



KAUPTHING BANK

KAUPTHING BANK HF.

(incorporated in Iceland as a public limited company)

€12,000,000,000

Euro Medium Term Note Programme

Under this €12,000,000,000 Euro Medium Term Note Programme (the "**Programme**"), Kaupthing Bank hf. (the "**Issuer**") may from time to time issue notes (the "**Notes**") denominated in any currency agreed between the Issuer and the relevant Dealer (as defined below). Prior to the date of this Base Prospectus the maximum nominal amount of the Programme was €8,000,000,000.

The maximum aggregate nominal amount of all Notes from time to time outstanding under the Programme will not exceed €12,000,000,000 (or its equivalent in other currencies calculated as described in the Programme Agreement described herein), subject to increase as described herein.

The Notes may be issued on a continuing basis to one or more of the Dealers specified under "**Summary of the Programme**" and any additional Dealer appointed under the Programme from time to time by the Issuer (each a "**Dealer**" and together the "**Dealers**"), which appointment may be for a specific issue or on an ongoing basis. References in this Base Prospectus to the "**relevant Dealer**" shall, in the case of an issue of Notes being (or intended to be) subscribed by more than one Dealer, be to all Dealers agreeing to purchase such Notes.

An investment in Notes issued under the Programme involves certain risks. For a discussion of these see "**Risk Factors**".

Application has been made to the *Commission de Surveillance du Secteur Financier* (the "**CSSF**") in its capacity as competent authority under the Luxembourg Act dated 10th July, 2005 on prospectuses for securities to approve this document as a base prospectus. Application has also been made to the Luxembourg Stock Exchange for Notes issued under the Programme to be admitted to trading on the Luxembourg Stock Exchange's regulated market and to be listed on the Official List of the Luxembourg Stock Exchange.

Notice of the aggregate nominal amount of Notes, interest (if any) payable in respect of Notes, the issue price of Notes and any other terms and conditions not contained herein which are applicable to each Tranche (as defined under "**Terms and Conditions of the Notes**") of Notes will be set out in the final terms (the "**Final Terms**") which, with respect to Notes to be listed on the Luxembourg Stock Exchange, will be filed with the CSSF.

The Programme provides that Notes may be listed or admitted to trading, as the case may be on such other or further stock exchanges or markets as may be agreed between the Issuer and the relevant Dealer. The Issuer may also issue unlisted Notes and/or Notes not admitted to trading on any market.

The Issuer may agree with any Dealer that Notes may be issued in a form not contemplated by the Terms and Conditions of the Notes herein, in which event a Supplemental Base Prospectus under the Programme, if appropriate, will be made available which will describe the effect of the agreement reached.

Arranger Credit Suisse

Dealers

**Barclays Capital
Daiwa Securities SMBC Europe
Dresdner Kleinwort
Kaupthing Bank**

**Credit Suisse
Deutsche Bank
IXIS Corporate & Investment Bank
SEB Merchant Banking**

This Base Prospectus comprises a base prospectus for the purposes of Article 5.4 of Directive 2003/71/EC (the “*Prospectus Directive*”).

The Issuer having taken all reasonable care to ensure that such is the case made all reasonable enquiries, confirms that the information contained in this Base Prospectus is to the best of the knowledge of the Issuer in accordance with the facts and contains no omission likely to affect its import. The Issuer accepts responsibility accordingly.

The Dealers have not independently verified the information contained herein. Accordingly, no representation, warranty or undertaking, express or implied, is made and no responsibility or liability is accepted by the Dealers as to the accuracy or completeness of the information contained or incorporated in this Base Prospectus or any other information provided by the Issuer in connection with the Programme. No Dealer accepts any liability in relation to the information contained or incorporated by reference in this Base Prospectus or any other information provided by the Issuer in connection with the Programme.

No person is or has been authorised by the Issuer to give any information or to make any representation not contained in or not consistent with this Base Prospectus or any other information supplied in connection with the Programme or the Notes and, if given or made, such information or representation must not be relied upon as having been authorised by the Issuer or any of the Dealers. This Base Prospectus may only be used for the purposes for which it has been published.

Neither this Base Prospectus nor any other information supplied in connection with the Programme or any Notes (i) is intended to provide the basis of any credit or other evaluation or (ii) should be considered as a recommendation by the Issuer or any of the Dealers that any recipient of this Base Prospectus or any other information supplied in connection with the Programme or any Notes should purchase any Notes. Each investor contemplating purchasing any Notes should make its own independent investigation of the financial condition and affairs, and its own appraisal of the creditworthiness, of the Issuer. Neither this Base Prospectus nor any other information supplied in connection with the Programme or the issue of any Notes constitutes an offer or invitation by or on behalf of the Issuer or any of the Dealers to any person to subscribe for or to purchase any Notes.

Neither the delivery of this Base Prospectus nor the offering, sale or delivery of any Notes shall in any circumstances imply that the information contained herein concerning the Issuer is correct at any time subsequent to the date hereof or that any other information supplied in connection with the Programme is correct as of any time subsequent to the date indicated in the document containing the same. The Dealers expressly do not undertake to review the financial condition or affairs of the Issuer during the life of the Programme or to advise any investor in the Notes of any information coming to their attention. Investors should review, *inter alia*, the most recently published documents incorporated by reference into this Base Prospectus when deciding whether or not to purchase any Notes.

The Notes have not been and will not be registered under the United States Securities Act of 1933, as amended, (the “*Securities Act*”) and are subject to U.S. tax law requirements. Subject to certain exceptions, the Notes may not be offered, sold or delivered within the United States or to, or for the account or benefit of, U.S. persons (see “*Subscription and Sale*” below).

This Base Prospectus does not constitute an offer to sell or the solicitation of an offer to buy any Notes in any jurisdiction to any person to whom it is unlawful to make the offer or solicitation in such jurisdiction. The distribution of this Base Prospectus and the offer or sale of Notes may be restricted by law in certain jurisdictions. The Issuer and the Dealers do not represent that this Base Prospectus may be lawfully distributed, or that any Notes may be lawfully offered, in compliance with any applicable registration or other requirements in any such jurisdiction, or pursuant to an exemption available thereunder, or

assume any responsibility for facilitating any such distribution or offering. In particular, no action has been taken by the Issuer or the Dealers which would permit a public offering of any Notes or distribution of this document in any jurisdiction where action for that purpose is required. Accordingly, no Notes may be offered or sold, directly or indirectly, and neither this Base Prospectus nor any advertisement or other offering material may be distributed or published in any jurisdiction, except under circumstances that will result in compliance with any applicable laws and regulations. Persons into whose possession this Base Prospectus or any Notes may come must inform themselves about, and observe, any such restrictions on the distribution of this Base Prospectus and the offering and sale of Notes. In particular, there are restrictions on the distribution of this Base Prospectus and the offer or sale of Notes in the United States, the European Economic Area (including the United Kingdom, Italy and Iceland) and Japan, see “*Subscription and Sale*”.

All references in this document to “*U.S. dollars*”, “*U.S.\$*” and “*\$*” refer to United States dollars, to “*ISK*”, “*krona*” or “*krónur*” refer to the currency of Iceland, to “*Japanese Yen*” and “*Yen*” refer to the currency of Japan, to “*Swiss francs*” refer to the currency of Switzerland, to “*Sterling*” and “*£*” refer to pounds sterling and to “*euro*” and “*€*” refer to the currency introduced at the start of the third stage of European economic and monetary union pursuant to the Treaty establishing the European Community, as amended.

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In connection with the issue of any Tranche of Notes, the Dealer or Dealers (if any) named as the Stabilising Manager(s) (or persons acting on behalf of any Stabilising Manager(s)) in the applicable Final Terms may over-allot Notes (provided that, in the case of any Tranche of Notes to be admitted to trading on a regulated market in the European Economic Area, the aggregate principal amount of Notes allotted does not exceed 105 per cent. of the aggregate principal amount of the relevant Tranche) or effect transactions with a view to supporting the market price of the Notes at a level higher than that which might otherwise prevail. However, there is no assurance that the Stabilising Manager(s) (or persons acting on behalf of a Stabilising Manager) will undertake stabilisation action. Any stabilisation action may begin on or after the date on which adequate public disclosure of the final terms of the offer of the relevant Tranche of Notes is made and, if begun, may be ended at any time, but it must end no later than the earlier of 30 days after the issue date of the relevant Tranche of Notes and 60 days after the date of the allotment of the relevant Tranche of Notes.

SUMMARY OF THE PROGRAMME

This summary must be read as an introduction to this Base Prospectus and any decision to invest in any Notes should be based on a consideration of this Base Prospectus as a whole, including the documents incorporated by reference. Following the implementation of the relevant provisions of the Prospectus Directive in each Member State of the European Economic Area no civil liability will attach to the Issuer in any such Member State in respect of this Summary, including any translation hereof, unless it is misleading, inaccurate or inconsistent when read together with the other parts of this Base Prospectus. Where a claim relating to information contained in this Base Prospectus is brought before a court in a Member State of the European Economic Area, the plaintiff may, under the national legislation of the EEA State where the claim is brought, be required to bear the costs of translating the Base Prospectus before the legal proceedings are initiated. Words and expressions defined in "Form of the Notes" and "Terms and Conditions of the Notes" below shall have the same meanings in this summary.

Issuer: Kaupthing Bank hf. is a Northern European bank with shares listed on the Iceland Stock Exchange and the Stockholm Stock Exchange. It operates in ten countries, including all the Nordic countries, the United Kingdom, Luxembourg, Switzerland and the United States and two of the world's main business centres, London and New York. It holds banking licenses in six countries: Iceland, the United Kingdom, Denmark, Sweden, Finland and Luxembourg. In the United States, it operates through its subsidiary Kaupthing Securities Inc., a licensed broker-dealer. The United Kingdom, Iceland and Scandinavia currently are its most important markets, generating 34 per cent., 30 per cent. and 26 per cent., respectively, of its net operating income in 2005.

The Issuer offers integrated financial services to companies, institutional investors and individuals. Its services include investment banking, corporate banking, capital markets services and asset management and comprehensive wealth management for private banking clients. In addition, it operates a retail banking franchise in Iceland, where it has its headquarters and, to a lesser extent, in Sweden.

The Issuer is currently one of the eight largest banks in the Nordic region in terms of market capitalisation. It has expanded through organic growth and strategic acquisitions, such as the acquisition of FIH Erhvervsbank A/S in July 2004 for ISK 85,868 million and the more recent acquisition of UK-based bank Singer & Friedlander Group plc in July 2005 for ISK 63,708 million. The Issuer believes that these acquisitions have improved the quality of its loan portfolio and increased the diversification of its operations. However, FIH, being a wholesale commercial bank, generates lower interest margins than other parts of the Issuer's banking operations.

The Issuer operates across five core business segments:

- Investment Banking;
- Banking;
- Capital Markets;
- Treasury; and
- Asset Management and Private Banking.

In addition, the Issuer operates a number of ancillary units such as Risk Management, Information Technology, Finance and Sales and Marketing.

The Issuer believes that its results for 2005 reflect its focus on Northern Europe, which it considers to be its home market. Approximately 70 per cent. of its income in 2005 was generated outside Iceland. The Issuer expects this percentage to increase in 2006, as it seeks to expand its activities in Finland, Luxembourg and the United Kingdom.

The following tables summarise the Issuer's profit and loss accounts and balance sheets and provide certain key ratios as at 31st December in each of 2005 and 2004:

EUR Millions

(except where otherwise stated)

	<u>2005</u>	<u>2004</u>
Income Statement		
Net interest income	438	219
Net fee and commission income	300	159
Net financial income	499	195
Other income	120	25
Operating Income	1,357	598
Operating expenses	(465)	(283)
Impairment	(59)	(46)
Taxes	(150)	(51)
Minority interest	(24)	(7)
Net earnings	659	212

31.12.2005 01.01.2005

Balance Sheet

Assets

Cash and cash balances and central banks	467	75
Loans and advances	23,284	13,824
Financial assets measured at fair value	8,198	3,646
Financial assets available-for-sale	2	18
Investments in associates	186	44
Other assets	1,877	1,008
Total assets	34,014	18,614

Liabilities and equity

Deposits from credit institutions and central banks	932	389
Other deposits	6,508	2,421
Borrowings	20,838	11,598
Subordinated loans	1,375	690
Other liabilities and minority interest	1,761	1,728
Shareholders' equity	2,600	1,789
Total liabilities and equity	34,014	18,614

31.12.2005 01.01.2005

Key Ratios

Cost/income ratio	34.1%	47.3%
Return on shareholders' equity	34.0%	25.5%
Impairment on loans and advances for the year	0.1%	0.4%
Impairment on loans and advances at year-end	0.7%	1.4%
CAD ratio.....	12.2%	14.2%
Earnings per share (ISK)	75.2	35.6
Earnings per share diluted (ISK).....	73.9	35.1
P/E ratio.....	9.9	12.4

For further information on the financial results of the Issuer, please see the financial statements of the Issuer for the year ended 31st December, 2004 and 2005, incorporated by reference into this Base Prospectus.

Risk Factors:

There are certain factors that may affect the Issuer's ability to fulfil its obligations under the Notes issued under the Programme. These are set out under "*Risk Factors*" below and include (i) the risk that the Issuer's results can be adversely affected by general economic conditions and other business conditions, (ii) the risk that the substantial competitive pressures which the Issuer faces could adversely affect its results of operations, (iii) the risk that the Issuer may be unable to continue growing at historic levels due to a lack of acquisition opportunities and other acquisition related risks, (iv) the risk that regulatory change or enforcement initiatives could adversely affect the Issuer's business and (v) a range of standard banking risks including changes in interest rates and foreign exchange rates and operational, credit, market and liquidity risk, any of which may have an adverse affect on the Issuer's credit ratings and its cost of funds. In addition, there are certain factors which are material for the purpose of assessing the market risks associated with Notes issued under the Programme. These are set out under "*Risk Factors*" below and include the fact that the Notes may not be a suitable investment for all investors and the risks related to the structure of a particular issue of Notes.

Description:

Euro Medium Term Note Programme

Arranger:

Credit Suisse Securities (Europe) Limited

Dealers:

Barclays Bank PLC
 Credit Suisse Securities (Europe) Limited
 Daiwa Securities SMBC Europe Limited
 Deutsche Bank AG, London Branch
 Dresdner Bank Aktiengesellschaft
 IXIS Corporate & Investment Bank
 Kaupthing Bank hf.
 Skandinaviska Enskilda Banken AB (publ)

and any other Dealers appointed in accordance with the Programme Agreement.

Issuing and Principal Paying Agent:	Deutsche Bank AG, London Branch
Programme Size:	Up to €12,000,000,000 (or its equivalent in other currencies calculated as described under “ <i>General Description of the Programme</i> ”) outstanding at any time. The Issuer may increase the amount of the Programme in accordance with the terms of the Programme Agreement.
Notes issued under the Programme:	<p>The Issuer may issue fully or partly paid Notes, denominated in any currency agreed between the Issuer and the relevant Dealer, at an issue price which is at par or at a discount to, or premium over, par.</p> <p>Senior Notes, Subordinated Notes or Capital Notes may be issued under the Programme.</p> <p>The Notes may be issued on a continuing basis to one or more of the Dealers and any additional Dealer appointed under the Programme from time to time by the Issuer, which appointment may be for a specific issue or on an ongoing basis.</p> <p>Notes may be distributed by way of private or public placement, subject to the restrictions set out under “Subscription and Sale”, and in each case on a syndicated or non-syndicated basis.</p> <p>Notes may be issued as Fixed Rate Notes, Floating Rate Notes, Index Linked Notes, Dual Currency Notes or Zero Coupon Notes.</p> <p>Notes may be issued for any maturity greater than one month or such other minimum or maximum maturity as may be allowed or required from time to time by the relevant central bank (or equivalent body) or any laws or regulations applicable to the Issuer or the relevant Specified Currency.</p> <p>Notes may be issued which cannot be redeemed prior to their stated maturity (other than in specified instalments, if applicable, or for taxation reasons or following an Event of Default) or which are redeemable at the option of the Issuer and/or the holders of the Notes upon giving notice to the holders of the Notes or the Issuer, as the case may be, on a date or dates specified prior to such stated maturity and at a price or prices and on such other terms as may be agreed between the Issuer and the relevant Dealer.</p>

RISK FACTORS

The Issuer believes that the following factors may affect its ability to fulfil its obligations under Notes issued under the Programme. Most of these factors are contingencies which may or may not occur and the Issuer is not in a position to express a view on the likelihood of any such contingency occurring.

