gain on disposals of assets other than held for sale	8,784	3,896
Income from operating lease	4,128	769
Fair value adjustments on investment properties	513	400
Realised gain on investment properties	216	67
Net income (loss) from assets held for sale	7	(13)
Other income	2,571	3,263
Other operating income	16,219	8,382

Personnel

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

	2006	2005
Average number of full time equivalent positions during the year	2,630	2,318
Full time equivalent positions at the end of the year	2,719	2,368

52. Salaries and related expenses are specified as follows:

	2006	2005
Salaries	16,388	11,041
Bonus payments	11,606	5,407
Salary related expenses	5,576	3,869
Salaries and related expense	33,570	20,317

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 3,140 million at year end 2006.

53. 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	69.5	2.1	69.5	27.8	1.6	6.4
Directors:						
Sigurdur Einarsson, Chairman	69.5	30.5	69.5	27.8	1.6	7.4
Ásgeir Thoroddsen	4.6					-
Bjarnfredur Ólafsson	5.3					-
Brynja Halldórsdóttir	4.6					-
Finnur Ingólfsson	4.6					-
Gunnar Páll Pálsson	4.6					-
Hjörleifur Thor Jakobsson	4.6					-
Niels de Coninck-Smith	3.5					-
Tommy Persson	4.6					-
María Sólbergsdóttir	1.2					-

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	Salaries	Benefits	Bonuses	Pension fund payment	Stock options shares	Shares at year end
CEO in Iceland and Denmark:						
Ingólfur Helgason	30.0	2.0	40.0		0.5	3.3
Lars Johansen	57.0	3.2	25.4			-
Five Group Managing Directors	99.9	9.0	97.0	3.5	1.6	4.6

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 5 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 2006 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 31.7 million for the year 2006.

The CEO and the Chairman of the Board exercised in 2006 stock options that were granted 2003. The difference in exercise price and market price were ISK 674 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 99.

Auditors' fee

	2006	2005
54. Auditors' fee is specified as follows:		
Audit of the Financial Statements	262	140
Other related audit service	33	33
Review of the Interim Financial Statements	36	42
Other service	121	71
Auditors' fee	452	286
Fee to others than the Parent Company's auditors, included in the above total	366	237

Impairment

55. Impairment is specified as follows:

	2006	2005
Impairment on loans	4,857	2,450
Impairment on goodwill	451	1,522
Impairment on intangible assets	819	417
Impairment on other assets	1,270	1,939
Impairment on assets	6,127	4,389

Income tax expense

56. Tax assets and tax liabilities recognised in the Income Statement are specified as follows:

	2006	2005
Current tax expense:		
Current year	10,154	8,115
Deferred tax expense:		
Changes in temporary differences	4,482	3,113
Income tax expense	14,636	11,228

Reconciliation of effective tax rate:	2006		2005	
Earnings before income tax		101,083		62,284
Income tax using the domestic corporation tax rate	18.0%	18,195	18.0%	11,211
Effect of tax rates in foreign jurisdictions	(0.3%)	(290)	0.8%	526
Non-deductible expense	1.4%	1,394	0.4%	252
Tax exempt revenues	(2.8%)	(2,786)	(0.2%)	(145)
Tax incentives not recognised in the Income Statement	0.2%	171	(0.9%)	(532)
Other changes	(2.0%)	(2,048)	(0.1%)	(84)
Effective tax rate	14.5%	14,636	18.0%	11,228

Earnings per share

57. Earnings per share are specified as follows:

	2006	2005
Net earnings attributable to the shareholders of Kaupthing Bank hf.	85,302	49,260
Weighted average Share capital:		
Weighted average of outstanding shares for the year	671.0	655.2
Effects of stock options	20.3	10.9
Weighted average of Share capital for the year	691.3	666.1
Basic earnings per share	127.1	75.2
Diluted earnings per share	123.4	73.9
Number of outstanding shares at the end of the year, million	732.1	663.8
Number of total shares at the end of the year, million	752.4	674.8
Average number of own shares, million	8.4	5.7
Number of own shares at the end of the year, million	8.4	0.7

Notes to the Balance Sheet

Cash and balances with central banks

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

	2006	2005
Cash and cash balances	10,537	16,869
Cash equivalent	96,424	18,008
Cash and balances with central banks	106,961	34,877

Loans to credit institutions

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

	2006	2005
Money market loans	242,284	97,544
Bank accounts	95,828	46,881
Overdrafts	7,902	1,733
Repos	50,753	0
Other loans	88,567	49,436
Loans to credit institutions	485,334	195,594

Loans to customers

	2006	2005
60. Loans to customers specified by types of loans:		
Overdrafts	113,354	101,452
Finance lease	93,006	51,212
Subordinated loans	7,369	7,647
Other loans	2,341,462	1,396,342
Provision for loans	(16,582)	(12,953)
Loans to customers	2,538,609	1,543,700
61. Loans to customers specified by sectors:		
Individuals	16.6%	17.3%
Holding companies	13.5%	9.8%
Industry	24.3%	19.1%
Real estate	15.6%	12.7%
Service	19.9%	27.0%
Trade	8.5%	12.4%
Transportation	1.6%	1.7%
Loans to customers	100.0%	100.0%
62. Specification of subordinated loans:		
Loans to customers	4,907	5,796
Bonds and other fixed income securities	2,462	1,851
Subordinated loans	7,369	7,647
63. Provisions on loans are specified as follows:		
Specific provision	13,404	9,155
Collective assessment	3,178	3,798
Provision on loans	16,582	12,953
64. Changes in the provision on loans are specified as follows:		
Balance at the beginning of the year	12,953	12,294
Acquisition through business combination	0	1,765
Impairment on loans during the year	4,857	2,450
Exchange rate difference on translation	1,786	(518)
Write-offs during the year	(3,203)	(3,212)
Payment of loans previously written-off	189	174
Provision on loans	16,582	12,953

Included within interest income is ISK 642 million (2005: ISK 552 million) with respect of interest income accrued on impairment on financial assets and ISK 161 million (2005: ISK 112 million) with respect to the unwind of the impairment provision discount.

Non-performing loans are classified as aggregated exposures of customers for which the Bank has made specific provisions in part or in full. Non-performing loans amounted at year end 2006 to ISK 25,506 million (2005: ISK 15,078 million), 1.00% of total loans to customers (2005: 0.98%).

Financial assets

65. Financial assets are specified as follows:

2006	Trading assets	Fin. assets designated at fair value	Fin. assets available for sale	Derivatives used for hedging	Total
Bonds and debt instruments					
Listed	26,208	246,620	0	0	272,828
Unlisted	3,559	31,369	0	0	34,928
Mortgage loans	0	10,508	0	0	10,508
Bonds and debt instruments	29,767	288,497	0	0	318,264
Shares and equity instruments					
Listed	78,463	35,353	0	0	113,816
Unlisted	10,481	34,559	164	0	45,204
Shares and equity instruments	88,944	69,912	164	0	159,020
Derivatives					
OTC derivatives	50,011	0	0	0	50,011
Futures	15	0	0	0	15
Other trading derivatives	15,428	0	0	0	15,428
Derivatives	65,454	0	0	0	65,454
Derivatives used for hedging					
Fair value hedge	0	0	0	2,953	2,953
Portfolio hedge of interest rate risk	0	0	0	3,500	3,500
Derivatives used for hedging	0	0	0	6,453	6,453
Securities used for hedging					
Bonds and debt instruments	66,732	0	0	0	66,732
Shares and equity instruments	47,011	2,195	0	0	49,206
Securities used for hedging	113,743	2,195	0	0	115,938
Financial assets	297,908	360,604	164	6,453	665 ,129

65. con'd

2005	Trading assets	Fin. assets designated at fair value	Fin. assets available for sale	Derivatives used for hedging	Total
Bonds and debt instruments					
Listed	169,714	78,730	0	0	248,444
Unlisted	0	130,098	0	0	130,098
Mortgage loans	0	12,033	0	0	12,033
Bonds and debt instruments	169,714	220,861	0	0	390,575
Shares and equity instruments					
Listed	54,273	18,323	0	0	72,596
Unlisted	10,025	31,567	167	0	41,759
Shares and equity instruments	64,298	49,890	167	0	114,355
Derivatives					
OTC derivatives	12,644	0	0	0	12,644
Futures	18	0	0	0	18
Other trading derivatives	8,385	0	0	0	8,385
Derivatives	21,047	0	0	0	21,047
Derivatives used for hedging					
Fair value hedge	0	0	0	982	982
Portfolio hedge of interest rate risk	0	0	0	3,477	3,477
Derivatives used for hedging	0	0	0	4,459	4,459
Securities used for hedging					
Bonds and debt instruments	28,710	0	0	0	28,710
Shares and equity instruments	53,388	0	0	0	53,388
Securities used for hedging	82,098	0	0	0	82,098
Financial assets	337,157	270,751	167	4,459	612,534

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

	2006	2005
Financial institutes	270,879	117,982
Government	1,032	81,666
Corporates	16,586	21,213
Bonds and debt instruments designated at fair value	288,497	220,861

Pledged assets

67. Pledged assets are specified as follows:

	2006	2005
Mortgage loans in Kaupthing Mortgage fund	84,165	0

In the ordinary course of business, the Bank enters into transactions that result in the transfer of financial assets to third parties or special entity. The Bank has transferred retail mortgage loans to the Kaupthing Mortgage 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.