In addition, factors which are material for the purpose of assessing the market risks associated with Notes issued under the Programme are also described below.

The Issuer believes that the factors described below represent the principal risks inherent in investing in Notes issued under the Programme, but the inability of the Issuer to pay interest, principal or other amounts on or in connection with any Notes may occur for other reasons which may not be considered significant risks by the Issuer based on information currently available to it or which it may not currently be able to anticipate.

Prior to making any investment decision, prospective investors and their financial and legal advisers should carefully consider all of the information in this document and, in particular, the risks and uncertainties described below should be considered carefully. In particular, Notes denominated or payable in or determined by reference to a foreign or composite currency or to one or more interest rates, currencies or other indices or formulas are not an appropriate investment for investors who are unsophisticated with respect to foreign currency transactions or transactions involving the applicable interest rate or currency index or other indices or formulas. The matters described below, among other factors, should be carefully considered by any prospective investor.

This document contains forward looking statements that involve inherent risks and uncertainties. Actual results may differ significantly from the results discussed in such forward-looking statements. Factors that might cause such differences include those discussed below.

All references to “we”, “us” and “our” under “Factors that may affect the Issuer’s ability to fulfil its obligations under the Notes issued under the Programme” are references to the Issuer.

Factors that may affect the Issuer’s ability to fulfil its obligations under Notes issued under the Programme

Our financial condition and results of operations may be adversely affected by movements in interest rates.

In recent years, our results of operations have depended to a great extent on earnings attributable to net interest income. Net interest income represented approximately 32 per cent. of our operating income in 2005, approximately 37 per cent. in 2004 and approximately 32 per cent. of net operating income in 2003.

Our financial operations are dependent on interest rate and other monetary policies of governments and central banks in the jurisdictions in which we operate as well as changes to such policies. For example, loans with fixed rates will become less profitable if interest rates rise. In particular, the policies of the Economic and Monetary Union of the European Union, the United Kingdom, Iceland, Denmark and Sweden are significant for us and are subject to change. We currently are operating in an increasing interest rate environment. A significant portion of our liabilities are short to medium term and we may have to refinance these obligations at higher rates. At 31st December, 2005, ISK 921,039 million or 42.4 per cent. of our total financial liabilities matured in one to five years while ISK 598,613 million of our financial assets matured in that period. The European Central Bank raised interest rates once between 31st December, 2004 and 31st December, 2005, from 3.00 per cent. to 3.25 per cent., and three times since then on 8th March, 2006 to 3.50 per cent., on 15th June, 2006 to 3.75 per cent. and on 9th August, 2006 to 4.00 per cent. The Central Bank of Iceland raised interest rates five times between 31st December, 2004 and 31st December, 2005 from 8.25 per cent. to 10.50 per cent., and five times since then

on 26th January, 2006 to 10.75 per cent., on 4th April, 2006 to 11.50 per cent., on 23rd May, 2006 to 12.25 per cent., on 10th July, 2006 to 13.00 per cent. and on 16th August, 2006 to 13.50 per cent.

Our net interest margin has declined and we expect it will continue to decline as a result of, among other factors, rising interest rates, a flattening yield curve, and exposure to increased competition. A significant fall in our average interest rates charged on loans to customers that is not fully matched by a decrease in interest rates on our funding sources, or a significant rise in interest rates on our funding sources that is not fully matched by a rise in our interest rates charged, could have a material adverse effect on our business, financial condition and results of operations.

Our business, results of operations and financial condition are affected by conditions in Iceland

Our business, results of operations and financial condition are affected directly by economic and political conditions in Iceland. Although the Icelandic economy has experienced high growth rates in recent years, there can be no assurance that these growth rates will continue or that there will not be a downturn in the Icelandic economy. Recently, interest rates and the rate of inflation in Iceland have been rising. The Central Bank of Iceland has increased its “policy interest rate” from 8.25 per cent. at 31st December, 2004 to 10.50 per cent. at 31st December, 2005. Inflation has increased to 4.0 per cent. for 2005 from 3.2 per cent. in 2004 and 2.1 per cent. in 2003.

Our loan portfolio is concentrated in certain currencies, industries and borrowers

Our loan portfolio is exposed to relatively high concentration in certain market sectors. As of 31st December, 2005, loans to customers in the service sector (including financial services, public administration and technical services), loans to customers in industry (including manufacturing, food and beverage and construction) and loans to individuals comprised 27 per cent., 19 per cent. and 17 per cent. respectively, of our loan portfolio (excluding loans to banks and off-balance sheet credit related commitments). Furthermore, as of that date, our ten largest borrowers represented 12.1 per cent. of our loan portfolio and our 20 largest borrowers represented 18.2 per cent. of our portfolio (in each case excluding loans to banks and off-balance sheet credit related commitments), and loans to our single largest borrower represented 1.9 per cent. of our total loan portfolio (excluding loans to banks and off-balance sheet credit-related commitments). Following the acquisition of FIH, our exposure to the service sector as a percentage of total loans declined significantly due to the composition of FIH’s loan portfolio, while our concentration in the manufacturing, real estate, food and beverage and banking and finance sectors increased. Our total exposure to non-ISK denominated loans comprised approximately 85 per cent. of our loan portfolio (excluding loans to banks and off-balance sheet credit related commitments). Although our loan portfolio has recently become more diversified, our financial condition will continue to be sensitive to downturns in certain industries and the consequent inability of clients to meet their obligations to us. Declines in the financial condition of our largest borrowers and adverse currency movements relative to the Icelandic krona also could have a material adverse effect on our business, financial condition and results of operations.

After the merger with Búnadarbanki Islands hf. (“*Búnadarbanki*”) in 2003, we wrote off approximately ISK 1.4 billion in non-performing loans in 2003, and have increased our provisions for loans to customers in certain sectors, particularly in the fishing, building and food and beverage industries. There can be no assurance that further unanticipated provisions for non-performing loans through loan losses or write-offs will not be required in the future, particularly with respect to FIH and Singer & Friedlander, which we acquired in 2004 and 2005, respectively, or other banking operations that we may acquire in the future.

We may be unable to adequately assess the credit risk of potential borrowers and may provide advances to certain customers that increase our credit risk exposure

We are exposed to the risk that third parties who owe us money, securities or other assets will not meet, or will be unable to meet, their obligations to us. The availability of accurate and comprehensive financial information and general credit information on which to base credit decisions is more limited for small- and medium-sized enterprises (“SMEs”) than is the case for large corporate clients, and is even more limited for individuals. SMEs form the majority of our client base. SMEs usually have less capital and business experience than large businesses and are hence more likely to default on their loans. Loans to SMEs and loans to individuals represented 65 per cent. and 17 per cent., respectively, of our total loan portfolio as of 31st December, 2005. Therefore, in spite of any credit risk determination procedures which we have in place, we may be unable to evaluate correctly the current financial condition of each prospective borrower and, in the case of SMEs, to determine their long-term financial viability. The failure of any member of our group to accurately assess the credit risk of prospective borrowers and lending to higher risk borrowers could have a material adverse effect on our business, financial condition and results of operations.

Adverse price fluctuations of the securities in our proprietary trading portfolio could have a material adverse effect on our results of operations and financial condition

We have a substantial investment portfolio that includes equity and debt securities of some of the largest issuers of securities in Iceland and Northern Europe. As of 31st December, 2005 our equity and debt investment portfolios totalled ISK 114,209 million and ISK 407,230 million, respectively, and accounted for 4.5 per cent. and 16 per cent., respectively, of our total assets. A fall in the price of our Icelandic or other securities could substantially reduce the value of our securities portfolio and the amount of our other operating income attributable to trading gains.

In addition, we maintain large positions in individual issues of securities or total claims (including but not limited to loans, bank overdrafts, equity holdings or other forms of financial exposures) on one individual counterparty or group of financially connected counterparties, which have sometimes led to material losses, and there can be no assurance that future losses from these holdings will not occur. Further, market liquidity constraints can limit our ability to sell large blocks of these securities at attractive prices. Adverse developments affecting these issuers or liquidity for their shares could have a material adverse effect on our business, financial condition and results of operations.

A decline in the value or illiquidity of the collateral securing our loans may adversely affect our loan portfolios

A substantial portion of our loans to corporate and individual borrowers are secured by collateral such as real estate, securities, ships and, in the case of fishing vessels, together with their non-transferable fishing quotas, receivables, raw materials and inventories. Downturns in the relevant markets or general deterioration of economic conditions in the industries in which these borrowers operate, or in the United Kingdom, Iceland, Denmark or Sweden generally, or other markets in which the collateral is located, may result in declines in the value of collateral securing loans to levels below the outstanding principal balance on those loans. A decline in the value of collateral securing these loans or the inability to obtain additional collateral may, in some cases, require us to reclassify the relevant loans, establish additional provisions for loan losses and increase reserve requirements. In addition, a failure to recover the expected value of collateral in the case of foreclosure may expose us to losses which could have a material adverse effect on our business, financial condition and results of operations.

Liquidity risk may impair our ability to fund our operations and adversely affect our financial condition

Ready access to funds is essential to any banking business, including ours. We rely almost entirely on continuous access to financial markets for short and long-term financing. An inability on our part to access funds or to access the markets from which we raise funds may put our positions in liquid assets at risk and lead us to be unable to finance our operations adequately. A rising interest rate environment compounds the risk that we will not be able to access funds at favourable rates. These and other factors also could lead creditors to form a negative view of our liquidity, which could result in less favourable credit ratings, higher borrowing costs and less accessible funds. In addition, because we receive a portion of our funding from retail deposits, we also are subject to the risk that depositors could withdraw their funds at a rate faster than the rate at which borrowers repay their loans, thus causing liquidity strains.

In addition, our ability to raise or access funds may be impaired by factors that are not specific to our operations, such as general market conditions, the sovereign rating of Iceland, severe disruption of the financial markets or negative views about the prospects for the industries to which we provide a large proportion of our loans. Strains on our liquidity caused by any of these factors or otherwise could adversely affect our financial performance and competitive position.

Our income from investment banking activities and investments for our own account is subject to fluctuation

For the year ended 31st December, 2005, we derived approximately 24 per cent. of our net operating income from our investment banking activities. Our income from our investment banking activities is comprised of fee income and gains on investments. Our fee income is in part related to the number and size of the capital market and corporate advisory transactions in which we participate and on underlying market conditions. Fees generated by these transactions are typically not recurring and are subject to volatility. Accordingly, income from our investment banking business tends to be variable, and any reduction in the number and/or size of such transactions will affect our results of operations. In addition, our investment banking unit invests in unlisted and listed companies with a view towards exiting these investments in a limited time from the date of acquisition. We also could be adversely affected by a decline in the value or the illiquid nature of this investment portfolio, which is subject to factors affecting the industries in which the companies in the portfolio operate as well as to general market fluctuations.

Trading and investment activities within our treasury unit are inherently exposed to significant risk

Our treasury unit maintains trading and investment positions in various financial and other assets, including currency and related derivative instruments as both agent and principal. These positions are exposed to a number of risks related to the movement of market prices in the underlying instruments. This includes the risk of unfavourable market price and interest rate movements relative to our long or short positions, a decline in the market liquidity of related instruments, volatility in market prices or foreign currency exchange rates relating to these positions, and the risk that instruments chosen to hedge certain positions do not track the market value of those positions.

A mismatch of our positions in foreign currency could adversely affect our financial condition

Our reporting currency is the Icelandic krona. As of 31st December, 2005, approximately 85 per cent. of our loan portfolio was comprised of non-ISK-denominated loans. In addition, we trade currency on behalf of our clients and for our own account and maintain open currency positions in currencies other than Icelandic krona. We do not fully hedge our foreign currency exposure at all times. Although we have taken steps to limit this exposure, adhere to regulatory limits and establish

strict limits aimed at reducing currency risk, there can be no assurance that future mismatches will not occur or that trading limits will not be breached. As a result, fluctuations in exchange rates could have a material adverse effect on our business, financial condition and results of operations.

We may be unable to continue to grow through acquisitions

A significant proportion of our growth in recent years has been driven by acquisitions, including the acquisition of JP Nordiska AB in Sweden in 2002, the merger with Búnadarbanki in Iceland in 2003, the acquisition of FIH in Denmark in 2004 and the acquisition of Singer & Friedlander in the United Kingdom in 2005.

We continue to evaluate potential acquisition and investment opportunities that could further expand our international banking operations and we plan to leverage off our existing client base and banking operations to expand our business through cross-selling of our products, especially in the areas of investment banking and acquisition and leveraged finance. These efforts will require significant financial resources and the attention of our board of directors and senior management, which could place a strain on management resources and adversely impact the management of our current operations. Further, no assurance can be given that we will be successful in identifying and acquiring appropriate candidates in the key markets in which we operate, or that other businesses in the future will achieve the return on investments made by us in prior periods.

We have historically financed the majority of our acquisitions through the issuance of shares as well as subordinated bonds. There can be no assurance that we will be able to obtain such financing on favourable terms in the future, or at all. Our failure to successfully realize our strategy could have a material adverse effect on our business, financial condition and results of operations.

We may fail to properly integrate our acquired operations

Since 2000, we have acquired ten financial institutions, primarily in Northern Europe. We intend to continue to grow our business through further expansion in Northern Europe as well as through further penetration of the banking markets in which we currently operate. Expansion of our operations will require significant investment, increased operating costs, greater allocation of management resources away from daily operations, continued development and integration of our financial and information management control systems across multiple banking platforms, continued training of management and other personnel, adequate employee supervision and delivery of consistent client product and service messages. In addition, we continue to integrate some of our recent acquisitions, in particular Singer & Friedlander, into our business, which will involve further challenges and commitment of resources. Our failure to effectively manage these issues as well as our growth, while at the same time maintaining adequate focus on our current operations, could have a material adverse effect on our business, financial condition and results of operations.

Our loan portfolio may not continue to grow at the historical rate

In 2002, our loan portfolio (excluding inter-bank loans and off-balance sheet credit-related commitments) grew by 32 per cent. to ISK 269,333 million and, in 2003, by 30 per cent. to ISK 350,995 million (in each case, giving pro forma effect to our acquisition of Búnadarbanki). Part of the growth in 2003 was attributable to the consolidation of the loan portfolio of Bankaktiebolag JP Nordiska, following its acquisition in 2002. In 2004, our customer loan portfolio grew by 203 per cent. to ISK 992,400 million, mainly due to the acquisition of FIH. In 2005, our customer loan portfolio grew by 57 per cent. to ISK 1,556,653 million, principally due to the acquisition of Singer & Friedlander as well as organic growth in Denmark and Iceland. It is unlikely that, absent other acquisitions in the future, we will be able to achieve similar rates of loan portfolio growth. Furthermore, there are a limited number of high credit quality corporate customers to whom banking services may be provided in our target markets. The pace of our loan portfolio growth may be constrained by, among other factors, our ability to increase lending volumes to customers that

meet our credit quality standards. There can be no assurance that our strategy to continue to expand our banking network throughout the Nordic region and to target these corporate customers will succeed. If we are unable to further expand our loan portfolio in general and our corporate customer base in particular, we may not generate sufficient interest income to offset any decline in net interest margins, which could have a material adverse effect on our business, financial condition and results of operations.

The implementation of Basel II may adversely affect our results of operations and financial condition

The risk-adjusted capital guidelines promulgated by the Basel Committee on Banking Supervision, which include guidelines for capital adequacy and implementation, will take effect on 1st January, 2007. At this time, we are unable to quantify how the revised guidelines will affect our requirements for capital and the impact these changes will have on our capital position. However, it is possible that our deployment and use of capital may have to be altered to ensure that the revised capital adequacy requirements are satisfied. Such actions could have a material adverse effect on our business, financial condition and results of operations.

We face increasing competition in the markets in which we operate

We face challenges from domestic and international competitors in the various markets in which we operate. Some of our competitors, including well-established domestic banks in each of the markets in which we operate, as well as international banks with operations in most of the markets in which we operate, may have better banking relationships with the corporate clients that comprise our target customer bases and may have greater resources and better local market knowledge than we do. These and other factors related to competition could have a material adverse effect on our ability to compete effectively in these markets, and adversely affect our business, financial condition and results of operations.

In addition, we face increased pressure to meet rising customer demands to provide new banking products that are developing rapidly in Northern Europe. There is no guarantee that our management and employees will succeed in adopting new work methods and approaches to customer service that will keep up with the pace of change in the current banking environment, which may adversely affect our ability to successfully compete in our primary markets.

Further, the number of banking transactions conducted over the internet in the markets in which we operate has grown in recent years and is expected to grow further. We may be unable to compete with other banks that offer more extensive online services to their customers than we currently offer to our customers. There can be no assurance that some of our clients will not choose to transfer some or all of their business to competitors, which could adversely affect our business, financial condition and results of operations.

Our banking businesses entail operational risks

We are exposed to many types of operational risk, including the risk of fraud by employees or others, operational errors, including clerical or record keeping errors or errors resulting from faulty computer or telecommunications systems or from external events that may affect our operations and reputation. Our business activities require us to record and process a large number of transactions accurately on a daily basis. The recording and processing of these transactions are potentially exposed to the risk of human and technological errors or a breakdown in internal controls relating to the due authorisation of transactions. A failure or delay in recording or processing transactions, or any other material breakdown in internal controls, could subject us to claims for losses and regulatory fines and penalties. Consequently, we could suffer reputational or financial harm, which could have a material adverse affect on our financial condition and results of operations. Given our high volume of transactions, errors may be repeated or compounded before

they are discovered and rectified, and there can be no assurance that risk assessments made in advance will adequately estimate the costs of these errors.

We are exposed to unidentified and unanticipated risks

Our risk management strategies may fail under certain circumstances, particularly when confronted with risks that have not been identified or anticipated. Risk methodologies and techniques that we adopt to assess credit risk, market risk and operational risk may be flawed or may not take all risks into account, and it is possible that the methods for assessing these risks are not sound or are based on faulty information, or that they will be misunderstood, not implemented correctly or misapplied by our personnel. In addition, our risk management policies are constantly being re-evaluated and there may be a lag in implementation. A failure of our risk management techniques could have a material adverse effect on our business, financial condition and results of operations.

We may be vulnerable to the failure of our IT systems and breaches of our security systems

We rely on the proper functioning and continuity of our IT systems. Any significant interruption, degradation, failure or lack of capacity of our IT systems or any other systems in our clearing operations or elsewhere could cause us to fail to complete transactions on a timely basis or at all. A sustained failure of our IT systems centrally or across our branches would have a significant impact on our operations and the confidence of our customers in the reliability and safety of our banking systems.

In addition, when we acquire new operations, we need to integrate the IT systems of the acquired business with our existing systems and may experience disruptions or inefficiencies until that integration is complete. We have not yet completed the integration of the IT systems of Singer & Friedlander with our systems and cannot assure you that we will be able to do so on a timely basis or without undue disruption to our business.

The secure transmission of confidential information is a critical element of our operations. We cannot guarantee that existing security measures will prevent security breaches, including break-ins, viruses or disruptions. Persons that circumvent the security measures could use our or our clients' confidential information wrongfully, which could expose us to a risk of loss, adverse regulatory consequences or litigation.

There are regulatory and legal risks inherent in our businesses

All of our operations entail considerable regulatory and legal risk. Each member of our group is subject to government regulation and inquiry as financial companies in the markets in which they operate, and regulations may be extensive and may change rapidly. In addition, many of our operations are contingent upon licenses issued by financial authorities of the countries in which we operate.

Violations of rules and regulations, whether intentional or unintentional, may lead to the withdrawal of some of these licenses. Any breach of these or other regulations may adversely affect our reputation or financial condition. In addition, existing laws and regulations could be amended, the manner in which laws and regulations are enforced or interpreted could change and new laws or regulations could be adopted, which could adversely affect the way we operate our business and our market reputation.

We are also exposed to legal risks in our role as a financial intermediary and a consultant to third party businesses. These risks include potential liability for our role in determining the price of a company, for advice we provide to participants in corporate transactions and in disputes over the terms and conditions of complex trading arrangements. We also face the possibility that counterparties in complex or high-risk trading transactions will claim that we failed to properly inform them of the associated risks or that they were not authorised or permitted to enter into these

transactions with us and that their obligations are therefore not enforceable. We are also exposed to customer claims.

We may also be subject to claims arising from disputes with employees for, among other things, alleged illegal dismissal, discrimination or harassment. These risks may often be difficult to assess or quantify and their existence and magnitude often remain unknown for substantial periods of time. Liability resulting from any of the foregoing or other claims could have a material adverse effect on our business, financial condition and results of operations.

All the Northern European countries are members of the European Economic Area or the European Union. This provides us with regulatory conditions similar to those of other European banks. However, it should be noted that interpretation and implementation of rules on securities trading may still differ among countries. Moreover, the length of history and volume of trading in the different markets vary and, consequently, so does the legal certainty of the framework within which we operate. Thus, we face a risk of incurring liability from violations of these regulations, which could have a material adverse effect on our business, financial condition and results of operations.

Our businesses are subject to the general economic conditions prevailing in the European Economic Area and elsewhere

The profitability of our businesses could be adversely affected by a decline in general economic conditions in the European Economic Area, Western Europe or the United States. These factors could also have a material adverse effect on our business, financial condition and results of operations. An economic downturn in the Nordic region could impact our results and financial position by affecting demand for our products and services. Such a downturn could also impact the credit quality of our counterparties by increasing the risk that a greater number of their respective customers would default on their loans or other obligations, or would refrain from seeking additional credit.

We may be unable to recruit or retain experienced and qualified personnel

Our continuing success depends, in part, on our ability to continue to attract, retain and motivate qualified and experienced banking and management personnel, particularly those individuals who are experienced in investment banking and acquisition finance. Competition for personnel with relevant expertise is intense, due to the relatively small number of available qualified individuals. Competition for qualified personnel, including senior management, is particularly intense in Iceland, where the unemployment rate is currently below 2 per cent.

Geographical location of employment may also make it less attractive to a large portion of potential applicants. Further, a loss of key employees with institutional and client knowledge could have a material adverse effect on our reputation and our business, financial condition and results of operations.

We rely on certain key members of management

We are highly dependent on our chief executive officer and senior management. The loss of the services of key members of our senior management or staff may significantly delay our business objectives and could have a material adverse effect on our business, financial condition and results of operations. In addition, competition in Iceland to hire qualified personnel could have a material adverse effect on our ability to recruit new senior managers.

Our insurance coverage may not adequately cover losses resulting from the risks for which they are insured

We maintain customary insurance policies for our operations, including insurance for our liquid assets, money transport and directors' and officers' liability, as well as insurance against computer crimes and for employee dishonesty and mistakes. Due to the nature of our operations and the

nature of the risks that we face, there can be no assurance that the coverage that we maintain is adequate to cover the losses for which we believe we are insured.

Factors which are material for the purpose of assessing the market risks associated with Notes issued under the Programme

The Notes may not be a suitable investment for all investors

Each potential investor in the Notes must determine the suitability of that investment in light of its own circumstances. In particular, each potential investor should:

- (i) have sufficient knowledge and experience to make a meaningful evaluation of the Notes, the merits and risks of investing in the Notes and the information contained or incorporated by reference in this Base Prospectus or any applicable supplement;
- (ii) have access to, and knowledge of, appropriate analytical tools to evaluate, in the context of its particular financial situation, an investment in the Notes and the impact the Notes will have on its overall investment portfolio;
- (iii) have sufficient financial resources and liquidity to bear all of the risks of an investment in the Notes, including Notes with principal or interest payable in one or more currencies, or where the currency for principal or interest payments is different from the potential investor's currency;
- (iv) understand thoroughly the terms of the Notes and be familiar with the behaviour of any relevant indices and financial markets; and
- (v) be able to evaluate (either alone or with the help of a financial adviser) possible scenarios for economic, interest rate and other factors that may affect its investment and its ability to bear the applicable risks.

Some Notes are complex financial instruments. Sophisticated institutional investors generally do not purchase complex financial instruments as stand-alone investments. They purchase complex financial instruments as a way to reduce risk or enhance yield with an understood, measured, appropriate addition of risk to their overall portfolios. A potential investor should not invest in Notes which are complex financial instruments unless it has the expertise (either alone or with a financial adviser) to evaluate how the Notes will perform under changing conditions, the resulting effects on the value of the Notes and the impact this investment will have on the potential investor's overall investment portfolio.

Risks related to the structure of a particular issue of Notes

A wide range of Notes may be issued under the Programme. A number of these Notes may have features which contain particular risks for potential investors. Set out below is a description of the most common such features:

Notes subject to optional redemption by the Issuer

An optional redemption feature of Notes is likely to limit their market value. During any period when the Issuer may elect to redeem Notes, the market value of those Notes generally will not rise substantially above the price at which they can be redeemed. This also may be true prior to any redemption period.

The Issuer may be expected to redeem Notes when its cost of borrowing is lower than the interest rate on the Notes. At those times, an investor generally would not be able to reinvest the redemption proceeds at an effective interest rate as high as the interest rate on the Notes being redeemed and may only be able to do so at a significantly lower rate. Potential investors should consider reinvestment risk in light of other investments available at that time.

Index Linked Notes and Dual Currency Notes

The Issuer may issue Notes with principal or interest determined by reference to an index or formula, to changes in the prices of securities or commodities, to movements in currency exchange rates or other factors (each, a **Relevant Factor**). In addition, the Issuer may issue Notes with principal or interest payable in one or more currencies which may be different from the currency in which the Notes are denominated. Potential investors should be aware that:

- (i) the market price of such Notes may be volatile;
- (ii) they may receive no interest;
- (iii) payment of principal or interest may occur at a different time or in a different currency than expected;
- (iv) they may lose all or a substantial portion of their principal;
- (v) a Relevant Factor may be subject to significant fluctuations that may not correlate with changes in interest rates, currencies or other indices;
- (vi) if a Relevant Factor is applied to Notes in conjunction with a multiplier greater than one or contains some other leverage factor, the effect of changes in the Relevant Factor on principal or interest payable likely will be magnified; and
- (vii) the timing of changes in a Relevant Factor may affect the actual yield to investors, even if the average level is consistent with their expectations. In general, the earlier the change in the Relevant Factor, the greater the effect on yield.

The historical experience of an index should not be viewed as an indication of the future performance of such index during the term of any Index Linked Notes. Accordingly, you should consult your own financial and legal advisers about the risk entailed by an investment in any Index Linked Notes and the suitability of such Notes in light of their particular circumstances.

Partly-paid Notes

The Issuer may issue Notes where the issue price is payable in more than one instalment. Failure to pay any subsequent instalment could result in an investor losing all of his investment.

Variable rate Notes with a multiplier or other leverage factor

Notes with variable interest rates can be volatile investments. If they are structured to include multipliers or other leverage factors, or caps or floors, or any combination of those features or other similar related features, their market values may be even more volatile than those for securities that do not include those features.

Inverse Floating Rate Notes

Inverse Floating Rate Notes have an interest rate equal to a fixed rate minus a rate based upon a reference rate such as LIBOR. The market values of those Notes typically are more volatile than market values of other conventional floating rate debt securities based on the same reference rate (and with otherwise comparable terms). Inverse Floating Rate Notes are more volatile because an increase in the reference rate not only decreases the interest rate of the Notes, but may also reflect an increase in prevailing interest rates, which further adversely affects the market value of these Notes.

Target Redemption Notes

Potential investors should be aware that Target Redemption Notes will have a variable maturity which depends on when and if the pre-determined interest amount is reached. In addition and as

a result, the market value of such a Note may be more volatile than the market value of other conventional fixed or variable rate debt securities.

Range Accrual Notes

Potential investors should be aware that, depending on the performance of the reference rate, they may receive no interest or less interest than on other conventional fixed or variable rate debt securities. In addition and as a result, the market value of such Notes may be more volatile than the market value of other conventional fixed or variable rate debt securities.

Fixed/Floating Rate Notes

Fixed/Floating Rate Notes may bear interest at a rate that converts from a fixed rate to a floating rate, or from a floating rate to a fixed rate. Where the Issuer has the right to effect such a conversion, this will affect the secondary market and the market value of the Notes since the Issuer may be expected to convert the rate when it is likely to produce a lower overall cost of borrowing. If the Issuer converts from a fixed rate to a floating rate in such circumstances, the spread on the Fixed/Floating Rate Notes may be less favourable than then prevailing spreads on comparable Floating Rate Notes tied to the same reference rate. In addition, the new floating rate at any time may be lower than the rates on other Notes. If the Issuer converts from a floating rate to a fixed rate in such circumstances, the fixed rate may be lower than then prevailing rates on its Notes.

Notes issued at a substantial discount or premium

The market values of securities issued at a substantial discount or premium from their principal amount tend to fluctuate more in relation to general changes in interest rates than do prices for conventional interest-bearing securities. Generally, the longer the remaining term of the securities, the greater the price volatility as compared to conventional interest-bearing securities with comparable maturities.

The Issuer's obligations under Subordinated Notes are subordinated

The Issuer's obligations under Subordinated Notes will be unsecured and subordinated and will rank junior in priority of payment to Senior Liabilities. **Senior Liabilities** means any unconditional, unsubordinated and unsecured obligations of the Issuer. Although Subordinated Notes may pay a higher rate of interest than comparable Notes which are not subordinated, there is a real risk that an investor in Subordinated Notes will lose all or some of his investment should the Issuer become insolvent.

The Issuer's obligations under the Capital Notes issued by it will be unsecured and unconditional obligations of the Issuer. In the event of the insolvency or voluntary or involuntary liquidation of the Issuer, the rights of the holders of the Capital Notes and any relative Receipts and Coupons to payments of the principal amount of the Capital Notes and any other amounts including interest due in respect of the Capital Notes; and where the whole or any part of the principal amount of the Capital Notes has been converted into conditional capital contributions as described below and such conditional capital contributions have not been reconverted and reinstated as provided below, the providers of such conditional capital contributions, in respect of such conditional capital contributions, shall rank:

- (i) *pari passu* without any preference among the holders of the Capital Notes and any relative Receipts and Coupons and such providers;
- (ii) at least *pari passu* with the rights of the holders of any other outstanding Capital Securities (as defined in Conditions 2(c)) whether or not such Capital Securities have been converted in the manner described below and at least *pari passu* with the rights of the holders of any other obligations of the Issuer constituting or eligible ("eligible" to be construed, *mutatis mutandis*, as provided in the definition of Capital Event in Condition 2(c)) as constituting Tier

1 Capital (as defined in Conditions 2(c)) of the Issuer, in each case in relation to their rights as such holders and to payments in respect thereof;

- (ii) in priority to the rights of holders of all classes of ordinary share capital, preferred share capital and other share capital and/or establishment funds (*hlutafe eda stofnfe*) and/or comparable capital and reserves (*sambaerilegt egid fev*), of the Issuer and in priority to the rights of holders of any obligation of the Issuer expressed to rank junior to the Capital Notes, in each case in relation to their rights as such holders and to payments in respect thereof; and
- (v) junior in right of payment to the payment of any present or future claims under Senior Obligation and Subordinated Obligations.