The Bank has entered into repurchase agreements that are conducted under terms usual and customary to standard lending, and stock borrowing and lending activities. Pledged assets according to these agreements amounted to ISK 121 billion at year end 2006 (2005: ISK 48 billion).

68. The Bank sold equity instruments during the year with a fair value of EUR 450 million for cash that has been included as a cash flow from operating activities. The Bank has continuing on and off Balance Sheet exposure to the market price of the equity shares with a maximum potential exposure of EUR 360 million against which the Bank has placed EUR 81 million cash collateral, subject to a requirement for additional collateral based on changes in the market price of the equity shares. The Bank has maximum potential exposure of EUR 360 million, although the Bank has the right to increase the exposure to EUR 400 million.

Investment in associates

69. Investment in associates are specified as follows:

	2006	2005
Carrying amount at the beginning of the year	13,888	3,649
Additions	5,400	1,805
Sold during the year	(11,868)	(42)
Transfers	0	7,671
Profit share	1,194	1,396
Dividend received	(4,103)	(102)
Foreign currency translation	793	(489)
Carrying amount at the end of the year	5,304	13,888

Main associates are specified as follows:

	Currency	Total assets	Total liabilities	Owner-ship	Profit share	Nominal value	Book value
Drake Management LLC, USA	USD	11,578	7,329	20.0%	604	10	2,082
Greidslumidlun hf., Iceland	ISK	30,173	28,007	39.5%	165	84	1,757
Mezzanin Kapital A/S, Denmark	DKK	5,696	3,313	22.7%	(1)	159	542
FMS Holding af 2004 A/S, Denmark	DKK	633	302	25.0%	2	113	265
Reiknistofa Bankanna, Iceland	ISK	1,717	199	17.3%	0	0	263
JHM Holsted Holding A/S, Denmark	DKK	1,545	761	25.0%	0	197	197
Eighteen other associates					424	20	198
					1,194		5,304

Intangible assets

70. The Bank performed impairment test on the carrying amount of goodwill as at 31 December 2006. 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 segments. The integration of these changes in emphasis into the Bank's organization has begun and a number of organisational changes have already been made, all with the aim of uniting the Bank and increasing its transparency.

The Bank has now defined the five independent CGU of the Bank's operation which are the business segments, each devising its own budget and responsible for its own results. Furthermore, the costs of the ancillary units are distributed proportionally among the 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. In the budget for 2006, return on equity is expected to be higher than the Bank's objective. In the assessment, future return on equity is expected to be similar to the average of group of comparable units to each CGU.

Goodwill devides as follows on CGU:	Goodwill	Discount rate	Net earnings: Est. CAGR 1), year 1-4
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%
Goodwill	63,118		
2005			
Capital Markets	4,618	10.9%	<2%
Investment Banking	6,826	10.9%	<2%
Treasury	3,971	10.9%	<2%
Asset Management and Private Banking	4,689	9.0%	>100%
Banking	30,377	8.2%	<2%
Goodwill	50,481		

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

1) CAGR: Compound Annual Growth Rate

71. Intangible assets are specified as follows:	Goodwill	Other intangible assets	Total
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	0	1,810	1,810
Impairment	(451)	(819)	(1,270)
Amortisation	0	(1,062)	(1,062)
Intangible assets	63,118	5,183	68,301
2005			
Balance at the beginning of the year	34,011	1,087	35,098
Acquisition through business combination	394	942	1,336
Exchange rate difference	(1,178)	(69)	(1,247)
Additions during the year	18,775	2,883	21,658
Impairment	(1,521)	0	(1,521)
Amortisation	0	(381)	(381)
Intangible assets	50,481	4,462	54,943

In 2006 Kaupthing Singer & Friedlander closed its Investment Management business in Leeds. Impairment testing was undertaken on these balances as at 30 September 2006 based on the most recent information available. The results of the impairment testing suggested a full write-off of Intangible assets amounting to ISK 819 million and Goodwill amounting to ISK 451 million or total ISK 1,270 million.

Investment property

72. Investment property is specified as follows:	2006	2005
Balance at the beginning of the year	24,156	19,155
Exchange rate difference	3,426	5
Additions during the year	3,475	4,839
Disposals during the year	(2,347)	(208)
Revaluation during the year	96	365
Transfers	2,778	0
Investment property	31,584	24,156

The Bank's Investment property was revalued at 31 December 2006 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.

73. 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:

	2006	2005
Less than one year	1,682	917
Over 1 year and up to 5 years	4,391	3,768
Over 5 years	21,682	15,263
Minimum lease payments under non-cancellable leases	27,755	19,948

During the year 2006 ISK 2,274 million (2005: ISK 1,530 million) was recognised as rental income in the Income Statement and ISK 20 million (2005: ISK 2 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 32 million relating to investment property that was unlet compared to ISK 5 million for the year before.

Property and equipment

74. Property and equipment are specified as follows:

	Real estate	Machinery and equipm.	Operating lease	Total 2006	Total 2005
Balance at the beginning of the year	8,276	7,998	19,368	35,642	10,781
Acquisitions through business combination	0	0	0	0	22,884
Exchange rate difference	467	1,362	6,019	7,848	(411)
Additions during the year	4,571	3,643	5,604	13,818	4,965
Disposals during the year	(1,996)	(1,301)	(1,330)	(4,627)	(2,159)
Transfers	(2,234)	0	(579)	(2,813)	0
Impairment	0	0	0	0	(418)
Gross carrying amount at the end of the year	9,084	11,702	29,082	49,868	35,642
Previously depreciated	1,665	5,476	6,068	13,209	4,689
Acquisitions through business combination	0	0	0	0	7,274
Exchange rate difference	(289)	1,279	1,971	2,961	(236)
Depreciation during the year	301	1,436	3,177	4,914	2,437
Transfers	445	0	(480)	(35)	0
Disposals during the year	(78)	(668)	(901)	(1,647)	(955)
Total depreciation at the end of the year	2,044	7,523	9,835	19,402	13,209
Property and equipment	7,040	4,179	19,247	30,466	22,433

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

	2006	2005
Depreciation of property and equipment	4,914	2,437
Amortisation of intangible assets	1,062	381
Depreciation and amortisation	5,976	2,818

76. Property under construction

During the year ended 31 December 2006, the Bank's construction cost of a new building for future use as headquarters; incurred up to ISK 1,212 million including the acquisition cost of the land in the year 2005.

77. 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:

	2006	2005
Less than one year	851	3
Over 1 year and up to 5 years	3,322	19
Over 5 years	4,414	102
Minimum lease payments under non-cancellable leases	8,587	124

During the year ended 31 December 2006 ISK 2,033 million was recognised as rental income in the Income Statement and ISK 8 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 2005 amounted ISK 1,530 million and ISK 2 million, respectively.

Other assets

78. Other assets are specified as follows:

	2006	2005
Unsettled securities trading	90,427	16,091
Accounts receivables	8,617	6,997
Accrued income	8,004	4,868
Prepaid expenses	2,846	2,887
Non-current assets and disposal groups classified as held for sale	2,334	2,302
Sundry assets	5,646	537
Other assets	117,874	33,682

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

Borrowings

79. Borrowings are specified as follows:

Bonds issued	1,762,483	1,158,806
Bills issued	156,203	164,910
Money market loans	373,285	200,581
Other loans	107,968	32,270
Borrowings	2,399,939	1,556,567

Included are Repurchase agreements with banks amounting to ISK 94,913 million at the end of December compared to ISK 14,376 millon at year end 2005.