No holder of a Capital Note or any relative Receipt or Coupon or provider of any conditional capital contribution who shall in the event of the insolvency voluntary or involuntary liquidation of the Issuer be indebted to the Issuer shall be entitled to exercise any right of set-off or counterclaim against moneys owed by the Issuer in respect of the Capital Notes or conditional capital contributions held or provided by such holder or provider, as the case may be.

To the extent that it may be required to avoid the Issuer no longer meeting the requirements with respect to Minimum Own Funds (as defined in Condition 2(d)) the Board of Directors of the Issuer, by resolution passed at a board meeting, may decide that the principal amount (or part thereof, as the case may be) of each Capital Note will be utilised by writing down all or part of the principal amount to the extent and by the amount required to avoid falling below the required Minimum Own Funds and converting such aggregate amount ("**Converted Amount**") into a conditional capital contribution.

Reconversion and reinstatement (in whole or in part) as obligations in respect of the Capital Notes of the Converted Amount may only be made out of Unallocated Distributable Profits (as defined in Condition 2(e)) of the Issuer and subject to a resolution of the board of Directors of the Issuer.

Under certain conditions, interest payments under Capital Notes may be deferred

If, in relation to any issue of Capital Notes, the principal amount (or part thereof) is converted into a conditional capital contribution, the rights of the holders of the Capital Notes or any relative Receipts and Coupons in respect of the Converted Amount will thereupon be converted into rights of providers of conditional capital contributions as set out in the Conditions.

Any deferral of interest payments is likely to have an adverse effect on the market price of the Capital Notes. In addition, as a result of the interest deferral provision of the Capital Notes, the market price of the Capital Notes may be more volatile than the market prices of other debt securities on which original issue discount or interest accrues that are not subject to such deferrals and may be more sensitive generally to adverse changes in the Issuer's financial condition.

Risks related to Notes generally

Set out below is a brief description of certain risks relating to the Notes generally:

Modification

The conditions of the Notes contain provisions for calling meetings of Noteholders to consider matters affecting their interests generally. These provisions permit defined majorities to bind all Noteholders including Noteholders who did not attend and vote at the relevant meeting and Noteholders who voted in a manner contrary to the majority.

The Notes will be unsecured, and therefore will effectively be subordinated to any secured debt

The Notes will not be secured by any of its assets or those of its subsidiaries. As a result, the Notes are effectively subordinated to any secured debt the Issuer may incur. In any liquidation,

dissolution, bankruptcy or other similar proceeding, the holders of the Issuer's secured debt may assert rights against the secured assets in order to receive full payment of their debt before the assets may be used to pay the holders of the Notes.

EU Savings Directive

Under EC Council Directive 2003/48/EC on the taxation of savings income, Member States are required, from 1st July, 2005, to provide to the tax authorities of another Member State details of payments of interest (or similar income) paid by a person within its jurisdiction to an individual resident in that other Member State. However, for a transitional period, Belgium, Luxembourg and Austria are instead required (unless during that period they elect otherwise) to operate a withholding system in relation to such payments (the ending of such transitional period being dependent upon the conclusion of certain other agreements relating to information exchange with certain other countries). A number of non-EU countries and territories including Switzerland have agreed to adopt similar measures (a withholding system in the case of Switzerland) with effect from the same date.

If a payment were to be made or collected through a Member State which has opted for a withholding system and an amount of, or in respect of, tax were to be withheld from that payment, neither the Issuer nor any Paying Agent nor any other person would be obliged to pay additional amounts with respect to any Note as a result of the imposition of such withholding tax. If a withholding tax is imposed on payment made by a Paying Agent, the Issuer will be required to maintain a Paying Agent in a Member State that will not be obliged to withhold or deduct tax pursuant to the Directive.

Change of law

The conditions of the Notes are based on English law and, in the case of Conditions 2(b), 2(c), 2(d), 2(e), 5(h), 7(e) and 7(l) Icelandic law, in effect as at the date of this Base Prospectus. No assurance can be given as to the impact of any possible judicial decision or change to English law, Icelandic law or administrative practice after the date of this Base Prospectus.

Trading in the clearing systems

In relation to any issue of Notes which have a minimum denomination and are tradeable in the clearing systems in amounts above such minimum denomination which are smaller than it, should definitive Notes be required to be issued, a holder who does not have an integral multiple of the minimum denomination in his account with the relevant clearing system at the relevant time may not receive all of his entitlement in the form of definitive Notes unless and until such time as his holding becomes an integral multiple of the minimum denomination.

Risks related to the market generally

Set out below is a brief description of the principal market risks, including liquidity risk, exchange rate risk, interest rate risk and credit risk:

The secondary market generally

Notes may have no established trading market when issued, and one may never develop. If a market does develop, it may not be very liquid. Therefore, investors may not be able to sell their Notes easily or at prices that will provide them with a yield comparable to similar investments that have a developed secondary market. This is particularly the case for Notes that are especially sensitive to interest rate, currency or market risks, are designed for specific investment objectives or strategies or have been structured to meet the investment requirements of limited categories of investors. These types of Notes generally would have a more limited secondary market and more

price volatility than conventional debt securities. Illiquidity may have a severely adverse effect on the market value of Notes.

Exchange rate risks and exchange controls

The Issuer will pay principal and interest on the Notes in the Specified Currency. This presents certain risks relating to currency conversions if an investor's financial activities are denominated principally in a currency or currency unit (the **Investor's Currency**) other than the Specified Currency. These include the risk that exchange rates may significantly change (including changes due to devaluation of the Specified Currency or revaluation of the Investor's Currency) and the risk that authorities with jurisdiction over the Investor's Currency may impose or modify exchange controls. An appreciation in the value of the Investor's Currency relative to the Specified Currency would decrease (1) the Investor's Currency-equivalent yield on the Notes, (2) the Investor's Currency equivalent value of the principal payable on the Notes and (3) the Investor's Currency equivalent market value of the Notes.

Government and monetary authorities may impose (as some have done in the past) exchange controls that could adversely affect an applicable exchange rate. As a result, investors may receive less interest or principal than expected, or no interest or principal.

Interest rate risks

Investment in Fixed Rate Notes involves the risk that subsequent changes in market interest rates may adversely affect the value of the Fixed Rate Notes.

Credit ratings may not reflect all risks

One or more independent credit rating agencies may assign credit ratings to the Notes. The ratings may not reflect the potential impact of all risks related to structure, market, additional factors discussed above, and other factors that may affect the value of the Notes. A credit rating is not a recommendation to buy, sell or hold securities and may be revised or withdrawn by the rating agency at any time.

Legal investment considerations may restrict certain investments

The investment activities of certain investors maybe subject to subject to law or review or regulation by certain authorities. Each potential investor should determine for itself, on the basis of professional advice where appropriate, whether and to what extent (1) Notes are lawful investments for it, (2) Notes can be used as collateral for various types of borrowing and (3) other restrictions apply to its purchase or pledge of any Notes. Financial institutions should consult their legal advisers or the appropriate regulators to determine the appropriate treatment of Notes under any applicable risk-based capital or similar rules.

DOCUMENTS INCORPORATED BY REFERENCE

The following documents which have been previously published or are published simultaneously with this Base Prospectus and have been filed with the CSSF shall be deemed to be incorporated in, and form part of, this Base Prospectus:

- (a) the Annual Report 2004 which contains the auditors report and the audited non-consolidated and consolidated financial statements for the financial year ended 31st December, 2004 including the information set out at the following pages in particular:

	Annual Report 2004
Balance Sheet	90
Income Statement	89
Statement of Cash Flows.....	92
Notes	93-116
Auditors Report	88

Any other information not listed above but contained in such document is incorporated by reference for information purposes only;

- (b) the Annual Report 2005 which contains the auditors report and audited consolidated financial statements for the financial year ended 31st December 2005

including the information set out at the following pages in particular:

	Annual Report 2005
Balance Sheet	90
Income Statement	89
Statement of Cash Flows.....	92-93
Notes	94-151
Auditors Report	88

Any other information not listed above but contained in such document is incorporated by reference for information purposes only; and

- (c) the interim consolidated financial statements of the Issuer for the six months ended 30th June, 2006 including the information set out at the following pages in particular:

	Interim Consolidated Financial Statements
Balance Sheet	6
Income Statement	5
Condensed Statement of Cash Flows	8
Notes	9-22
Auditors Report	4

Any other information not listed above but contained in such document is incorporated by reference for information purposes only.

Following the publication of this Base Prospectus a supplement may be prepared by the Issuer and approved by the CSSF in accordance with Article 16 of the Prospectus Directive. Statements contained in any such supplement (or contained in any document incorporated by reference therein) shall, to the extent applicable (whether expressly, by implication or otherwise), be deemed to modify or supersede statements contained in this Base

Prospectus or in a document which is incorporated by reference in this Base Prospectus. Any statement so modified or superseded shall not, except as so modified or superseded, constitute a part of this Base Prospectus.

Copies of documents incorporated by reference in this Base Prospectus can be obtained from the Issuer's Office as set out at the end of this Base Prospectus. In addition, such documents will be available, free of charge, from the principal office in Luxembourg of Fortis Banque Luxembourg S.A. (the "**Luxembourg Listing Agent**") for Notes admitted to the official list of the Luxembourg Stock Exchange and to trading on the Regulated Market of the Luxembourg Stock Exchange. This Base Prospectus will also be published on the Luxembourg Stock Exchange's website (www.bourse.lu).

The Issuer will, in the event of any significant new factor, material mistake or inaccuracy relating to information included in this Base Prospectus which is capable of affecting the assessment of any Notes, prepare a supplement to this Base Prospectus or publish a new Base Prospectus for use in connection with any subsequent issue of the Notes.

GENERAL DESCRIPTION OF THE PROGRAMME

The following general description does not purport to be complete and is taken from, and is qualified in its entirety by, the Summary and the remainder of this Base Prospectus and, in relation to the terms and conditions of any particular Tranche of Notes, the applicable Final Terms. The Issuer and any relevant Dealer may agree that Notes shall be issued in a form other than that contemplated in the Terms and Conditions, in which event, in the case of listed Notes only, if appropriate, a supplemental Base Prospectus will be published.

This general description constitutes a general description of the Programme for the purposes of Article 22.5(3) of Commission Regulation (EC) No 809/2004 implementing the Prospectus Directive.

Words and expressions defined in “*Form of the Notes*” and “*Terms and Conditions of the Notes*” shall have the same meanings in this summary.

Form of Notes:	The Notes will be issued in bearer form as described in “ <i>Form of the Notes</i> ”.
Distribution:	Notes may be distributed by way of private or public placement and in each case on a syndicated or non-syndicated basis.
Currencies:	Subject to any applicable legal or regulatory restrictions, any currency agreed between the Issuer and the relevant Dealer.
Redenomination:	The applicable Final Terms may provide that certain Notes may be redenominated in euro. The relevant provisions applicable to any such redenomination are contained in Condition 4.
Maturities:	The Notes will have such maturities (or no maturity) as may be agreed between the Issuer and the relevant Dealer, subject to such minimum or maximum maturities as may be allowed or required from time to time by the relevant central bank (or equivalent body) or any laws or regulations applicable to the Issuer or the relevant Specified Currency.
Issue Price:	Notes may be issued on a fully-paid or a partly-paid basis and at an issue price which is at par or at a discount to, or premium over, par.
Certain Restrictions:	Each issue of Notes denominated in a currency in respect of which particular laws, guidelines, regulations, restrictions or reporting requirements apply will only be issued in circumstances which comply with such laws, guidelines, regulations, restrictions or reporting requirements from time to time (see “ <i>Subscription and Sale</i> ”) including the following restrictions applicable at the date of this Base Prospectus.

Notes having a maturity of less than one year

Notes having a maturity of less than one year will, if the proceeds of the issue are accepted in the United Kingdom, constitute deposits for the purposes of the prohibition on accepting deposits contained in section 19 of the Financial Services and Markets Act 2000 unless they are issued to a limited class of professional investors and have a denomination of at least £100,000 or its equivalent, see “*Subscription and Sale*”.

According to the Luxembourg Act relating to prospectuses for securities, the CSSF is not competent to approve prospectuses for the listing of money market instruments having a maturity at issue of less than 12 months and complying also with the definition of securities in that Act.

Fixed Rate Notes: Fixed interest will be payable on such date or dates as may be agreed between the Issuer and the relevant Dealer and on redemption and will be calculated on the basis of such Day Count Fraction as may be agreed between the Issuer and the relevant Dealer.

Floating Rate Notes: Floating Rate Notes will bear interest at a rate determined:

- (i) on the same basis as the floating rate under a notional interest rate swap transaction in the relevant Specified Currency governed by an agreement incorporating the 2000 ISDA Definitions (as published by the International Swaps and Derivatives Association, Inc., and as amended and updated as at the Issue Date of the first Tranche of the Notes of the relevant Series); or
- (ii) on the basis of a reference rate appearing on the agreed screen page of a commercial quotation service; or
- (iii) on such other basis as may be agreed between the Issuer and the relevant Dealer.

The margin (if any) relating to such floating rate will be agreed between the Issuer and the relevant Dealer for each Series of Floating Rate Notes.

Index Linked Notes: Payments of principal in respect of Index Linked Redemption Notes or of interest in respect of Index Linked Interest Notes will be calculated by reference to such index and/or formula or to changes in the prices of securities or commodities or to such other factors as the Issuer and the relevant Dealer may agree.

Other provisions in relation to Floating Rate Notes and Index Linked Interest Notes: Floating Rate Notes and Index Linked Interest Notes may also have a maximum interest rate, a minimum interest rate or both.

Interest on Floating Rate Notes and Index Linked Interest Notes in respect of each Interest Period, as agreed prior to issue by the Issuer and the relevant Dealer, will be payable on such Interest Payment Dates, and will be calculated on the basis of such Day Count Fraction, as may be agreed between the Issuer and the relevant Dealer.

Dual Currency Notes: Payments (whether in respect of principal or interest and whether at maturity or otherwise) in respect of Dual Currency Notes will be made in such currencies, and based on such rates of exchange, as the Issuer and the relevant Dealer may agree.

Zero Coupon Notes: Zero Coupon Notes will be offered and sold at a discount to their nominal amount and will not bear interest.

Target Redemption Notes: Target Redemption Notes may bear interest at a variable rate or at a rate that converts from a fixed rate to a variable rate. The cumulative interest earned on a Target Redemption Note cannot

exceed a pre-determined amount. If and when that pre-determined amount is reached, the Target Redemption Note is redeemed.

Range Accrual Notes: Range Accrual Notes generally bear interest at a variable rate reflecting the amount of time during a specified period in which a specified reference rate falls within a defined range.

Redemption: The applicable Final Terms will indicate either that the relevant Notes cannot be redeemed prior to their stated maturity (if any) (other than in specified instalments, if applicable, or for taxation reasons or following an Event of Default) or that such Notes will be redeemable at the option of the Issuer and/or the Noteholders upon giving notice to the Noteholders or the Issuer, as the case may be, on a date or dates specified prior to such stated maturity (if any) and at a price or prices and on such other terms as may be agreed between the Issuer and the relevant Dealer.

The applicable Final Terms may provide that Notes may be redeemable in two or more instalments of such amounts and on such dates as are indicated in the applicable Final Terms.

Notes having a maturity of less than one year may be subject to restrictions on their denomination and distribution, see "*Certain Restrictions – Notes having a maturity of less than one year*" above.

In addition, in the case of Capital Notes only, upon the occurrence of a Special Event (as described in Condition 7), the Issuer may, at its option, having given not less than 30 days' nor more than 60 days' notice to the holders of the Capital Notes in accordance with Condition 14 (which notice shall be irrevocable), redeem all (but not some only) of the Capital Notes on the date(s) specified in the applicable Final Terms at an amount equal to the Special Event Redemption Amount (as specified in the applicable Final Terms).

Any redemption of Capital Notes is subject to the prior approval of the Financial Supervisory Authority of Iceland (*Fjármálaeftirlitid*) (the "FSA") (provided that such approval is at such time required to be given in accordance with applicable rules, regulations and policies of the FSA).

Denomination of Notes: Notes will be issued in such denominations as may be agreed between the Issuer and the relevant Dealer save that the minimum denomination of each Note will be such amount as may be allowed or required from time to time by the relevant central bank (or equivalent body) or any laws or regulations applicable to the relevant Specified Currency, see "*Certain Restrictions – Notes having a maturity of less than one year*" above, and save that the minimum denomination of each Note admitted to trading on a regulated market within the European Economic Area or offered to the public in a Member State of the European Economic Area in circumstances which require the publication of a prospectus under the Prospectus Directive will be €1,000 (or if the Notes are denominated in a currency other than euro, the equivalent amount in such currency).

Taxation: All payments in respect of the Notes will be made without deduction for or on account of withholding taxes imposed by any Tax

Jurisdiction, subject as provided in Condition 8. In the event that any such deduction is made, the Issuer will, save in certain limited circumstances provided in Condition 8, be required to pay additional amounts to cover the amounts so deducted.

- Negative Pledge: The terms of the Notes will contain a negative pledge provision as further described in Condition 3.
- Cross Default: The terms of the Notes will contain a cross default provision as further described in Condition 10.
- Status of the Senior Notes: The Senior Notes will constitute direct, unconditional, unsubordinated and, subject to the provisions of Condition 3, unsecured obligations of the Issuer and will rank *pari passu* among themselves and (save for certain obligations required to be preferred by law) equally with all other unsecured obligations (other than subordinated obligations, if any) of the Issuer, from time to time outstanding.
- Subordination: Payments in respect of the Capital Notes and the Subordinated Notes will be subordinated as described in Conditions 2(b) and 2(c).
- Rating: The rating of Notes to be issued under the Programme will be specified in the applicable Final Terms.
- Listing and Admission to Trading: Application has been made to the CSSF to approve this document. Application has also been made to the Luxembourg Stock Exchange for Notes issued under the Programme to be admitted to trading on the Luxembourg Stock Exchange's regulated market and to be listed on the Official List of the Luxembourg Stock Exchange.
- Notes may be listed or admitted to trading, as the case may be, on other or further stock exchanges or markets agreed between the Issuer and the relevant Dealer in relation to the Series. Notes which are neither listed nor admitted to trading on any market may also be issued.
- The applicable Final Terms will state whether or not the relevant Notes are to be listed and/or admitted to trading and, if so, on which stock exchanges and/or markets.
- Governing Law: The Notes will be governed by, and construed in accordance with, English law, except the provisions of Conditions 2(b), 2(c), 2(d), 2(e), 5(h), 7(e) and 7(l) which will be governed by Icelandic law.
- Selling Restrictions: There are restrictions on the offer, sale and transfer of the Notes in the United States, the European Economic Area (including the United Kingdom, Italy and Iceland) and Japan and such other restrictions as may be required in connection with the offering and sale of a particular Tranche of Notes, see "*Subscription and Sale*".

FORM OF THE NOTES

Each Tranche of Notes will be in bearer form and will be initially issued in the form of a temporary global note (a “**Temporary Global Note**”) or, if so specified in the applicable Final Terms, a permanent Global Note (a “**Permanent Global Note**”) which, in either case, will:

- (i) if the Global Notes are intended to be issued in new global note (“**NGN**”) form, as stated in the applicable Final Terms, be delivered on or prior to the original issue date of the Tranche to a common safekeeper (the “**Common Safekeeper**”) for Euroclear Bank S.A./N.V. (“**Euroclear**”) and Clearstream Banking, société anonyme (“**Clearstream, Luxembourg**”); and
- (ii) if the Global Notes are not intended to be issued in NGN Form, be delivered on or prior to the original issue date of the Tranche to a common depository (the “**Common Depository**”) for Euroclear and Clearstream, Luxembourg.

Whilst any Note is represented by a Temporary Global Note, payments of principal, interest (if any) and any other amount payable in respect of the Notes due prior to the Exchange Date (as defined below) will be made (against presentation of the Temporary Global Note if the Temporary Global Note is not intended to be issued in NGN form) only to the extent that certification (in a form to be provided) to the effect that the beneficial owners of interests in such Note are not U.S. persons or persons who have purchased for resale to any U.S. person, as required by U.S. Treasury regulations, has been received by Euroclear and/or Clearstream, Luxembourg and Euroclear and/or Clearstream, Luxembourg, as applicable, has given a like certification (based on the certifications it has received) to the Agent.

On and after the date (the “**Exchange Date**”) which is 40 days after a Temporary Global Note is issued, interests in such Temporary Global Note will be exchangeable (free of charge) upon a request as described therein either for (i) interests in a Permanent Global Note of the same Series or (ii) for definitive Notes of the same Series with, where applicable, receipts, interest coupons and talons attached (as indicated in the applicable Final Terms and subject, in the case of definitive Notes, to such notice period as is specified in the applicable Final Terms), in each case against certification of beneficial ownership as described above unless such certification has already been given. The holder of a Temporary Global Note will not be entitled to collect any payment of interest, principal or other amount due on or after the Exchange Date unless, upon due certification, exchange of the Temporary Global Note for an interest in a Permanent Global Note or for definitive Notes is improperly withheld or refused.

Payments of principal, interest (if any) or any other amounts on a Permanent Global Note will be made through Euroclear and/or Clearstream, Luxembourg (against presentation or surrender (as the case may be) of the Permanent Global Note if the Permanent Global Note is not intended to be issued in NGN form) without any requirement for certification.

The applicable Final Terms will specify that a Permanent Global Note will be exchangeable (free of charge), in whole but not in part, for definitive Notes with, where applicable, receipts, interest coupons and talons attached upon (i) not less than 60 days’ written notice from Euroclear and/or Clearstream, Luxembourg (acting on the instructions of any holder of an interest in such Permanent Global Note) to the Agent as described therein, (ii) only upon the occurrence of an Exchange Event or (iii) at any time at the request of the Issuer. For these purposes, “**Exchange Event**” means that (i) an Event of Default (as defined in Condition 10) has occurred and is continuing, (ii) the Issuer has been notified that both Euroclear and Clearstream, Luxembourg have been closed for business for a continuous period of 14 days (other than by reason of holiday, statutory or otherwise) or have announced an intention permanently to cease business or have in fact done so and no successor clearing system is available or (iii) the Issuer has or will become subject to adverse tax consequences which would not be suffered were the Notes represented by the Permanent Global Note in definitive form. The Issuer will promptly give notice to Noteholders in accordance with Condition 14 if an Exchange Event occurs. In the event of the occurrence of an

Exchange Event, Euroclear and/or Clearstream, Luxembourg (acting on the instructions of any holder of an interest in such Permanent Global Note) may give notice to the Agent requesting exchange and, in the event of the occurrence of an Exchange Event as described in (iii) above, the Issuer may also give notice to the Agent requesting exchange. Any such exchange shall occur not later than 45 days after the date of receipt of the first relevant notice by the Agent.

The following legend will appear on all Notes which have an original maturity of more than 365 days and on all receipts and interest coupons relating to such Notes:

“ANY UNITED STATES PERSON WHO HOLDS THIS OBLIGATION WILL BE SUBJECT TO LIMITATIONS UNDER THE UNITED STATES INCOME TAX LAWS, INCLUDING THE LIMITATIONS PROVIDED IN SECTIONS 165(j) AND 1287(a) OF THE INTERNAL REVENUE CODE.”

The sections referred to provide that United States holders, with certain exceptions, will not be entitled to deduct any loss on Notes, receipts or interest coupons and will not be entitled to capital gains treatment of any gain on any sale, disposition, redemption or payment of principal in respect of such Notes, receipts or interest coupons.

Notes which are represented by a Global Note will only be transferable in accordance with the rules and procedures for the time being of Euroclear or Clearstream, Luxembourg, as the case may be.

Pursuant to the Agency Agreement (as defined under “*Terms and Conditions of the Notes*”), the Agent shall arrange that, where a further Tranche of Notes is issued which is intended to form a single Series with an existing Tranche of Notes, the Notes of such further Tranche shall be assigned a common code and ISIN which are different from the common code and ISIN assigned to Notes of any other Tranche of the same Series until at least the expiry of the distribution compliance period (as defined in Regulation S under the Securities Act) applicable to the Notes of such Tranche.

Any reference herein to Euroclear and/or Clearstream, Luxembourg shall, whenever the context so permits (except in relation to Notes issued in NGN form), be deemed to include a reference to any additional or alternative clearing system specified in the applicable Final Terms.

A Note may be accelerated by the holder thereof in certain circumstances described in Condition 10. In such circumstances, where any Note is still represented by a Global Note and the Global Note (or any part thereof) has become due and repayable in accordance with the Terms and Conditions of such Notes and payment in full of the amount due has not been made in accordance with the provisions of the Global Note then the Global Note will become void at 8.00 p.m. (London time) on such day. At the same time, holders of interests in such Global Note credited to their accounts with Euroclear and/or Clearstream, Luxembourg, as the case may be, will become entitled to proceed directly against the Issuer on the basis of statements of account provided by Euroclear and/or Clearstream, Luxembourg on and subject to the terms of a deed of covenant (the “**Deed of Covenant**”) dated 2nd September, 2005 and executed by the Issuer.

Applicable Final Terms

Set out below is the form of Final Terms which will be completed for each Tranche of Notes issued under the Programme.

[Date]

KAUPTHING BANK HF.

Issue of [Aggregate Nominal Amount of Tranche] [Title of Notes] under the €12,000,000,000 Euro Medium Term Note Programme

PART A – CONTRACTUAL TERMS

Terms used herein shall be deemed to be defined as such for the purposes of the Conditions set forth in the Base Prospectus dated 31st August, 2006 which constitutes a base prospectus for the purposes of the Prospectus Directive (Directive 2003/71/EC) (the **Prospectus Directive**). This document constitutes the Final Terms of the Notes described herein for the purposes of Article 5.4 of the Prospectus Directive and must be read in conjunction with the Base Prospectus. Full information on the Issuer and the offer of the Notes is only available on the basis of the combination of these Final Terms and the Base Prospectus. The Base Prospectus is available for viewing at the office of the Issuer at Borgartun 19, 105 Reykjavic, Iceland and on the Luxembourg Stock Exchange's website (www.bourse.lu) and copies may be obtained from the Principal Paying Agent at Winchester House, 1 Great Winchester Street, London, EC2N 2DB.

[The following alternative language applies if the first tranche of an issue which is being increased was issued under an Base Prospectus with an earlier date.]

Terms used herein shall be deemed to be defined as such for the purposes of the Conditions (the "Conditions") set forth in the Base Prospectus dated [original date]. This document constitutes the Final Terms of the Notes described herein for the purposes of Article 5.4 of the Prospectus Directive (Directive 2003/71/EC) (the "**Prospectus Directive**") and must be read in conjunction with the Base Prospectus dated 31st August, 2006 which constitutes a base prospectus for the purposes of the Prospectus Directive, save in respect of the Conditions which are extracted from the Base Prospectus dated [original date] and are attached hereto. Full information on the Issuer and the offer of the Notes is only available on the basis of the combination of these Final Terms and the Base Prospectuses dated 31st August, 2006 and [original date]. Copies of such Base Prospectuses are available for viewing at the office of the Issuer at Borgartun 19, 105 Reykjavic, Iceland and on the Luxembourg Stock Exchange's website (www.bourse.lu) and copies may be obtained from the Principal Paying Agent at Winchester House, 1 Great Winchester Street, London EC2N 2DB.

[Include whichever of the following apply or specify as "Not Applicable" (N/A). Note that the numbering should remain as set out below, even if "Not Applicable" is indicated for individual paragraphs or sub-paragraphs. Italics denote directions for completing the Final Terms.]

[When adding any other final terms or information consideration should be given as to whether such terms or information constitute "significant new factors" and consequently trigger the need for a supplement to the Base Prospectus under Article 16 of the Prospectus Directive.]

[If the Notes have a maturity of less than one year from the date of their issue, the minimum denomination may need to be £100,000 or its equivalent in any other currency.]

- | | | |
|----|----------------------|--------------------|
| 1. | Issuer: | Kaupthing Bank hf. |
| 2. | (i) Series Number: | [] |
| | (ii) Tranche Number: | [] |

(If fungible with an existing Series, details of that Series, including the date on which the Notes become fungible)

3. Specified Currency or Currencies: []
4. Aggregate Nominal Amount:
- (i) Series: []
- (ii) Tranche: []
5. Issue Price: [] per cent. of the Aggregate Nominal Amount [plus accrued interest from [insert date] (if applicable)]
6. Specified Denominations: []
(If an issue of Notes is (i) NOT admitted to trading on an European Economic Area exchange; and (ii) only offered in the European Economic Area in circumstances where a prospectus is not required to be published under the Prospectus Directive, the €1,000 minimum denomination is not required.)
7. (i) Issue Date: []
- (ii) Interest Commencement Date: []
8. Maturity Date: [Fixed rate – specify date/
Floating rate – Interest Payment Date falling on or nearest to [specify month]
Capital Notes – Undated]
9. Interest Basis: [[] per cent. Fixed Rate]
[[LIBOR/EURIBOR] +/- [] per cent. Floating Rate]
[Zero Coupon]
[Index Linked Interest]
[Dual Currency Interest]
[Target Redemption Interest]
[Range Accrual Interest]
[specify other]
(further particulars specified below)
10. Redemption/Payment Basis: [Redemption at par]
[Index Linked Redemption]
[Dual Currency Redemption]
[Partly Paid]
[Instalment]
[specify other]
(N.B. If the Final Redemption Amount is less than 100 per cent. of the nominal value the Notes will be derivative securities for the purposes of the Prospectus Directive and the requirements of Annex XII to the Prospectus Directive Regulation will apply)

11. Change of Interest Basis or Redemption/ Payment Basis: [Specify details of any provision for change of Notes into another Interest Basis or Redemption/ Payment Basis]
12. Put/Call Options: [Investor Put]
[Issuer Call]
[(further particulars specified below)]
13. (a) Status of the Notes: [Senior/Subordinated/Capital Notes]

[in the case of Capital Notes, specify any details of special provisions of Tier 1 qualifying Capital Notes including relevant interest deferral provisions and details of utilisation/conversion]
- (b) Date Board approval for issuance of Notes obtained: []
(N.B. Only relevant where Board (or similar) authorisation is required for the particular tranche of Notes, i.e. if the Notes are subordinated or are to be listed on a stock exchange outside the European Economic Area)
14. Method of distribution: [Syndicated/Non-syndicated/Capital Notes]

PROVISIONS RELATING TO INTEREST (IF ANY) PAYABLE

15. **Fixed Rate Note Provisions** [Applicable/Not Applicable]
(If not applicable, delete the remaining sub-paragraphs of this paragraph)
- (i) Rate(s) of Interest: [] per cent. per annum [payable [annually/semi-annually/quarterly] in arrear]
(If payable other than annually, consider amending Condition 5(a))
- (ii) Interest Payment Date(s): [[] in each year up to and including the Maturity Date]/[specify other]
(NB: This will need to be amended in the case of long or short coupons)
- (iii) Fixed Coupon Amount(s): [] per [] in nominal amount
- (iv) Broken Amount(s): [Insert particulars of any initial or final broken interest amounts which do not correspond with the Fixed Coupon Amount]
- (v) Day Count Fraction: [30/360 or Actual/Actual (ICMA) or specify other]
- (vi) Determination Date(s): [] in each year
[Insert regular interest payment dates, ignoring issue date or maturity date in the case of a long or short first or last coupon]

NB: This will need to be amended in the case of regular interest payment dates which are not of equal duration NB: Only relevant where Day Count Fraction is Actual/Actual (ICMA)]