Subordinated loans

80. Subordinated loans are specified as follows:

	Currency	Orginal interest	Interest change	Interest after change	Maturity date	2006 Book value	2005 Book value
Loans that qualify as Tier I capital:							
Issued in 2001	ISK	8.7%	2011		No maturity date	1,310	1,232
Issued in 2004	EUR	5.9%	2014	3 m Euribor + 245bp	No maturity date	15,095	12,545
Issued in 2005	EUR	6.3%	2010	6.3%	No maturity date	16,685	13,517
Issued in 2005	ISK	3 m Reibor + 1.4%			No maturity date	3,353	3,352
Issued in 2005	USD	5.1%			No maturity date	11,798	10,555
Issued in 2006	ISK	3 m Reibor + 1.4%			No maturity date	3,576	0
						51,817	41,201
Loans that qualify as Tier II capital:							
Issued in 1996	DKK	0.0%			2007	228	370
Issued in 1999	EUR	6.4%			2009	3,067	2,545
Issued in 1999	JPY	0.0%			2032	3,513	3,057
Issued in 1999	USD	4.8%			2032	3,948	3,660
Issued in 2000	ISK	7.0%	2007	9.0%	2012	2,135	1,974
Issued in 2000	ISK	6.0%	2005	7.5%	2010	0	1,216
Issued in 2001	ISK	6.0%	2006	7.5%	2011	122	129
Issued in 2001	ISK	8.0%	2006	10.0%	2011	0	1,223
Issued in 2002	ISK	6.0%	2007	7.5%	2012	1,021	948
Issued in 2002	ISK	7.5%	2009	10.0%	2014	1,429	1,334
Issued in 2002	ISK	8.0%			2026	264	247
Issued in 2002	EUR	3 m Euribor + 115bp	2007	3 m Euribor + 365bp	2012	474	374
Issued in 2003	GBP	7.5%			2019	6,976	5,646
Issued in 2004	ISK	5.4%	2009	7.4%	2014	1,666	1,557
Issued in 2004	EUR	3 m Euribor + 65bp	2009	3 m Euribor + 165bp	2014	28,281	22,284
Issued in 2004	DKK	3.0%			2008	142	112
Issued in 2005	USD	7.5%	2010	4x(CMS 10y/2y) 10%/3.75%	2045	5,512	4,835
Issued in 2005	EUR	6.5%	2010	4x(CMS 10y/2y) 9%/3%	2045	7,903	6,227
Issued in 2005	EUR	3 m Euribor + 40bp	2012	3 m Euribor + 140bp	2017	4,758	3,749
Issued in 2006	USD	7.1%			2016	92,774	0
						164,213	61,487
Subordinated loans						216,030	102,688

Financial liabilities measured at fair value

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

	2006	2005
Trading liabilities	51,095	32,003
Derivatives used for hedging - portfolio hedge of interest rate risk	8,768	13,276
Mortgage funding measured at fair value	11,401	14,994
Financial liabilities measured at fair value	71,264	60,273

82. Trading liabilities are specified as follows:

	2006	2005
Short position in equity instruments held for trading	2,122	3,765
Derivatives held for trading	48,788	27,942
Other liabilities held for trading	185	296
Trading liabilities	51,095	32,003

83. Derivatives used for hedging are specified as follows:

	2006	2005
Fair value hedge	1,070	0
Portfolio hedge of interest rate risk	7,698	13,276
Derivatives used for hedging	8,768	13,276

Tax assets and tax liabilities

84. Tax assets and liabilities are specified as follows:

	Assets	Liabilities
Current tax	26	10,179
Deferred tax	5,808	13,030
Tax assets and liabilities	5,834	23,209

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

2006	Assets	Liabilities	Net
Balance at the beginning of the year	5,004	10,343	(5,339)
Exchange rate difference on translation	234	689	(455)
Other changes	0	(581)	581
Calculated income tax for the year	596	15,232	(14,636)
Income tax recognised in equity	0	(2,474)	2,474
Income tax to be paid in next year	(26)	(10,179)	10,155
Net tax assets and (liabilities)	5,808	13,030	(7,222)

2005	Assets	Liabilities	Net
Balance at the beginning of the year	1,092	4,408	(3,316)
Acquisition through business combination	3,987	4,333	(346)
Disposals during the year	0	(474)	474
Exchange rate difference on translation	(150)	(932)	782
Calculated income tax for the year	75	11,303	(11,228)
Income tax to be paid in next year	0	(8,295)	8,295
Net tax assets and (liabilities)	5,004	10,343	(5,339)

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

	At Jan. 1	Exchange rate and other adjustments	Business combination and disposal	Recognised in profit or loss	Recognised in equity	At Dec. 31
2006						
Shares in other companies	1,516	190	0	1,326	0	3,032
Currency linked assets and liabilities	502	65	0	3,447	(2,474)	1,540
Loans	5,643	724	0	(942)	0	5,425
Derivatives	(841)	(183)	0	1,121	0	97
Investment property and property and equipment	455	104	0	888	0	1,447
Other assets and liabilities	(667)	(734)	0	(1,303)	0	(2,704)
Carry forward taxable loss	(1,269)	(291)	0	(55)	0	(1,615)
Change in deferred tax	5,339	(125)	0	4,482	(2,474)	7,222
2005						
Shares in other companies	575	(57)	(22)	1,020	0	1,516
Currency linked assets and liabilities	346	(38)	(12)	206	0	502
Loans	3,639	(480)	(141)	2,625	0	5,643
Derivatives	(153)	16	6	(710)	0	(841)
Investment property and property and equipment	356	(31)	(14)	144	0	455
Other assets and liabilities	65	(7)	(3)	(722)	0	(667)
Carry forward taxable loss	(1,512)	(185)	58	370	0	(1,269)
Change in deferred tax	3,316	(782)	(128)	2,933	0	5,339

Other liabilities

87. Other liabilities are specified as follows:

	2006	2005
Unsettled securities trading	91,661	8,478
Provisions	4,666	3,271
Accounts payable	4,410	3,573
Sundry liabilities	48,211	29,173
Other liabilities	148,948	44,495

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

88. Provisions are specified as follows:

Provision for pensions	3,679	2,815
Provision for losses on guarantees	263	0
Other provisions	724	456
Provisions	4,666	3,271

Shareholders' equity

89. According to the Parent Company's Articles of Association, total Share capital amounts to ISK 7,405 million. At year end 2006 own shares amounted to ISK 84 million and Share capital, according to the Balance Sheet amounted to ISK 7,321 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 meetings of the Bank.

	2006		2005	
Increase in Share capital during the year is broken down as follows:	Share capital	Market value	Share capital	Market value
Shares outstanding at 1 January	6,638	495,195	6,521	293,732
Issued new shares	759	55,558	39	416
Purchases and sales of treasury stock	(76)	(5,730)	78	3,706
Changes in market value	0	70,673	0	197,340
Shares outstanding at 31 December	7,321	615,696	6,638	495,194
Own shares	84	7,064	7	485

90. Movement in Share capital during the year segregates as follows:

	Share capital	Share premium	Stock options	Total
2006				
Balance at 1 January 2006	6,638	114,437	169	121,244
Issued new shares	759	54,799	0	55,558
Purchases and sales of treasury stock	(76)	(5,948)	0	(6,024)
Exercised stock options	0	224	(224)	0
Stock option expense	0	0	571	571
Balance 31 December 2006	7,321	163,512	516	171,349
2005				
Balance at 1 January 2005	6,521	110,402	157	117,080
Issued new shares	39	377	0	416
Purchases and sales of treasury stock	78	3,628	0	3,706
Exercised stock options	0	30	(30)	0
Stock option expense	0	0	42	42
Balance 31 December 2005	6,638	114,437	169	121,244

The cost of issuing new shares in 2006, amounting to ISK 1,939 million, has been deducted from share premium.

Reserves

91. Movement in reserves were as follows:

	Pension reserve	Fair value reserve	Translation reserve	Total
2006				
Balance at 1 January	(480)	(2)	(1,058)	(1,540)
Translation difference	0	0	18,289	18,289
Changes in fair value of available-for-sale financial assets	0	(9)	0	(9)
Deferred pension reserve	480	0	0	480
Balance 31 December	0	(11)	17,231	17,220
2005				
Balance at 1 January	0	0	(670)	(670)
Translation difference	0	0	(388)	(388)
Changes in fair value of available-for-sale financial assets	0	(2)	0	(2)
Deferred pension reserve	(480)	0	0	(480)
Balance 31 December	(480)	(2)	(1,058)	(1,540)

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 a foreign subsidiaries.

Pension reserve

The pension reserve includes the changes in the pension obligation.

Equity ratio

92. Equity at the end of the year amounts to ISK 334,892 million. The equity ratio, calculated in accordance with Article 84 of the Act on Financial Undertakings, was 15.0%. According to the law the ratio may not be lower than 8.0%.