- (vii) Other terms relating to the method of calculating interest for Fixed Rate Notes: [None/Give details]
16. **Floating Rate Note Provisions** [Applicable/Not Applicable]
(If not applicable, delete the remaining sub-paragraphs of this paragraph)
- (i) Specified Period(s)/Specified Interest Payment Dates: []
- (ii) Business Day Convention: [Floating Rate Convention/Following Business Day Convention/Modified Following Business Day Convention/Preceding Business Day Convention/*specify other*]
- (iii) Additional Business Centre(s): []
- (iv) Manner in which the Rate of Interest and Interest Amount is to be determined: [Screen Rate Determination/ISDA Determination/*specify other*]
- (v) Party responsible for calculating the Rate of Interest and Interest Amount (if not the Agent): []
- (vi) Screen Rate Determination:
- Reference Rate: []
(Either LIBOR, EURIBOR or other, although additional information is required if other – including fallback provisions in the Agency Agreement)
- Interest Determination Date(s): []
(Second London business day prior to the start of each Interest Period if LIBOR (other than Sterling or euro LIBOR), first day of each Interest Period if Sterling LIBOR and the second day on which the TARGET System is open prior to the start of each Interest Period if EURIBOR or euro LIBOR)
- Relevant Screen Page: []
(In the case of EURIBOR, if not Telerate Page 248 ensure it is a page which shows a composite rate or amend the fallback provisions appropriately)
- (vii) ISDA Determination:

- Floating Rate Option: []
 - Designated Maturity: []
 - Reset Date: []
 - (viii) Margin(s): [+/-] [] per cent. per annum
 - (ix) Minimum Rate of Interest: [] per cent. per annum
 - (x) Maximum Rate of Interest: [] per cent. per annum
 - (xi) Day Count Fraction: [Actual/365
Actual/365 (Fixed)
Actual/365 (Sterling)
Actual/360
30/360
30E/360
Other]
(See Condition 5 for alternatives)
 - (xii) Fall back provisions, rounding provisions and any other terms relating to the method of calculating interest on Floating Rate Notes, if different from those set out in the Conditions: []
- 17. Zero Coupon Note Provisions** [Applicable/Not Applicable]
(If not applicable, delete the remaining subparagraphs of this paragraph)
- (i) Accrual Yield: [] per cent. per annum
 - (ii) Reference Price: []
 - (iii) Any other formula/basis of determining amount payable: []
 - (iv) Day Count Fractions in relation to Early Redemption Amount and late payment: [Conditions 7(f)(iii) and 7(k) apply/specify other]
(Consider applicable day count fraction if not U.S. dollar denominated)
- 18. Index Linked Interest Note Provisions** [Applicable/Not Applicable]
(If not applicable, delete the remaining subparagraphs of this paragraph)
- (i) Index/Formula: [give or annex details]
 - (ii) Calculation Agent responsible for calculating the interest due: []
 - (iii) Provisions for determining Coupon where calculation by reference to Index and/or Formula is impossible or impracticable: [need to include a description of market disruption or settlement disruption events and adjustment provisions]
 - (iv) Specified Period(s)/Specified Interest Payment Dates: []

- (v) Business Day Convention: [Floating Rate Convention/Following Business Day Convention/Modified Following Business Day Convention/Preceding Business Day Convention/*specify other*]
- (vi) Additional Business Centre(s): []
- (vii) Minimum Rate of Interest: [] per cent. per annum
- (viii) Maximum Rate of Interest: [] per cent. per annum
- (ix) Day Count Fraction: []
19. **Dual Currency Interest Note Provisions** [Applicable/Not Applicable]
(If not applicable, delete the remaining sub-paragraphs of this paragraph)
- (i) Rate of Exchange/method of calculating Rate of Exchange: [*give or annex details*]
- (ii) Calculation Agent, if any, responsible for calculating the interest payable: []
- (iii) Provisions applicable where calculation by reference to Rate of Exchange impossible or impracticable: [*need to include a description of market disruption or settlement disruption events and adjustment provisions*]
- (iv) Person at whose option Specified Currency(ies) is/are payable: []
20. Target Redemption Note Provisions: [Not Applicable/*give or annex details*]
21. Range Accrual Note Provisions: [Not Applicable/*give or annex details*]

PROVISIONS RELATING TO REDEMPTION

22. Issuer Call: [Applicable/Not Applicable]
(If not applicable, delete the remaining sub-paragraphs of this paragraph)
- (i) Optional Redemption Date(s): []
- (ii) Optional Redemption Amount of each Note and method, if any, of calculation of such amount(s): [] per Note of [] Specified Denomination
- (iii) If redeemable in part:
- (a) Minimum Redemption Amount: []
- (b) Maximum Redemption Amount: []
- (iv) Notice period (if other than as set out in the Conditions): []
(*N.B. If setting notice periods which are different to those provided in the Conditions, the Issuer is advised to consider the practicalities of distribution of information through intermediaries, for*

- example, clearing systems and custodians, as well as any other notice requirements which may apply, for example, as between the Issuer and the Agent)*
23. Investor Put: [Applicable/Not Applicable]
(If not applicable, delete the remaining sub-paragraphs of this paragraph)
- (i) Optional Redemption Date(s): []
- (ii) Optional Redemption Amount of each Note and method, if any, of calculation of such amount(s): [] per Note of [] Specified Denomination
- (iii) Notice period (if other than as set out in the Conditions): []
(N.B. If setting notice periods which are different to those provided in the Conditions, the Issuer is advised to consider the practicalities of distribution of information through intermediaries, for example, clearing systems and custodians, as well as any other notice requirements which may apply, for example, as between the Issuer and the Agent)
24. Target Redemption Provisions: [Not Applicable/give or annex details]
25. Final Redemption Amount of each Note: [[] per Note of [] Specified Denomination/specify other/see Appendix]
(N.B. In relation to any issue of Notes which are expressed at paragraph 6 above to have a minimum denomination and tradeable amounts above such minimum denomination which are smaller than it the following wording should be added: "For the avoidance of doubt, in the case of a holding of Notes in an integral multiple of [] in excess of [] as envisaged in paragraph 6 above, such holding will be redeemed at its nominal amount.")
(N.B. If the Final Redemption Amount is other than 100 per cent. of the nominal value the Notes will be derivative securities for the purposes of the Prospectus Directive and the requirements of Annex XII to the Prospectus Directive Regulation will apply.)
26. Early Redemption Amount of each Note payable on redemption for taxation reasons or on event of default and/or the method of calculating the same (if required or if different from that set out in Condition 7(f)): [] per Note of [] Specified Denomination
27. Capital Notes Provisions

- (i) Special Event Redemption Amount: []
- (ii) Special Event Redemption Date(s): []
- (iii) Investment Considerations: [In making an investment decision in respect of Capital Notes, potential investors should carefully consider the merits and risks of an investment in the Capital Notes and carefully review the Conditions and this Final Terms. In particular (i) the Capital Notes are undated and deeply subordinated; (ii) principal in respect of the Capital Notes may be converted into conditional capital contributions as described in Condition 2(d); (iii) conditional capital contributions may only be reconverted and reinstated as provided in Condition 2(e); (iv) the Issuer shall not pay accrued interest in certain circumstances as provided in Condition 5; and (v) the Capital Notes may be redeemed at the option of the Issuer, as specified in the applicable Final Terms subject to prior approval of the FSA and provided that any conditional capital contributions have been reconverted and reinstated as provided in Condition 2(e), all as further described in Condition 7./Other]

GENERAL PROVISIONS APPLICABLE TO THE NOTES

28. (a) Form of Notes: [Temporary Global Note exchangeable for a Permanent Global Note which is exchangeable for Definitive Notes [on 60 days' notice given at any time/only upon an Exchange Event]]
- [Temporary Global Note exchangeable for Definitive Notes on and after the Exchange Date]
- [Permanent Global Note exchangeable for Definitive Notes [on 60 days' notice given at any time/only upon an Exchange Event]]
- (Ensure that this is consistent with the wording in the "Form of the Notes" section in the Base Prospectus and the Notes themselves. N.B. Need to amend Exchange Events to disapply any Noteholder/Issuer optional exchange where Notes are expressed to have a minimum denomination of EUR 50,000 and are tradeable in integral multiples of EUR 1,000 thereafter in order for Notes to be accepted by the clearing systems.)*
- (b) New Global Note: [Yes][No]

29. Additional Financial Centre(s) or other special provisions relating to Payment Dates: [Not Applicable/give details]
(Note that this item relates to the place of payment and not Interest Period end dates to which items 16(iii) and 18(vi) relate)
30. Talons for future Coupons or Receipts to be attached to Definitive Notes (and dates on which such Talons mature): [Yes/No. If yes, give details]
31. Details relating to Partly Paid Notes: amount of each payment comprising the Issue Price and date on which each payment is to be made and consequences of failure to pay, including any right of the Issuer to forfeit the Notes and interest due on late payment: [Not Applicable/give details. NB: a new form of Temporary Global Note and/or Permanent Global Note may be required for Partly Paid issues]
32. Details relating to Instalment Notes:
- (i) Instalment Amount(s): [Not Applicable/give details]
- (ii) Instalment Date(s): [Not Applicable/give details]
33. Redenomination applicable: Redenomination [not] applicable
[(If Redenomination is applicable, specify the applicable Day Count Fraction and any provisions necessary to deal with floating rate interest calculation (including alternative reference rates)]
34. Other final terms: [Not Applicable/give details]
(When adding any other final terms consideration should be given as to whether such terms constitute “significant new factors” and consequently trigger the need for a supplement to the Base Prospectus under Article 16 of the Prospectus Directive.)

DISTRIBUTION

35. (i) If syndicated, names [and addresses]** of Managers [and underwriting commitments]:** [Not Applicable/give names [and addresses and underwriting commitments]**] *(Include names and addresses of entities agreeing to underwrite the issue on a firm commitment basis and names and addresses of the entities agreeing to place the issue without a firm commitment or on a “best efforts” basis. If such entities are not the same as the Managers.)***
- (ii) Date of Subscription Agreement**** []****
- (iii) Stabilising Manager (if any): [Not Applicable/give name]
36. If non-syndicated, name [and address]** of relevant Dealer: [Name [and address]**]

- 37. Total commission and concession**: [] per cent. of the Aggregate Nominal Amount**
- 38. Whether TEFRA D or TEFRA C rules applicable or TEFRA rules not applicable: [TEFRA D/TEFRA C/TEFRA not applicable]
- 39. Additional selling restrictions: [Not Applicable/*give details*]

[LISTING AND ADMISSION TO TRADING APPLICATION

These Final Terms comprise the final terms required to list and have admitted to trading the issue of Notes described herein pursuant to the €12,000,000,000 Euro Medium Term Note Programme of Kaupthing Bank hf.]

RESPONSIBILITY

The Issuer accepts responsibility for the information contained in these Final Terms. [[]has been extracted from []. The Issuer confirms that such information has been accurately reproduced and that, so far as it is aware and is able to ascertain from information published by [], no facts have been omitted which would render the reproduced information inaccurate or misleading.]

Signed on behalf of the Issuer:

By:
Duly authorised

PART B – OTHER INFORMATION

1. LISTING

- (i) Listing: [Luxembourg/other (*specify*)/None]
- (ii) Admission to trading: [Application has been made for the Notes to be admitted to trading on [] with effect from [].] [Not Applicable.]
(Where documenting a fungible issue need to indicate that original securities are already admitted to trading.)**
- (iii) Estimate of total expenses related to admission to trading:* []*

2. RATINGS

- Ratings: The Notes to be issued have been rated:
- Moody's: []
Fitch Ratings Ltd: []
[[Other]: []]
- [Need to include a brief explanation of the meaning of the ratings if this has previously been published by the rating provider.]**
(The above disclosure should reflect the rating allocated to Notes of the type being issued under the Programme generally or, where the issue has been specifically rated, that rating.)

[3. NOTIFICATION

The [*name of competent authority in home Member State*] [has been requested to provide/has provided - *include first alternative for an issue which is contemporaneous with the establishment or update of the Programme and the second alternative for subsequent issues*] the [*names of competent authorities of host Member States*] with a certificate of approval attesting that the Prospectus has been drawn up in accordance with the Prospectus Directive.]

4. INTERESTS OF NATURAL AND LEGAL PERSONS INVOLVED IN THE ISSUE

[Save for any fees payable to the [Managers/Dealers], so far as the Issuer is aware, no person involved in the issue of the Notes has an interest material to the offer. - *Amend as appropriate if there are other interests*]

5. REASONS FOR THE OFFER, ESTIMATED NET PROCEEDS AND TOTAL EXPENSES

- [(i) Reasons for the Offer: []
(See “Use of Proceeds” wording in Base Prospectus – if reasons for offer different from making profit and/or hedging certain risks will need to include those reasons here.)]**

[(ii)] Estimated net proceeds: []
*(If proceeds are intended for more than one use will need to split out and present in order of priority. If proceeds insufficient to fund all proposed uses state amount and sources of other funding.)***

[(iii)] Estimated total expenses: [] *[Expenses are required to be broken down into each principal intended "use" and presented in order of priority of "uses".]***
(N.B. If the Notes are derivative securities to which Annex XII of the Prospectus Directive Regulation applies (i) above is required where the reasons for the offer are different from making profit and/or hedging certain risks and, where such reasons are inserted in (i), disclosure of net proceeds and total expenses at (ii) and (iii) above are also required.)

6. **YIELD** (*Fixed Rate Notes only*)

Indication of yield: []
*[Calculated as [include details of method of calculation in summary form] on the Issue Date.]***

The yield is calculated at the Issue Date on the basis of the Issue Price. It is not an indication of future yield.

7. **HISTORIC INTEREST RATES** (*Floating Rate Notes only*)**

Details of historic [LIBOR/EURIBOR/other] rates can be obtained from [Telerate].]

8. **PERFORMANCE OF INDEX, EXPLANATION OF EFFECT ON VALUE OF INVESTMENT AND ASSOCIATED RISKS AND OTHER INFORMATION CONCERNING THE UNDERLYING INDEX** (*Index-Linked Notes only*)**

[Need to include details of where past and future performance and volatility of the index can be obtained.]

*[Need to include a clear and comprehensive explanation of how the value of the investment is affected by the underlying index and the circumstances when the risks are most evident.]***

[Need to include a description of any market disruption or settlement disruption events that affect the underlying index and any adjustment rules in relation to events concerning the underlying index (if applicable).]

[Need to include the name of the index and a description if composed by the Issuer and if the index is not composed by the Issuer need to include details of where the information about the index can be obtained.]

9. PERFORMANCE OF RATE[S] OF EXCHANGE AND EXPLANATION OF EFFECT ON VALUE OF INVESTMENT (Dual Currency Notes only)

[Need to include details of where past and future performance and volatility of the relevant rates can be obtained.]