	2006		2005	
The ratio is calculated as follows:	Book value	Weighted value	Book value	Weighted value
Risk base:				
Assets recorded in the Financial Statements	4,055,396	2,875,539	2,540,811	1,841,833
Assets deducted from equity		(66,922)		(62,590)
Guarantees and other items not included in the Balance Sheet		259,023		166,028
		3,067,640		1,945,271
Equity:				
Tier I capital:				
Equity		334,892		202,512
Intangible assets		(65,276)		(54,943)
Assets deducted from equity		0		(6,742)
Subordinated loans		51,817		41,201
Tier II capital:				
Subordinated loans		160,717		61,285
Investment in credit institutions		(21,324)		(6,451)
		460,826		236,862
Equity ratio		15.0%		12.2%
Thereof Tier I ratio		10.5%		9.4%

Derivatives

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

	Principal				Book value	
	Up to 3 months	Over 3 months and up to a year	Over 1 year	Total	Assets	Liabilities
2006						
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	0	2,700	7,008	90	73
Equity options, sold unlisted agreements	338	0	2,700	3,038	151	10
Futures, agreements listed	1,527	0	0	1,527	15	0
Contracts for differences	3,959	0	0	3,959	32	0
	46,020	9,076	10,286	65,382	8,718	3,452
Credit derivative contracts:						
Credit default swaps	4,257	0	212,928	217,185	36	8
Total rate of return swaps	0	0	45,999	45,999	0	1,733
	4,257	0	258,927	263,184	36	1,741
Bond derivatives:						
Bond swaps, agreements unlisted	22,360	2,939	25,471	50,770	2,307	102
Options - purchased agreements	0	401	13,931	14,332	6,729	0
Options - sold agreements	0	401	13,931	14,332	0	6,717
	22,360	3,741	53,333	79,434	9,036	6,819
Derivatives	1,719,983	562,173	2,373,336	4,655,492	71,907	57,631

93. con'd

	Principal			Book value		
	Up to 3 months	Over 3 months and up to a year	Over 1 year	Total	Assets	Liabilities
2005						
Currency and interests rate derivatives, agreements unlisted:						
Forward exchange rate agreements	519,031	44,442	595	564,068	5,820	4,264
Interest rate and exchange rate agreements	78,372	167,328	777,591	1,023,291	14,558	40,044
Options - purchased agreements	2,399	4,395	25,945	32,739	861	0
Options - sold agreements	7,310	6,401	21,504	35,215	143	432
	607,112	222,566	825,635	1,655,313	21,382	44,740
Equity derivatives:						
Equity swaps, agreements unlisted	60,252	17,987	0	78,239	2,517	4,729
Equity options, purchased unlisted agreements	5,501	0	2,000	7,501	56	0
Equity options, sold unlisted agreements	2,357	0	2,000	4,357	0	144
Futures, agreements listed	920	0	0	920	0	2
	69,030	17,987	4,000	91,017	2,573	4,875
Credit derivative contracts:						
Credit default swaps	2,545	2,638	173,309	178,492	75	1
Bond derivatives:						
Bond swaps, agreements unlisted	6,343	4,218	25,155	35,716	71	1,154
Derivatives	685,030	247,409	1,028,099	1,960,538	24,101	50,770

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 30,575 million when calculating the equity ratio of the Bank at 31 December 2006 and ISK 27,158 million at 31 December 2005.

Off Balance Sheet Information

Obligations

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

	2006	2005
Guarantees	324,929	196,793
Credit default swaps, investment grade	217,186	179,147
Unused overdrafts	50,927	42,558
Loan commitments	317,689	165,066

The credit risk is valued at ISK 226 billion (2005: ISK 141 billion) for Guarantees, Credit default swaps, Unused overdrafts and Loan commitments when calculating the equity ratio of the Bank.

Operating lease commitments

95. At 31 December 2006, 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.

96. 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 18 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	6,714

Additional Information

Assets under management and custody

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

	2006	2005
Assets under management	1,403,376	1,073,651
Assets under custody	1,952,813	1,426,448

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

98. 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 (23.0%) and Kjalar Invest B.V. (9.7%). Information regarding related parties are as follows:

Loans to significant related companies:	2006	2005
Balance at the beginning of the year	36,888	26,889
Additions	91,274	28,382
Reductions	(18,606)	(18,383)
Balance at the end of the year	109,556	36,888

Comparison figures in this note have been changed because of a change in the definition of related parties. Balance at the end of year 2005 is ISK 33,823 million higher than in the Financial Statement for the year 2005.

Lýsing, which is a financial institution, supervised by FSA in Iceland, had ISK 39,380 million of the total loans to related parties at the end of year 2006.

98. con'd

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 17,716 million at 31 December 2006 and ISK 7,545 million at 31 December 2005. 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 2006. Transactions with related parties have been conducted on arm's length basis.

Stock options

99. During the year 2006, the Board of Directors of Kaupthing Bank hf. have decided on the basis of the Bank's stock option scheme to grant 564 employees in the Bank stock options to buy shares in the Bank. Stock option holders are entitled to exercise one third of their total stock option every year for three years between 20 January and 20 February, and the first period in which options can be exercised is from 20 January to 20 February 2008. The option has an exercise price of ISK 840 per share. The Board of Directors granted options on a total of 636 thousand shares.

At the same time as granting stock options to all employees, the Board of Directors of the Bank has also granted 455 employees stock options to buy 21.7 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 also from 20 January to 20 February each year, with the first exercise period in 2010. The option has an exercise price of ISK 830 per share during the first exercise period, ISK 872 per share during the 2011 exercise period and ISK 916 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
October 2002	180	Five years of service. The stock option is excercisable 2007	5 years	120
March 2004	3,248	Four years of service. The stock option is exercisable 2007-2008	4 years	303
December 2002	887	Six years of service. One third of total stock option is exercisable each year 2007-2008	6 years	65.22
November 2005	3,593	Three years of service. One third of total stock option is exercisable each year 2007-2009	3 years	600
November 2005	7,815	Three years of service. One third of total stock option is exercisable each year 2007-2009	3 years	600/630/660
December 2006	636	Three years of service. One third of total stock option is exercisable each year 2008-2010	3 years	840
December 2006	21,675	Five years of service. One third of total stock option is exercisable each year 2010-2012	5 years	830/872/916
Total share options	38,034			

99. con'd

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

	2006		2005	
	Weighted average exercise price	Number of options	Weighted average exercise price	Number of options
Outstanding at the beginning of the year	494	20,811	209	12,630
Forfeited during the year	521	(1,447)	112	(376)
Exercised during the year	278	(3,641)	108	(4,085)
Granted during the year	871	22,311	641	12,642
Outstanding at the end of the year	735	38,034	494	20,811

The options outstanding at 31 December 2006 have an exercise price in the range of 65,22 to 916 and a weighted average contractual life of 3.9 years.

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 during the year 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. Expected leave rate is 15% per year (9% for key employees).

The fair value of options granted in 2005 determined using the Black-Scholes valuations model was ISK 1,127 million which will be amortised over contractual life of options. The significant inputs into the model were share prices of 600 (600, 630 and 660 for key management), expected volatility of 15%, option life disclosed above, annual risk free interest rate of 7.4%, and expected dividends yield of 2.3%. The expected volatility is based on the historic volatility over the last 12 months before the grant date.

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 2006 ISK 347 million (2005: ISK 43 million) has been entered among Salaries and related expenses and ISK 360 million (2005: ISK 39 million) in the Balance Sheet as liability.

Events after the Balance Sheet date

100. There have been no material post Balance Sheet events which would require disclosure or adjustments to the 31 December 2006 Financial Statements. On 29 January 2007 the Board of Directors approved the Financial Statements and authorised for publication.

Subsidiaries

101. Shares in main subsidiaries are specified as follows:

Company	Country	Currency	Business Segments[1)]	Share capital in millions	Equity interest accum. %
Arion Custody Service hf.	Iceland	ISK	OD	115	100.0
Eik fasteignafélag hf.	Iceland	ISK	OD	707	100.0
FI-Holding A/S	Denmark	DKK	IB, CM, Tr, Ba, AM&PB	842	100.0
Kaupthing Bank Luxembourg S.A.	Luxembourg	EUR	CM, Tr, Ba, AM & PB	16,611	100.0
Kaupthing Bank Oyj	Finland	EUR	IB, CM, Tr, Ba, AM & PB	1,670	100.0
Kaupthing Føroyar Virdisbrævameklarafelag P/F	Faroe Islands	DKK	IB, CM, AM & PB	112	100.0
Kaupthing Holding UK Ltd. (KTSF)	UK	GBP	IB, CM, Tr, Ba, AM & PB	31,839	100.0
Kaupthing New York Inc.	USA	USD	CM	432	100.0
Kaupthing Norge AS	Norway	NOK	IB, CM, AM & PB	1,433	100.0
Kaupthing Sverige AB	Sweden	SEK	IB, CM, Tr, Ba, AM & PB	2,807	100.0
Kaupthing Líftryggingar hf.	Iceland	ISK	Ba	17	100.0
Kirna ehf.	Iceland	ISK	IB, Tr	31,770	100.0
New Bond Street Asset Management LLP	UK	GBP	Tr	-	100.0
Norvestia Oyj	Finland	EUR	CM	4,455	30.6
Kaupthing Bank Asset Management Company hf.	Iceland	ISK	AM & PB	44	100.0
Vidjar ehf.	Iceland	ISK	Ba	1	100.0
Sparisjódur Kaupthings hf.	Iceland	ISK	Ba	100	100.0

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

The Bank wields 54.4% of the votes in Norvestia Oyj and the company is thus considered to be a subsidiary of the Bank.