*[Need to include a clear and comprehensive explanation of how the value of the investment is affected by the underlying and the circumstances when the risks are most evident.]***

10. OPERATIONAL INFORMATION

- | | | |
|-------|--|---|
| (i) | ISIN Code: | [] |
| (ii) | Common Code: | [] |
| (iii) | Any clearing system(s) other than Euroclear Bank S.A./N.V. and Clearstream Banking, société anonyme and the relevant identification number(s): | [Not Applicable/give name(s) and number(s)] |
| (iv) | Delivery: | Delivery [against/free of] payment |
| (v) | Names and addresses of additional Paying Agent(s) (if any): | [] |
| (vi) | Intended to be held in a manner which would allow Eurosystem eligibility: | [Yes] [No]
[Note that the designation “yes” simply means that the Notes are intended upon issue to be deposited with one of the ICSDs as common safekeeper and does not necessarily mean that the Notes will be recognised as eligible collateral for Eurosystem monetary policy and intra-day credit operations by the Eurosystem either upon issue or at any or all times during their life. Such recognition will depend upon satisfaction of the Eurosystem eligibility criteria.] <i>[include this text if “yes” selected in which case the Notes must be issued in NGN form]</i> |

Notes:

* Delete if the minimum denomination is less than €50,000

** Delete if the minimum denomination is €50,000

*** Delete if the minimum denomination is €50,000 unless the Notes are derivative securities for the purposes of Annex XII of the Prospectus Directive Regulation

TERMS AND CONDITIONS OF THE NOTES

The following are the Terms and Conditions of the Notes which will be incorporated by reference into each Global Note (as defined below) and each definitive Note, in the latter case only if permitted by the relevant stock exchange or other relevant authority (if any) and agreed by the Issuer and the relevant Dealer at the time of issue but, if not so permitted and agreed, such definitive Note will have endorsed thereon or attached thereto such Terms and Conditions. The applicable Final Terms in relation to any Tranche of Notes may specify other terms and conditions which shall, to the extent so specified or to the extent inconsistent with the following Terms and Conditions, replace or modify the following Terms and Conditions for the purpose of such Notes. The applicable Final Terms (or the relevant provisions thereof) will be endorsed upon, or attached to, each Global Note and definitive Note. Reference should be made to "Form of the Notes" for a description of the content of Final Terms which will specify which of such terms are to apply in relation to the relevant Notes.

This Note is one of a Series (as defined below) of Notes issued by Kaupthing Bank hf. (the "**Issuer**") pursuant to the Agency Agreement (as defined below).

References herein to the "**Notes**" shall be references to the Notes of this Series and shall mean:

- (i) in relation to any Notes represented by a global Note (a "**Global Note**"), units of the lowest Specified Denomination in the Specified Currency;
- (ii) any Global Note; and
- (iii) any definitive Notes issued in exchange for a Global Note.

The Notes, the Receipts (as defined below) and the Coupons (as defined below) have the benefit of an Amended and Restated Agency Agreement (such Agency Agreement as amended and/or supplemented and/or restated from time to time, the "**Agency Agreement**") dated 31st August, 2006 and made between the Issuer, Deutsche Bank AG, London Branch as issuing and principal paying agent and agent bank (the "**Agent**", which expression shall include any successor agent) and the other paying agents named therein (together with the Agent, the "**Paying Agents**", which expression shall include any additional or successor paying agents).

Interest bearing definitive Notes have interest coupons ("**Coupons**") and, if indicated in the applicable Final Terms, talons for further Coupons ("**Talons**") attached on issue. Any reference herein to Coupons or coupons shall, unless the context otherwise requires, be deemed to include a reference to Talons or talons. Definitive Notes repayable in instalments have receipts ("**Receipts**") for the payment of the instalments of principal (other than the final instalment) attached on issue. Global Notes do not have Receipts, Coupons or Talons attached on issue.

The final terms for this Note (or the relevant provisions thereof) are set out in Part A of the Final Terms attached to or endorsed on this Note which supplements these Terms and Conditions (the "**Conditions**") and may specify other terms and conditions which shall, to the extent so specified or to the extent inconsistent with these Conditions, replace or modify these Conditions for the purposes of this Note. References to the "**applicable Final Terms**" are to Part A of the Final Terms (or the relevant provisions thereof) attached to or endorsed on this Note.

Any reference to "**Noteholders**" or "**holders**" in relation to any Notes shall mean the holders of the Notes and shall, in relation to any Notes represented by a Global Note, be construed as provided below. Any reference herein to "**Receiptholders**" shall mean the holders of the Receipts and any reference herein to "**Couponholders**" shall mean the holders of the Coupons and shall, unless the context otherwise requires, include the holders of the Talons.

As used herein, "**Tranche**" means Notes which are identical in all respects (including as to listing and admission to trading) and "**Series**" means a Tranche of Notes together with any further Tranche or Tranches of Notes which are (i) expressed to be consolidated and form a single series and (ii)

identical in all respects (including as to listing and admission to trading) except for their respective Issue Dates, Interest Commencement Dates and/or Issue Prices.

The Noteholders, the Receiptholders and the Couponholders are entitled to the benefit of the Deed of Covenant (the “**Deed of Covenant**”) dated 2nd September, 2005 and made by the Issuer. The original of the Deed of Covenant is held by the common depository for Euroclear (as defined below) and Clearstream, Luxembourg (as defined below).

Copies of the Agency Agreement and the Deed of Covenant are available for inspection during normal business hours at the specified office of each of the Paying Agents.

Copies of the applicable Final Terms are available for viewing at the office of the Issuer at Borgartun 19, 105 Reykjavik, Iceland and copies may be obtained from the Principal Paying Agent at Winchester House, 1 Great Winchester Street, London EC2N 2DB. The Noteholders, the Receiptholders and the Couponholders are deemed to have notice of, and are entitled to the benefit of, all the provisions of the Agency Agreement, the Deed of Covenant and the applicable Final Terms which are applicable to them. The statements in these Terms and Conditions include summaries of, and are subject to, the detailed provisions of the Agency Agreement.

Words and expressions defined in the Agency Agreement or used in the applicable Final Terms shall have the same meanings where used in these Terms and Conditions unless the context otherwise requires or unless otherwise stated and provided that, in the event of inconsistency between the Agency Agreement and the applicable Final Terms, the applicable Final Terms will prevail.

1. FORM, DENOMINATION AND TITLE

The Notes are in bearer form and, in the case of definitive Notes, serially numbered, in the Specified Currency and the Specified Denomination(s). Notes of one Specified Denomination may not be exchanged for Notes of another Specified Denomination.

This Note may be a Fixed Rate Note, a Floating Rate Note, a Zero Coupon Note, an Index Linked Interest Note, a Dual Currency Interest Note, a Range Accrual Note, a Target Redemption Note or a combination of any of the foregoing, depending upon the Interest Basis shown in the applicable Final Terms.

This Note may be an Index Linked Redemption Note, an Instalment Note, a Dual Currency Redemption Note, a Partly Paid Note or a combination of any of the foregoing, depending upon the Redemption/Payment Basis shown in the applicable Final Terms.

This Note may also be a Senior Note, a Subordinated Note or a Capital Note, as indicated in the applicable Final Terms.

Whenever there is any adjustment to the principal amount of any Capital Note pursuant to the Conditions, upon presentation of such Capital Note to the Agent at its specified office, a record of such adjustment shall be endorsed by it on such Capital Note provided that any failure to so present or record shall not in any way affect the decrease or increase pursuant to Condition 2(d).

Definitive Notes are issued with Coupons attached, unless they are Zero Coupon Notes in which case references to Coupons and Couponholders in these Terms and Conditions are not applicable.

Subject as set out below, title to the Notes, Receipts and Coupons will pass by delivery. The Issuer and the Paying Agents will (except as otherwise required by law) deem and treat the bearer of any Note, Receipt or Coupon as the absolute owner thereof (whether or not overdue and notwithstanding any notice of ownership or writing thereon or notice of any

previous loss or theft thereof) for all purposes but, in the case of any Global Note, without prejudice to the provisions set out in the next succeeding paragraph.

For so long as any of the Notes is represented by a Global Note held on behalf of Euroclear Bank S.A./N.V. ("**Euroclear**") and/or Clearstream Banking, société anonyme ("**Clearstream, Luxembourg**"), each person (other than Euroclear or Clearstream, Luxembourg) who is for the time being shown in the records of Euroclear or of Clearstream, Luxembourg as the holder of a particular nominal amount of such Notes (in which regard any certificate or other document issued by Euroclear or Clearstream, Luxembourg as to the nominal amount of such Notes standing to the account of any person shall be conclusive and binding for all purposes save in the case of manifest error) shall be treated by the Issuer and the Paying Agents as the holder of such nominal amount of such Notes for all purposes other than with respect to the payment of principal or interest on such nominal amount of such Notes, for which purpose the bearer of the relevant Global Note shall be treated by the Issuer and any Paying Agent as the holder of such nominal amount of such Notes in accordance with and subject to the terms of the relevant Global Note and the expressions "**Noteholder**" and "**holder of Notes**" and related expressions shall be construed accordingly. Notes which are represented by a Global Note will be transferable only in accordance with the rules and procedures for the time being of Euroclear and Clearstream, Luxembourg, as the case may be.

References to Euroclear and/or Clearstream, Luxembourg shall, whenever the context so permits (except in relation to Notes issued in NGN form), be deemed to include a reference to any additional or alternative clearing system specified in the applicable Final Terms.

2. STATUS OF THE SENIOR NOTES AND SUBORDINATION

(a) Status of the Senior Notes

The Senior Notes and any relative Receipts and Coupons are direct, unconditional, unsubordinated and (subject to the provisions of Condition 3) unsecured obligations of the Issuer and rank *pari passu* among themselves and (save for certain obligations required to be preferred by law) equally with all other unsecured obligations (other than subordinated obligations, if any) of the Issuer, from time to time outstanding.

(b) Status of the Subordinated Notes

The Subordinated Notes and any relative Receipts and Coupons are unsecured and unconditional obligations of the Issuer, subordinated in accordance with and for the purposes of Chapter X; Liquid Assets and Own Funds; Article 84 of the Act on Financial Undertakings No. 161/2002 (the "**Act**") of the Icelandic Parliament, and rank *pari passu* and ratably and without any preference among themselves and accordingly, on the insolvency or voluntary or involuntary liquidation of the Issuer, the Subordinated Notes rank in right of payment:

- (i) after payment of all obligations of the Issuer which are not expressed to be subordinated in accordance with and for the purposes of Chapter X; Liquid Assets and Own Funds; Article 84 of the Act (or any provision in any other Act of the Icelandic Parliament which modifies or replaces those provisions) ("**Senior Obligations**");
- (ii) at least *pari passu* with all other obligations of the Issuer (other than obligations of the Issuer in respect of Tier I Capital of the Issuer) (as defined below) which are expressed to be subordinated in accordance with and for the purposes of Chapter X; Liquid Assets and Own Funds; Article 84 of the Act (or any provision in any other Act of the Icelandic Parliament which modifies or replaces those provisions) ("**Subordinated Obligations**");
- (iii) before all obligations of the Issuer in respect of Capital Securities of the Issuer;

- (iv) in priority to the rights of holders of all classes of ordinary share capital, preferred share capital and other share capital and/or establishment funds (*hlutafe eda stofnfe*) and/or comparable capital and reserves (*sambaerilegt eigid fe*), of the Issuer and in priority to the rights of holders of any obligation of the Issuer expressed to rank junior to the Capital Notes, in each case in relation to their rights as such holders and to payment in respect thereof.

The Issuer undertakes that for so long as any of the Subordinated Notes, Receipts or Coupons remain outstanding (as defined in the Agency Agreement) it will not create any subordinated obligation other than in accordance with and for the purposes of Chapter X; Liquid Assets and Own Funds; Article 84 of the Act or any provision in any other Act of the Icelandic Parliament which modifies or replaces those provisions). The provisions of this Condition 2(b) shall be governed by, and construed in accordance with, Icelandic law.

(c) Status of the Capital Notes

The Capital Notes and any relative Receipts and Coupons are unsecured and unconditional obligations of the Issuer, subordinated in accordance with and for the purposes of Chapter X: Liquid Assets and Own Funds; Article 84 of the Act as described below.

In the event of the insolvency or voluntary or involuntary liquidation of the Issuer, the rights of:

- (a) the holders of the Capital Notes and any relative Receipts and Coupons to payments of the principal amount of the Capital Notes and any other amounts including interest due in respect of the Capital Notes; and
- (b) where the whole or any part of the principal amount of the Capital Notes has been converted into conditional capital contributions as described below and such conditional capital contributions have not been reconverted and reinstated as provided below, the providers of such conditional capital contributions, in respect of such conditional capital contributions,

shall rank:

- (i) *pari passu* without any preference among the holders of the Capital Notes and any relative Receipts and Coupons and such providers;
- (ii) at least *pari passu* with the rights of the holders of any other outstanding Capital Securities whether or not such Capital Securities have been converted in the manner described below and at least *pari passu* with the rights of the holders of any other obligations of the Issuer constituting or eligible (“eligible” to be construed, *mutatis mutandis*, as provided in the definition of Capital Event) as constituting Tier I Capital of the Issuer, in each case in relation to their rights as such holders and to payments in respect thereof;
- (iii) in priority to the rights of holders of all classes of ordinary share capital, preferred share capital and other share capital and/or establishment funds (*hlutafe eda stofnfe*) and/or comparable capital and reserves (*sambaerilegt eigid fev*), of the Issuer and in priority to the rights of holders of any obligation of the Issuer expressed to rank junior to the Capital Notes, in each case in relation to their rights as such holders and to payments in respect thereof; and
- (iv) junior in right of payment to the payment of any present or future claims under Senior Obligation and Subordinated Obligations.

No holder of a Capital Note or any relative Receipt or Coupon or provider of any conditional capital contribution who shall in the event of the insolvency voluntary or involuntary

liquidation of the Issuer be indebted to the Issuer shall be entitled to exercise any right of set-off or counterclaim against moneys owed by the Issuer in respect of the Capital Notes or conditional capital contributions held or provided by such holder or provider, as the case may be.

The Issuer reserves the right to issue Capital Securities in the future or other obligations constituting or eligible as constituting Tier I Capital of the Issuer, provided, however, that any such obligations may not in the event of insolvency or voluntary or involuntary liquidation of the Issuer rank in priority to the Capital Notes.

A “**Capital Event**” means the determination by the Issuer (such determination to be evidenced by a certificate signed by two Directors of the Issuer and to be binding on the Capital Noteholders without further investigation (copies of such certificate to be available for inspection at the specified office of the Agent)), having received confirmation or similar proof thereof from the Financial Supervisory Authority of Iceland (*fjármálaeftirlitid*) or any successor (the “FSA”), that the Capital Notes are no longer eligible for inclusion in Tier I Capital of the Issuer and for these purposes the Capital Notes shall be deemed to be so “eligible” notwithstanding that any limits in respect of obligations which can be included in determining such eligibility would be exceeded by including in such determination all or any part of the Capital Notes and accordingly for these purposes any such limits shall be disregarded.

“**Capital Securities**” means any subordinated and undated debt instruments of the Issuer which are recognised Tier I Capital from time to time by the FSA and including, where the context so requires, the Capital Notes.

“**Tier I Capital**” means capital which is treated as issued tier I capital (*Eiginfjárháttur A*) by the FSA either on a solo or on a consolidated basis.

(d) Utilisation and Conversion of Capital Notes

To the extent that it may be required to avoid the Issuer no longer meeting the requirements with respect to minimum own funds (“**Minimum Own Funds**”) as set out in The Act on Financial Undertaking (161/2002), as amended, of the Icelandic Parliament the Board of Directors of the Issuer, by resolution passed at a board meeting, may decide that the principal amount (or part thereof, as the case may be) of each Capital Note will be utilised by writing down all or part of the principal amount to the extent and by the amount required to avoid falling below the required Minimum Own Funds and converting such aggregate amount (the “**Converted Amount**”) into a conditional capital contribution. The rights of the holders of the Capital Notes on any relative Receipts and Coupons in respect of the Converted Amount will thereupon be converted into rights of providers of conditional capital contributions as set out herein.

Upon utilisation of the Converted Amount as above the Issuer shall give notice to the Capital Noteholders in accordance with Condition 14.

Utilisation of the Converted Amount for the purpose of avoiding the Issuer’s own funds falling below the required Minimum Own Funds shall be made prior to the utilisation for the same purpose of the principal amount of outstanding perpetual/undated subordinated debt issued by the Issuer (other than other Capital Securities) and shall be made following the utilisation for the same purpose of the principal amount of Capital Securities and any other securities ranking junior to the Capital Notes and outstanding at the time of such utilisation and *pro rata* to the principal amount of Capital Securities ranking *pari passu* with the Capital Notes and outstanding at the time of such utilisation.