Risk Management Information

102. 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 segments: Banking; Asset Management and Private Banking; Investment Banking; Capital Markets and Treasury. It also has ancillary divisions such as Risk Management, Finance, Sales and Marketing, Information Technology, Leagal Department, Back Office and Human Resources.

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 reduce the value of a security or portfolio. 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) 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.

d) 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 Kaupthing's operations as the Bank requires funding to support its investments.

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.

102. con'd

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's 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 Group CEO or his deputy as a member of the Board Credit Committee in each subsidiary. This is necessary since the Group CEO is responsible for maintaining the Bank's exposures within legal and policy limits and then the decision authority needs be included.

The pricing of each credit granted should reflect the risk taken. The client's interests should 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.

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 should 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 should be 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 Kaupthing 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

102. con'd

loss on these accounts is equal to the amount of the limits although they may only be partly used at any one time. In practise, 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:

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 loans 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.

102. con'd

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.

Market risk strategy

Kaupthings 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 price risk of listed and unlisted securities, both shares and bonds, interest rate risk, currency risk or other market variables influenced by market forces.

These investments are either taken as a service to clients for example as an underwriting commitment, a co-investment in an acquisition, market making in capital markets etc. – or the investments are made with the strategy of the Bank in mind and then primarily in financial service companies.

The Bank should keep firm track of the market risk embedded in market investments at Group level and make sure that the total estimated market risk does not exceed the market risk allowance set by the Bank's Board of Directors. The aim is to monitor the market risk in real time so that market risk operations can take the best investment opportunities available at each time without violating their risk limits. Additional provisions are imposed depending on the type of market risk operation.

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.

Interest rate risk

104. Interest-rate risk increased quite significantly at year end 2004 following the introduction of fixed-interest mortgage products, but it remains closely monitored. The table below shows the interest rate risk by currency and maturity. 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.

The total amount of indexed assets of the Bank amounted to ISK 325,845 million (2005: ISK 237,218 million), and the total amount of indexed liabilities amounted to ISK 180,241 million (2005: 129,917 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 reprice 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 repricing 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 100bp simultanously. The table lists the resulting profit and loss broken down by currency and duration buckets for both banking and trading book.

Currency		Within1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
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)
CHF	Trading	51	89	(56)	3	0	87
	Banking	(2)	(40)	(92)	(21)	(37)	(192)
Other	Trading	(762)	196	(44)	735	(15)	110
	Banking	(9)	(68)	(113)	72	(332)	(450)

104. con'd

Currency		Within 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
2005							
ISK	Trading	0	(1)	(1)	(94)	(578)	(674)
	Banking	10	19	2	22	(13,446)	(13,393)
DKK	Trading	162	43	(106)	(865)	(768)	(1,534)
	Banking	(28)	(171)	(367)	(418)	(455)	(1,439)
EUR	Trading	(175)	(156)	(23)	(59)	19	(394)
	Banking	233	358	(25)	261	398	1,225
GBP	Trading	(29)	(33)	(1)	(6)	12	(57)
	Banking	41	251	(146)	(25)	(139)	(18)
USD	Trading	(1)	(33)	(16)	(1)	(1)	(52)
	Banking	39	55	(35)	(123)	(866)	(930)
CHF	Trading	7	2	(2)	0	0	7
	Banking	4	35	(87)	(6)	18	(36)
Other	Trading	0	(13)	(10)	(57)	29	(51)
	Banking	25	26	(27)	5	40	69

The table shows interest rate risk by currency and maturity in millions of ISK. Risk is measured by assuming a 1% simultaneous upward shift in all yields curves in the relevant maturity band.

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 bonds, but the management of currency risk is handled separately. Market price risk is measured with Value-at-Risk, and the total Bank Value at Risk (99%, 10 days) was ISK 5.5 billion (2005: ISK 3.4 billion) at 31 December 2006.

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.

	Iceland	Scandinavia	Other
2006			
Equity risk	989	4,374	10
Interest risk	306	697	
VaR	1,035	4,429	10
Group VaR			5,476
2005			
Equity risk	1,571	2,130	5
Interest risk	232	589	
VaR	1,588	2,209	5
Group VaR			3,446

105. con'd

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

2006	High	Low	Average
Equity risk	6,261	2,150	3,637
Interest risk	585	596	814
Overall risk	6,302	2,218	3,719
2005			
Equity risk	4,022	1,146	2,868
Interest risk	809	373	560
Overall risk	4,004	1,273	2,922

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 quity base against adverse movements in foreign exchange rates. Net exposures per currency are monitored centrally in the Bank.

If the ISK exchange rate index depreciated by 25% from its year end 2006 level then it would affect the equity ratio of the Bank by 0%.

The total amount of assets in foreign currencies in the Bank's Consolidated Financial Statements is ISK 3,437 billion (2005: ISK 2,242 billion), and the total amount of liabilities amounted to ISK 3,048 billion (2005: ISK 2,198 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	Other	Total
Cash and balances with central banks	964	5,986	34,516	65,007	488	106,961
Loans to credit institutions	31,897	128,141	92,504	129,696	103,096	485,334
Loans to customers	351,196	451,171	582,576	553,032	600,634	2,538,609
Bonds and debt instruments	19,330	73,180	158,251	25,198	42,305	318,264
Shares and equity instruments	54,055	40,409	16,609	10,034	37,913	159,020
Derivatives	14,151	19,899	7,560	5,876	17,968	65,454
Derivatives used for hedging	0	1,836	3,500	0	1,117	6,453
Securities used for hedging	101,279	2,429	2,539	803	8,888	115,938
Investments in associates	2,075	0	1,136	11	2,082	5,304
Intangible assets	6,694	173	32,009	28,551	874	68,301
Investment property	14,551	4,202	9,783	3,048	0	31,584
Property and equipment	5,996	686	651	22,594	539	30,466
Tax assets	0	184	0	3,868	1,782	5,834
Other assets	16,606	5,404	74,336	9,555	11,973	117,874
Total assets	618,794	733,700	1,015,970	857,273	829,659	4,055,396

106. con'd

Liabilities and equity	ISK	EUR	DKK	GBP	Other	Total
Due to credit institutions and central banks	11,533	65,411	2,120	6,755	24,637	110,456
Deposits	185,580	104,291	55,553	276,199	129,035	750,658
Borrowings	111,085	1,238,924	47,695	279,304	722,931	2,399,939
Subordinated loans	14,660	76,478	369	6,976	117,547	216,030
Financial liabilities measured at fair value	12,176	7,914	27,068	10,492	13,614	71,264
Tax liabilities	10,161	3,100	5,526	4,199	223	23,209
Other liabilities	13,736	17,082	68,597	22,682	26,851	148,948
Equity and minority interest	324,093	10,774	0	25	0	334,892
Total liabilities and equity	683,024	1,523,974	206,928	606,632	1,034,838	4,055,396
Net on-Balance Sheet position	(64,230)	(790,274)	809,042	250,641	(205,179)	
Net off-Balance Sheet position	(108,554)	843,712	(749,479)	(206,904)	221,225	
Net position	(172,784)	53,438	59,563	43,737	16,046	

Operational risk strategy

107. 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 its 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 should keep firm track of the Operational risk the Bank is exposed to. Measurement should be done through Control and Risk Self Assessment, registration of loss events, near misses and quality deficiencies and through monitoring of potential risk indicators and other early-warning signals. Operational risk can be 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 Segment, 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:

Investment Banking	18%
Trading and sales	18%
Payment and settlement	18%
Corporate Banking	15%
Retail Banking	15%
Agency services	15%
Asset Management	12%
Retail brokerage	12%

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

Liquidity risk strategy

108. Liquidity risk is an unavoidable source of risk in Kaupthings 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 year end the number of days covered by the secured liquidity was 427.

Liquidity of Kaupthing Bank:	Up to 1 month	1-3 month	3-6 months	6-12 months	12-18 months	18-24 months
Secured liquidity	856,000	573,000	360,000	121,000	(136,000)	(237,000)

109. 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	106,961	0	0	0	0	106,961
Loans to credit institutions	87,284	320,642	23,672	47,597	6,139	485,334
Loans to customers	202,564	437,861	326,551	796,445	775,188	2,538,609
Bonds and debt instruments	1,097	53,114	4,861	157,506	101,686	318,264
Shares and equity instruments	88,944	69,912	0	164	0	159,020
Derivatives	4	18,517	12,190	25,176	9,567	65,454
Derivatives used for hedging	0	623	146	1,185	4,499	6,453
Securities used for hedging	115,938	0	0	0	0	115,938
Investments in associates	0	0	0	0	5,304	5,304
Intangible assets	0	0	0	0	68,301	68,301
Investment property	0	0	0	0	31,584	31,584
Property and equipment	0	0	0	0	30,466	30,466
Tax assets	0	0	26	5,808	0	5,834
Other assets	0	0	117,874	0	0	117,874
Assets 31.12.2006	602,792	900,669	485,320	1,033,881	1,032,734	4,055,396
Assets 31.12.2005	484,756	575,861	210,311	602,215	667,668	2,540,811

109. con'd

Liabilities	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	Total
Due to credit institutions and central banks	10,384	90,269	4,045	3,605	2,153	110,456
Deposits	226,966	409,317	86,755	21,459	6,161	750,658
Borrowings	3,569	489,330	442,860	1,105,436	358,744	2,399,939
Subordinated loans	0	0	0	3,437	212,593	216,030
Financial liabilities measured at fair value	3,503	15,658	7,684	32,277	12,142	71,264
Tax liabilities	0	0	10,180	13,029	0	23,209
Other liabilities	91,661	0	57,287	0	0	148,948
Liabilities 31.12.2006	336,083	1,004,574	608,811	1,179,243	591,793	3,720,504
Liabilities 31.12.2005	189,965	616,536	294,778	936,184	300,836	2,338,299
Assets - liabilities 31.12.2006	266,709	(103,905)	(123,491)	(145,362)	440,941	334,892
Assets - liabilities 31.12.2005	294,791	(40,675)	(84,467)	(333,969)	366,832	202,512

Fair value of financial instruments

110. 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.

Assets	Carrying value 2006	Fair value 2006	Unrealised gain (loss) 2006
Cash and balances with central banks	106,961	106,961	0
Loans	3,023,943	3,028,923	4,980
Financial assets measured at fair value	664,965	664,965	0
Financial assets available-for-sale	164	164	0
Liabilities			
Due to credit institutions and central banks	110,456	110,456	0
Deposits	750,658	750,292	366
Borrowings	2,399,939	2,397,319	2,620
Subordinated loans	216,030	217,850	(1,820)
Financial liabilities measured at fair value	71,264	71,264	0
Net unrealised gains not recognised in the Income Statement			6,146

110. con'd

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 as in note 65 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.

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.

b) Fair value established using valuation techniques

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.

Furthermore, 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.

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.

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.

Torben Møller Poulsen
As an expert in investments and the financial world, Torben Møller Poulsen demands a banking partner who can identify opportunities as well as he can. So when it comes to first-class services in investment banking and other financial services, Poulsen turns to Kaupthing Bank.

BOARD OF DIRECTORS

The Board of Directors is composed of nine members, to be elected at Kaupthing Bank's Annual General Meeting for a term of one year. Nine substitute members are also elected.

Sigurdur Einarsson

Sigurdur Einarsson, Executive Chairman

Mr. Einarsson, born in 1960, graduated as an economist from the University of Copenhagen in 1987. Between 1982 and 1988 he worked in the International Department and the Financial Department of Danske Bank. In 1988, he became Deputy Director of the International Division at Íslandsbanki hf. (now Glitnir banki hf.) and later served as Deputy Director of Treasury until he became Executive Director of Capital Markets at Íslandsbanki hf. in 1994. He joined Kaupthing Bank in 1994 and was the Bank's CEO from 1997 to 2003. Mr. Einarsson was appointed Executive Chairman in May 2003. Mr. Einarsson has the following holdings in Kaupthing Bank: 7,368,423 shares, 1,624,000 call options, 0 put options. Holdings of financially related parties: 14,111 shares.

Hjörleifur Thór Jakobsson

Hjörleifur Thór Jakobsson, Deputy Chairman

Mr. Jakobsson, born in 1957, graduated with a degree in mechanical engineering from the University of Iceland in 1981 and later received his MSc in engineering from Oklahoma State University in 1982. He worked for 15 years at Eimskip in various management positions, including Senior Director of Operations. Between 1999 and 2001, he served as the CEO of Hampidjan and was the CEO of Olíufélagid hf. from 2000 to 2006. Mr. Jakobsson currently acts as the CEO of Ker hf. (which plans to merge with Kjalar ehf., the sole shareholder of our second largest shareholder, Kjalar Invest B.V., according to an announcement by Egla hf. to the ICEX on 28 September 2006). Mr. Jakobsson was elected to Kaupthing Bank's Board in 2003. Mr. Jakobsson acts as CEO of Ker hf., Egla hf. Stallasel ehf., Vatnsholt ehf., Bláfeldarhraun ehf. and Heidarás ehf. He is member of the board of directors of Samskip hf., Stallasel ehf., Vatnsholt ehf., Bláfeldarhraun ehf., Festing ehf., Egla hf., Tankurinn ehf., D-3 Eignarhaldsfélag ehf., Heidarás ehf. and Bakkavogur ehf. and chairman of the board of Hekla hf., Iceland Seafood International ehf. and Hafrahlíd ehf. Mr. Jakobsson has the following holdings in Kaupthing Bank: 12,788 shares, 0 call options, 0 put options. Holdings of financially related parties: 8,827 shares.

Finnur Ingólfsson

Finnur Ingólfsson

Mr. Ingólfsson, born in 1954, graduated with a degree in economics from the University of Iceland in 1984. He worked as an assistant to the Minister of Fisheries of Iceland in 1983 and later as an assistant to the Minister of Health and Social Security of Iceland. Between 1991 and 1999 he served as a member of the Icelandic parliament and from 1995 to 1999 he also served as the Minister of Industry and Commerce of Iceland. From 2000 to 2003, he was a governor for the Central Bank of Iceland. He was the CEO of Vátryggingafélag Íslands hf. from 2003 to 2006 and CEO of VÍS eignarhaldsfélag hf. in 2006. Mr. Ingólfsson was elected to Kaupthing Bank's Board in 2003. Mr. Ingólfsson currently acts as chairman of the board of Icelandair Group hf., Icelandair ehf., and Bolmagn ehf.; board member of Foldás ehf., Hvanná ehf., Fikt ehf. and Íshestar ehf.; and CEO of Foldás ehf., Hvanná ehf. and Fikt ehf. Mr. Ingólfsson has the following holdings in Kaupthing Bank: 0 shares, 0 call options, 0 put options. Holdings of financially related parties: 154,000 shares.

Gunnar Páll Pálsson

Gunnar Páll Pálsson

Mr. Pálsson, born in 1961, graduated with a degree in business administration from the University of Iceland in 1987. He has worked for the Commercial Workers' Union of Reykjavík (Verzlunarmannafélag Reykjavíkur) for twelve years as an economist, as the CFO and now the CEO of the union. He was elected to Kaupthing Bank's Board in 2001. Mr. Pálsson serves as a board member of Lífeyrissjódur verslunarmanna and chairman of the board of Máttarstólpar ehf. Mr. Pálsson has the following holdings in Kaupthing Bank: 4,310 shares, 0 call options, 0 put options. Holdings of financially related parties: 5,922 shares.

Brynja Halldórsdóttir

Brynja Halldórsdóttir

Ms. Halldórsdóttir, born in 1957, graduated with a degree in business administration, specializing in macroeconomics from the University of Iceland in 1981. She was CFO of Verslunarbanki (Bank of Commerce) when it merged with three other Icelandic banks in 1989. In 2000, she became the CEO of Norvik hf., one of Iceland's premier international holding companies. In addition to her role as the CEO, she serves as the CFO of all of Norvik's subsidiaries. Ms Halldórsdóttir was elected to Kaupthing Bank's Board in 2004. Ms. Halldórsdóttir is the CEO of Norvik hf., Depo ehf., Ares fjárfestingarfélag ehf. and Byko Lettland ehf. She is a member of the board of Nóatún ehf., 11-11 ehf., Byko hf., EXPO Kópavogur ehf., Kostakaup ehf., Maxbúdin 300 ehf., Krónubúdin ehf., Sparkrónan ehf., Smáragardur ehf., Kaupás hf., CW Ltd. UK and Wayland Timber Ltd. UK. Ms. Halldórsdóttir has the following holdings in Kaupthing Bank: 9,206 shares, 0 call options, 0 put options. Holdings of financially related parties: 13,112,048 shares. Holdings of financially related parties according to forward contracts: 4,817,500 shares.

Tommy Persson

Tommy Persson

Mr. Persson, born in 1948, is the CEO of Länsförsäkringar AB for which he also serves as a member of the Board. In addition, he is vice-chairman of the Swedish Insurance Employers' Federation and EurAPCO AG. He is also a member of the board of Eureko BV. Mr. Persson was elected to Kaupthing Bank's Board in 2002. Mr. Persson has the following holdings in Kaupthing Bank: 5,000 shares, 0 call options, 0 put options. Holdings of financially related parties: 0 shares.

Ásgeir Thoroddsen

Ásgeir Thoroddsen

Mr. Thoroddsen, born in 1942, graduated with a Cand. Jur. degree from the University of Iceland in 1967 and later received a degree in public administration from New York University in 1971. Since 1977, he has been an attorney to the Supreme Court of Iceland. Mr. Thoroddsen was elected to Kaupthing Bank's Board in 2003. Mr. Thoroddsen serves as chairman of the board of Frjálsi lífeyrissjódurinn, Intrum á Íslandi ehf., Íshestar ehf. and Ako/Plastos hf. and as member of the board of Audur hf., Ísgengi ehf., ÁGT ehf., and Bakkavör Group hf. Mr. Thoroddsen has the following holdings in Kaupthing Bank: 718 shares, 0 call options, 0 put options. Holdings of financially related parties: 501 shares.

Niels de Coninck-Smith

Niels de Coninck-Smith

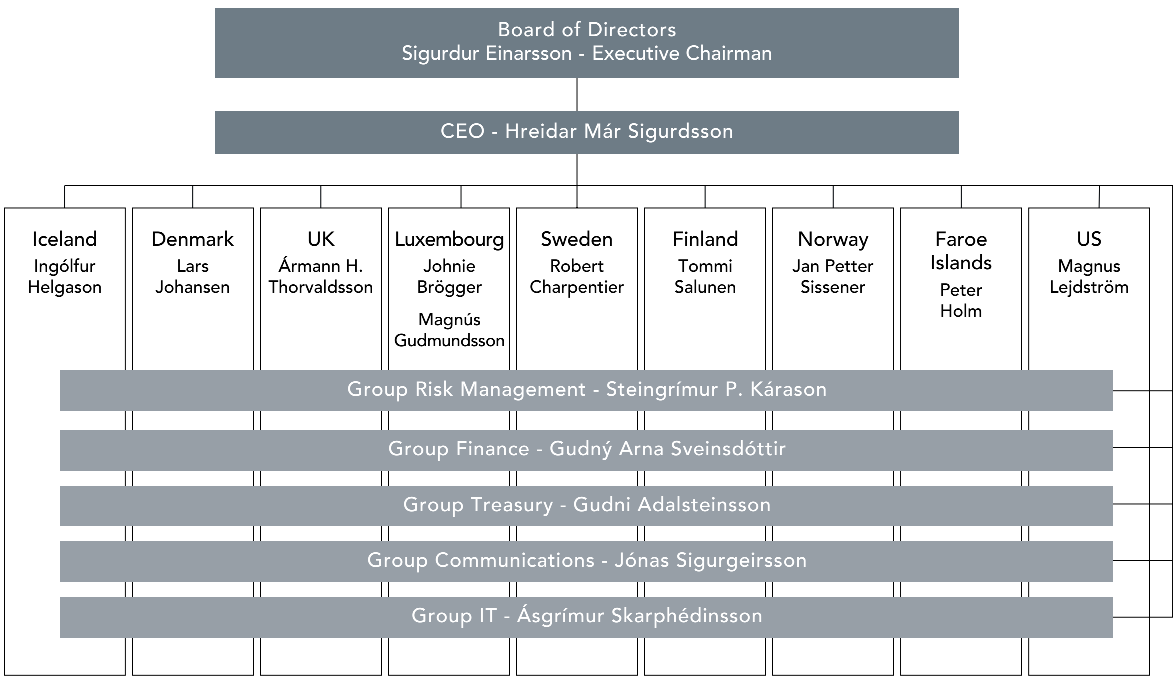
Mr. de Coninck-Smith, born in 1956, graduated with a MSc in 1980 from the Copenhagen School of Business and later received a masters in business administration concentrating in finance from the Wharton School of the University of Pennsylvania in 1982. From 1982 to 2002, he worked with McKinsey & Co. in a variety of capacities, including as a consultant, engagement manager, principal and director. Since 2002 he has acted as the CEO of Ferrosan A/S. Mr. de Coninck-Smith was elected to Kaupthing Bank's Board in 2005. Mr. de Coninck-Smith currently serves as a board member of Contura A/S, Carefarm A/S, Copenhagen International School and FVS A/S. Mr. de Coninck-Smith has the following holdings in Kaupthing Bank: 5,500 shares, 0 call options, 0 put options. Holdings of financially related parties: 0 shares.

Bjarnfredur H. Ólafsson

Bjarnfredur H. Ólafsson

Mr. Ólafsson, born in 1967, graduated with a Cand. Jur. degree from the University of Iceland in 1993, a masters of law in comparative law from the University of Miami School of Law in 1997 and a degree in international business administration from Nova Southeastern University School of Business & Entrepreneurship in 1998. From 1993 to 1996, he acted as senior attorney for the Icelandic Internal Revenue Service. In 1999, he co-founded and began work as a managing partner for Taxis Attorneys, which specializes in tax and company legislation and commercial agreements. He recently joined Logos Legal Services as a partner and head of the tax division. He serves as the national representative of the International Business and Tax Committee of the International Bar Association and is an attorney to the District Court of Iceland. Mr. Ólafsson was elected to Kaupthing Bank's Board in 2003. Mr. Ólafsson serves as CEO of Einsær hf. He is currently a chairman of the board of Generated Investments Íslandi ehf., OneSource Finance ehf. and Ex-Ice Íslandi ehf. and a board member of Einsær hf., Medalfell ehf. and Ufsastadir ehf. Mr. Ólafsson was elected to the board of Kaupthing Bank in 2003. He has the following holdings in Kaupthing Bank: 176 shares, 0 call options, 0 put options. Holdings of financially related parties: 352 shares.

SENIOR MANAGEMENT



Group Management

Hreidar Már Sigurdsson

Chief Executive Officer (CEO)

Mr. Sigurdsson, born in 1970, graduated with a degree in business administration from the University of Iceland in 1994 and joined Kaupthing's Asset Management Division later that year. He was appointed as our Deputy CEO in 1998 and served as Managing Director of Kaupthing New York Inc. from its inception in 2000 until 2001. In 2003, Mr. Sigurdsson was appointed as the CEO of Kaupthing Bank. He also served as the CEO of our operations in Iceland until September 2005, when a separate CEO was appointed for Iceland and Mr. Sigurdsson's responsibilities shifted focus to directing operations for the Kaupthing Bank Group.

Mr. Sigurdsson has the following holdings in Kaupthing Bank: 0 shares, 1,624,000 call options, 0 put options. Holdings of financially related parties: 6,572,039 shares. Related parties' rights according to a forward contract: 205,078 shares.

Gudný Arna Sveinsdóttir

Chief Financial Officer (CFO)

Ms. Sveinsdóttir, born in 1966, graduated with a degree in business administration from the University of Iceland in 1991 and later received a master's in finance and accounting from the University of Uppsala in 1996. From 1996 to 1997, she performed auditing work for several large international companies in Stockholm while working for Öhrlings Coopers & Lybrand (now ÖhrlingsPWC). Between 1997 and 2001, she worked as a Director of Accounting at Eimskip. In 2001, Ms. Sveinsdóttir became our Director of Accounting and was appointed as the Bank's Director of Finance & Accounting in May 2003. In 2005, Ms. Sveinsdóttir became the Bank's Chief Financial Officer.

Steingrímur Kárason

Chief Risk Officer (CRO)

Mr. Kárason, born in 1968, graduated with a degree in mechanical engineering from the University of Iceland in 1991, and later received a MSc in engineering in 1993 and a Ph.D. in 1997, both from the Massachusetts Institute of Technology. Mr. Kárason joined us in 1997 and worked in our Derivatives and Currency department until becoming the Bank's Chief Risk Officer in 1998.

Ásgrímur Skarphédinsson

Chief Information Officer (CIO)

Mr. Skarphédinsson, born in 1958, graduated with a bachelor of science degree in electrical engineering from Odense Teknikum in Denmark in 1982. After working as Head of the Systems Department for Skrifstofuvélar hf., he founded and managed Traffice Software. After that company was sold in 1995, he joined EJS to establish its Microsoft Consultancy Department. In 1997, Mr. Skarphédinsson joined Kaupthing Bank as Head of Information Technology and, in 2004, he was assigned to oversee the integration of the computer systems for all of the Bank's subsidiaries. In 2005, Mr. Skarphédinsson became Kaupthing Bank's Chief Information Officer.

Gudni Adalsteinsson

Chief Treasurer

Mr. Adalsteinsson, born in 1967, graduated with a bachelor of science degree in economics from the University of Iceland in 1991, and later received a masters in business administration from Cambridge University in 1998. He worked as an economist for the Federation of Icelandic Employers, from 1992 to 1997. Between 1998 and 2004, he served as a Director in the Fixed Income Division of Lehman Brothers in London and Frankfurt and between 2004 and 2005 he was a Director in the Fixed Income Division of Credit Suisse in Frankfurt. Mr. Adalsteinsson became Kaupthing Bank's Group Treasurer in 2005.

Jónas Sigurgeirsson

Chief Communications Officer (CCO)

Mr. Sigurgeirsson, born in 1968, graduated with a degree in history from the University of Iceland in 1992 and later pursued MBA studies at the University of Tampa from 1999 to 2000. Between 1993 and 1999, he managed a private publishing company. Mr. Sigurgeirsson joined the Bank's Investment Banking division in 2000, became Kaupthing Bank's Head of Investor Relations in 2003 and in 2005 he was appointed the Bank's Chief Communications Officer.

At year end the five Group Managing Directors owned in total 1.6 million shares in stock options and 4.6 million shares.

Managing Directors of Group Activities

Helgi Bergs

Global Head of Investment Banking

Mr. Bergs, born in 1966, graduated with a CS in mechanical engineering from the University of Iceland in 1993. From 1993 to 1997 he worked for Iceland Seafood both in Iceland and in the United Kingdom. In 1997 he joined Kaupthing in Corporate Finance, becoming Deputy Global Head of Corporate Finance in 2001. Mr. Bergs has been based in London since 2003 when he was appointed Managing Director of Kaupthing Limited. In 2005 Helgi was named Global Head of Investment Banking, overseeing the Group's global investment banking activities from the Bank's current offices in London, Kaupthing Singer & Friedlander.

Jan Petter Sissener

Global Head of Global Equity

In addition to Mr. Sissener's position as Head of Global Equity, he is also the Managing Director of Kaupthing Norge. For more detailed information on Mr. Sissener, please see his entry below under Managing Directors of Main Subsidiaries.

Managing Directors of Main Subsidiaries

Ingólfur Helgason

CEO of Kaupthing Bank in Iceland

Mr. Helgason, born in 1967, graduated with a degree in business administration from the University of Iceland in 1993, and in 1998 he became a licensed stockbroker. He joined Kaupthing in 1993, first as a private investor adviser and later in brokerage. Mr. Helgason was the Director of Capital Markets from 1997 to 2005, when he assumed the position of CEO of Kaupthing Bank in Iceland.

Mr. Helgason serves as the CEO of Kirna ehf. He is currently a board member of Sparisjódur Kaupthings hf. (chairman), Eik fasteignafélag hf., Eignarhaldsfélag Verdbréfathings hf., Kirna ehf., Kauphöll Íslands hf. and Verdbréfaskráning Íslands hf.

Mr. Helgason has the following holdings in Kaupthing Bank: 3,300,075 shares, 460,000 call options, 0 put options. Holdings of financially related parties: 0 share

Lars Johansen

CEO of FIH Erhvervsbank (Denmark)

Mr. Johansen, born in 1945, graduated with a master's degree in economics from the University of Copenhagen in 1970, followed by a PMD from Harvard Business School in 1984. From 1967 to 1993 Mr. Johansen worked for Privatbanken and Unibank in Copenhagen. From 1977 to 1985 he managed their capital markets and trading operations and from 1985 to 1993 he was a member of the Executive Board of Privatbanken and later Unibank A/S. From 1993 to 1996 Mr. Johansen ran his own advisory company, Johansen & Co., consulting on matters of corporate finance, and in 1996 he became CEO of the Copenhagen Stock Exchange. Since 1998 Mr. Johansen has served as the CEO of FIH Erhvervsbank A/S.

Mr Johansen has the following holdings in Kaupthing Bank: 0 shares, 4,000 call options, 0 put options. Holdings of financially related parties: 0 shares.

Ármann Thorvaldsson

Managing Director of Kaupthing Singer & Friedlander (UK)

Mr. Thorvaldsson, born in 1968, graduated with a BA in history from the University of Iceland in 1992 and later received his MBA from Boston University in 1994. He joined Kaupthing in 1994 as Director of Planning and Budgeting, later becoming Director of Corporate Finance in 1997 (which later became Investment Banking). In 2005 he was appointed managing director of Singer & Friedlander, which became Kaupthing Singer & Friedlander in 2006.

Tommi Salunen

Managing Director of Kaupthing Bank Oyj (Finland)

Mr. Salunen, born in 1972, graduated with a M.Sc. in economics with a focus on finance from the Helsinki School of Economics. In 1998 he joined Nordea Corporate Finance (Merita Corporate Finance) as an analyst, and later worked as associate director before becoming director. He continued with Nordea until 2006, most recently as Managing Director of Corporate Finance in Helsinki. Mr. Salunen has a strong background in M&A, leveraged finance, and private equity. In 2006 he was appointed Managing Director of Kaupthing Bank Oyj.

Jan Petter Sissener

Managing Director of Kaupthing Norge (Norway) – Global Head of Equity

Mr. Sissener, born in 1955, graduated with a degree in economics from the Institute of Business Administration in Oslo in 1980. He then worked in brokerage for Einar H. Vestnes until 1983, at which time he became a partner in Gunnar, Bohn & Co. In 1986 be began working for Carnegie in London and Norway, finally becoming partner in 1989. From 1994 to 2002 he served as the Norwegian Head of Equities for Orkla Finans, and from 2002 to 2003 as Norwegian Head of Equities for Alfred Berg ABN AMRO Norway. He was then Nordic Head of Equities for the same company from 2003 to 2005. Finally, in 2005 Mr. Sissener was appointed Managing Director of Kaupthing Norway.

Johnie W. Brøgger

Managing Director of Kaupthing Bank Luxembourg

Mr. Brøgger, born in 1958, graduated in 1986 from the Copenhagen School of Economics and Business Administration with a master's degree in accounting. From 1976 to 1986 he worked for Bikuben (today part of Danske Bank). From 1981 to 1985 he served in the Bank's head office in Copenhagen, working with corporate clients primarily in the Central Credit Department. In 1986 Mr. Brøgger began his work as Regional Manager and later as General Manager for Union Bank of Norway in Luxembourg until 1994, which included overseeing relationships with financial institutions in Iceland, Denmark, Sweden, Finland and northern Germany. Before joining Kaupthing in December 1999 he acted as General Manager and Deputy to the Managing Director of Nordvestbank (today known as VestjyskBank) in Denmark.

Magnús Gudmundsson

Managing Director of Kaupthing Bank Luxembourg

Mr. Gudmundsson, born in 1970, graduated with a degree in business administration from the University of Iceland in 1994, specializing in accounting and auditing. After graduation he joined Kaupthing as an investment adviser for private individuals, later becoming the head of the department. In 1996 Mr. Gudmundsson began managing Private Banking & Asset Management for Kaupthing Bank until 1998, when he took on the responsibility of establishing and managing Kaupthing Bank's operations in Luxembourg.

Magnus C. Lejdström

Managing Director of Kaupthing New York (US)

Mr. Lejdström, born in 1969, graduated from the University of Vermont, School of Business in 1991 with a BS in business administration, focusing on finance. After graduation he joined Svenska Handelsbanken in New York where he became a member of the corporate banking team. In 1996 he joined Skandinaviska Enskilda Banken as a Vice President and served as a Client Executive, Head of US Corporate Clients and as a senior member of SEB Management in New York until 2000. He then became a member of the management team and a partner with Nordic Partners Inc. Mr. Lejdström joined Kaupthing Bank from Credit Agricole Cheuvreux in 2004, as Managing Director of Kaupthing Securities Inc, and in 2005 became President of Kaupthing Securities Inc. and Managing Director of Kaupthing New York.

Peter Holm

Managing Director of Kaupthing Føroyar (Faroe Islands)

Mr. Holm, born in 1968, graduated with a BSc in computer science and economics from the Copenhagen Business School in 1992, later receiving his MSc in finance and accounting in 1995 from the same school. During his studies Peter also pursued fixed income research with Bikuben Securities Company in Copenhagen. In 1995 he began working as Managing Director of Finance at Føroya Banki until 2000. At that point Mr. Holm became Managing Director of Kaupthing Føroyar.

Robert Charpentier

Managing Director of Kaupthing Bank Sverige (Sweden)

Mr. Charpentier, born in 1965, graduated with a MSc in economics with a focus on international finance from the Swedish School of Economics and Business Administration in Helsinki in 1989. He joined Goldman, Sachs & Co. in London in 1989 where he worked as an analyst and associate before becoming the Executive Director of Debt Capital Markets for Nordic clients. In 1997 Mr. Chapentier moved to Sweden and became Senior Vice President, Head of Corporate Banking, for Swedbank Markets, the investment and merchant banking unit of the Swedbank Group. In 2000 he was promoted to the position of Executive Vice President at the Swedbank Group as Deputy Head of Swedbank Markets. Finally, in 2006 Mr. Charpentier was appointed Managing Director of Kaupthing Bank Sweden.