Where, pursuant to this Condition 2(d), writing down and conversion applies to part only of the principal amount of the Capital Notes, the part of the principal amount of each Capital Note to be subject to such writing down and conversion shall bear the same proportion to the total amount of the principal amount in respect of such Capital Note as the aggregate amount of the principal

amount of all the Capital Notes to be subject to such writing down and conversion bears to the aggregate outstanding principal amount of all the Capital Notes respectively. Any reconversion and reinstatement as provided below will be made on the same basis.

Utilisation of the Converted Amount as aforesaid may only be made provided:

- (a) that the Agent has received prior to such utilisation a certificate signed by two Directors of the Issuer confirming that, following such conversion to a Converted Amount, the rights of the providers thereof in respect of such amounts will rank as provided in Condition 2(c) (copies of such certificate will be available for inspection at the specified office of the Agent);
- (b) that the FSA shall have given its approval thereto provided that such approval can be validly given in accordance with the rules, regulations and policies of the FSA; and
- (c) that the Agent has received prior to such utilisation a certificate signed by two Directors of the Issuer confirming that following such conversion to a Converted Amount, such amount will be a conditional capital contribution and will be accounted for as such in the balance sheet of the Issuer (copies of such certificate will be available for inspection at the specified office of the Agent).

Utilisation as described above of the whole or part of the principal amount of the Capital Notes shall not constitute an Event of Default under Condition 10.

(e) Reconversion and Reinstatement of Capital Notes

Reconversion and reinstatement (in whole or in part) as obligations in respect of the Capital Notes of the Converted Amount may only be made out of Unallocated Distributable Profits of the Issuer and subject to a resolution of the Board of Directors of the Issuer.

Reconversion and reinstatement shall first be made in respect of perpetual/undated subordinated debt (other than Capital Securities) issued by the Issuer that may have been converted into conditional capital contributions.

Reconversion and reinstatement as obligations in respect of the Capital Notes of the Converted Amount shall be made *pro rata* with any amounts converted in respect of other Capital Securities of the Issuer ranking *pari passu* with the Capital Notes. For the avoidance of doubt, amounts converted in respect of Capital Securities and any other securities expressed to rank junior to the Capital Notes shall be reconverted and reinstated as debt only after the Converted Amount (and any other amounts converted in respect of other Capital Securities of the Issuer expressed to rank *pari passu* with the Capital Notes) has been reconverted and reinstated as aforesaid.

If the Issuer's own funds exceed the required Minimum Own Funds allowing for reconversion and reinstatement (in whole or in part) as debt of amounts converted in respect of subordinated indebtedness in the form of Capital Securities and/or perpetual/undated subordinated securities and/or any other securities or reconversion and reinstatement (in whole or in part) as obligations in respect of the Capital Notes of any Converted Amount, the Board of Directors of the Issuer shall subsequently decide that such reconversion and reinstatement shall be made with due observance taken to the prescribed ranking between the relevant instruments to the extent such replenishment does not result in the Issuer's own funds falling below the required Minimum Own Funds.

If and to the extent that any Converted Amount has been reconverted and reinstated as an obligation in respect of such Capital Note in the balance sheet of the Issuer, such amount shall be reconverted and reinstated as principal and shall be added to the principal amount of such Note not converted to a Converted Amount for all purposes thereafter (and references to "principal" and "principal amount" shall be construed accordingly) and interest shall start to accrue on such amount and become payable in accordance with the terms of the Capital Notes as from the date of such reconversion and reinstatement.

Upon reconversion and reinstatement as obligations in respect of the Notes of the Converted Amount as described above the Issuer shall give notice to the Capital Noteholders in accordance with Condition 14.

The principal amount of the Capital Notes may be utilised and converted as described above on one or more occasions.

“Bank Share Capital” means the ordinary share capital of the Issuer, together with all other securities of the Issuer, ranking *pari passu* with the ordinary shares of the Issuer as to participation in a liquidation surplus.

“Unallocated Distributable Profits” means, in respect of each fiscal year of the Issuer, the aggregate amount, as calculated during the course of such fiscal year in the individual financial statements of the Issuer, of accumulated retained earnings and any other reserves, surpluses, including current operating profits, capable under Icelandic law of being available for distribution as cash dividends to holders of Bank Share Capital in the following year.

3. NEGATIVE PLEDGE

So long as any of the Senior Notes, Receipts or Coupons remains outstanding the Issuer undertakes that it will not and that it will procure that none of its Subsidiaries will create or have outstanding any mortgage, charge, pledge, lien or other security interest (each a **“Security Interest”**) (other than a Permitted Security Interest) upon the whole or any part of its undertaking, assets or revenues (including any uncalled capital), present or future, in order to secure any Relevant Indebtedness (as defined below) or to secure any guarantee of or indemnity in respect of any Relevant Indebtedness unless (a) all amounts payable by it under the Senior Notes, Receipts and Coupons are equally and ratably secured therewith by such Security Interest or (b) such other Security Interest or other arrangement (whether or not it includes the giving of a Security Interest) is provided as shall be approved by an Extraordinary Resolution (as defined in the Agency Agreement) of the Noteholders.

Nothing in this Condition 3 shall prevent the Issuer or any Subsidiary of the Issuer, as the case may be, from creating or permitting to subsist a Security Interest upon a defined or definable pool of its assets including, but not limited to, receivables (not representing all of the assets of the Issuer or any Subsidiary of the Issuer, as the case may be) (the **“Secured Assets”**) which is or was created pursuant to any securitisation or like arrangement in accordance with established market practice (whether or not involving itself as the issuer of any issue of asset-backed securities) and whereby all payment obligations in respect of the Relevant Indebtedness of any Person or under any guarantee of or indemnity in respect of the Relevant Indebtedness of any other Person, as the case may be, secured on, or on an interest in the Secured Assets are to be discharged solely from the Secured Assets (or solely from (i) the Secured Assets and (ii) assets of a Person other than the Issuer or any Subsidiary of the Issuer).

For the purposes of these Conditions:

“Excluded Indebtedness” means any Relevant Indebtedness in respect of which the person or persons to whom any such Relevant Indebtedness is or may be owed by the relevant borrower has or have no recourse whatsoever to the Issuer or any Subsidiary (whether or not also the relevant borrower) for the repayment thereof other than:

- (i) recourse to such borrower for amounts limited to the cash flow or net cash flow (other than historic cash flow or historic net cash flow) from a Specified Asset; and/or
- (ii) recourse to such borrower for the purpose only of enabling amounts to be claimed in respect of such Relevant Indebtedness in an enforcement of any encumbrance given by such borrower over a Specified Asset or the income, cash flow or other proceeds deriving therefrom (or given by a shareholder or the like in the borrower over its shares)

or the like in the capital of the borrower) to secure such Relevant Indebtedness, provided that (a) the extent of such recourse to such borrower is limited solely to the amount of any recoveries made on any such enforcement, and (b) such person or persons is/are not entitled, by virtue of any right or claim arising out of or in connection with such Relevant Indebtedness, to commence proceedings for the winding up or dissolution of the borrower or to appoint or procure the appointment of any receiver, trustee or similar person or officer in respect of the borrower or any of its assets (save for the assets the subject of such encumbrance); and/or

- (iii) recourse of such borrower generally, or directly or indirectly to the Issuer or any Subsidiary, under any form of assurance, undertaking or support, which recourse is limited to a claim for damages (other than liquidated damages and damages required to be calculated in a specified way) for breach of an obligation (not being a payment obligation or an obligation to procure payment by another or an indemnity in respect thereof or any obligation to comply or to procure compliance by another with any financial ratios or other tests of financial condition) by the person against which such recourse is available;

“Government Entities” means any body, agency, ministry, department, authority, statutory corporation or other entity of or pertaining to a member state of the European Economic Area or the government thereof or any political subdivision, municipality or local government thereof (whether autonomous or not);

“Permitted Security Interest” means any security interest created by the Issuer or its Subsidiaries over the whole or any part of their present or future assets or revenues where such assets or revenues are comprised of the following (or are otherwise qualifying collateral for issues of covered bonds pursuant to any relevant contractual arrangements and/or specific provisions of the laws of Iceland relating to covered bonds): (i) mortgage receivables; or (ii) receivables against Government Entities; or (iii) asset-backed securities backed by any of the assets under paragraph (i) or (ii); or (iv) any other assets permitted by Icelandic law to collateralise the covered bonds, in each case provided that the creation of such security interest is pursuant to the relevant contractual arrangements or, as the case may be, specific provisions of the laws of Iceland relating to covered bonds applicable at the time of creation of such security interest;

“Person” means any individual, company, corporation, firm, partnership, joint venture, association, organisation, state or agency of a state or other entity, whether or not having separate legal personality;

“Relevant Indebtedness” means any present or future indebtedness (which term shall be construed so as to include any obligation (whether incurred as principal or as surety) for the payment or repayment of money, whether present or future, actual or contingent) in the form of, or represented or evidenced by, bonds, debentures, notes or other securities which are, or are intended to be, with the agreement of the issuer thereof, quoted, listed, dealt in or traded on any stock exchange or over-the-counter or other securities market other than such indebtedness which by its terms will mature within a period of one year from its date of issue and other than Excluded Indebtedness;

“Specified Asset” means an asset of the Issuer or any Subsidiary over which security is given in connection with any limited recourse securitisation or other asset-backed financing; and

“Subsidiary” means any entity whose affairs are required by law or in accordance with generally accepted accounting principles applicable to Iceland to be consolidated in the consolidated accounts of the Issuer.

4. REDENOMINATION

(a) *Redenomination*

Where redenomination is specified in the applicable Final Terms as being applicable, the Issuer may, without the consent of the Noteholders, the Receiptholders and the Couponholders, on giving prior notice to the Agent, Euroclear and Clearstream, Luxembourg and at least 30 days' prior notice to the Noteholders in accordance with Condition 14, elect that, with effect from the Redenomination Date specified in the notice, the Notes shall be redenominated in euro.

The election will have effect as follows:

- (i) the Notes and the Receipts shall be deemed to be redenominated into euro in the denomination of euro 0.01 with a principal amount for each Note and Receipt equal to the principal amount of that Note or Receipt in the Specified Currency, converted into euro at the Established Rate, provided that, if the Issuer determines, with the agreement of the Agent, that the then market practice in respect of the redenomination into euro of internationally offered securities is different from the provisions specified above, such provisions shall be deemed to be amended so as to comply with such market practice and the Issuer shall promptly notify the Noteholders, the stock exchange (if any) on which the Notes may be listed and the Paying Agents of such deemed amendments;
- (ii) save to the extent that an Exchange Notice has been given in accordance with paragraph (iv) below, the amount of interest due in respect of the Notes will be calculated by reference to the aggregate principal amount of Notes presented (or, as the case may be, in respect of which Coupons are presented) for payment by the relevant holder and the amount of such payment shall be rounded down to the nearest euro 0.01;
- (iii) if definitive Notes are required to be issued after the Redenomination Date, they shall be issued at the expense of the Issuer in the denominations of euro 1,000, euro 10,000, euro 100,000 and (but only to the extent of any remaining amounts less than euro 1,000 or such smaller denominations as the Agent may approve) euro 0.01 and such other denominations as the Agent shall determine and notify to the Noteholders;
- (iv) if issued prior to the Redenomination Date, all unmatured Coupons denominated in the Specified Currency (whether or not attached to the Notes) will become void with effect from the date on which the Issuer gives notice (the "**Exchange Notice**") that replacement euro-denominated Notes, Receipts and Coupons are available for exchange (provided that such securities are so available) and no payments will be made in respect of them. The payment obligations contained in any Notes and Receipts so issued will also become void on that date although those Notes and Receipts will continue to constitute valid exchange obligations of the Issuer. New euro-denominated Notes, Receipts and Coupons will be issued in exchange for Notes, Receipts and Coupons denominated in the Specified Currency in such manner as the Agent may specify and as shall be notified to the Noteholders in the Exchange Notice. No Exchange Notice may be given less than 15 days prior to any date for payment of principal or interest on the Notes;
- (v) after the Redenomination Date, all payments in respect of the Notes, the Receipts and the Coupons, other than payments of interest in respect of periods commencing before the Redenomination Date, will be made solely in euro as though references in the Notes to the Specified Currency were to euro. Payments will be made in euro by credit or transfer to a euro account (or any other account to which euro may be credited or transferred) specified by the payee or, at the option of the payee, by a euro cheque;

- (vi) if the Notes are Fixed Rate Notes and interest for any period ending on or after the Redenomination Date is required to be calculated for a period ending other than on an Interest Payment Date, it will be calculated by applying the Rate of Interest to each Specified Denomination, multiplying such sum by the applicable Day Count Fraction, and rounding the resultant figure to the nearest sub-unit of the relevant Specified Currency, half of any such sub-unit being rounded upwards or otherwise in accordance with applicable market convention; and
- (vii) if the Notes are Floating Rate Notes, the applicable Final Terms will specify any relevant changes to the provisions relating to interest.

(b) *Definitions*

In these Conditions, the following expressions have the following meanings:

“Established Rate” means the rate for the conversion of the Specified Currency (including compliance with rules relating to roundings in accordance with applicable European Community regulations) into euro established by the Council of the European Union pursuant to Article 123 of the Treaty;

“euro” means the currency introduced at the start of the third stage of European economic and monetary union pursuant to the Treaty;

“Redenomination Date” means (in the case of interest bearing Notes) any date for payment of interest under the Notes or (in the case of Zero Coupon Notes) any date, in each case specified by the Issuer in the notice given to the Noteholders pursuant to paragraph (a) above and which falls on or after the date on which the country of the Specified Currency first participates in the third stage of European economic and monetary union; and

“Treaty” means the Treaty establishing the European Community, as amended.

5. INTEREST

(a) *Interest on Fixed Rate Notes*

Each Fixed Rate Note bears interest on its outstanding nominal amount (or, if it is a Partly Paid Note, the amount paid up) from (and including) the Interest Commencement Date at the rate(s) per annum equal to the Rate(s) of Interest. Interest will be payable in arrear on the Interest Payment Date(s) in each year up to (and including) the Maturity Date.

Except as provided in the applicable Final Terms, the amount of interest payable on each Interest Payment Date in respect of the Fixed Interest Period ending on (but excluding) such date will amount to the Fixed Coupon Amount. Payments of interest on any Interest Payment Date will, if so specified in the applicable Final Terms, amount to the Broken Amount so specified.

As used in these Terms and Conditions, **“Fixed Interest Period”** means the period from (and including) an Interest Payment Date (or the Interest Commencement Date) to (but excluding) the next (or first) Interest Payment Date.

If interest is required to be calculated for a period other than a Fixed Interest Period or if no Fixed Coupon Amount is specified in the applicable Final Terms, such interest shall be calculated by applying the Rate of Interest to each Specified Denomination, multiplying such sum by the applicable Day Count Fraction, and rounding the resultant figure to the nearest sub-unit of the relevant Specified Currency, half of any such sub-unit being rounded upwards or otherwise in accordance with applicable market convention.

“Day Count Fraction” means, in respect of the calculation of an amount of interest in accordance with this Condition 5(a):

- (i) if “Actual/Actual (ICMA)” is specified in the applicable Final Terms:
 - (a) in the case of Notes where the number of days in the relevant period from (and including) the most recent Interest Payment Date (or, if none, the Interest Commencement Date) to (but excluding) the relevant payment date (the “**Accrual Period**”) is equal to or shorter than the Determination Period during which the Accrual Period ends, the number of days in such Accrual Period divided by the product of (1) the number of days in such Determination Period and (2) the number of Determination Dates (as specified in the applicable Final Terms) that would occur in one calendar year; or
 - (b) in the case of Notes where the Accrual Period is longer than the Determination Period during which the Accrual Period ends, the sum of:
 - (1) the number of days in such Accrual Period falling in the Determination Period in which the Accrual Period begins divided by the product of (x) the number of days in such Determination Period and (y) the number of Determination Dates that would occur in one calendar year; and
 - (2) the number of days in such Accrual Period falling in the next Determination Period divided by the product of (x) the number of days in such Determination Period and (y) the number of Determination Dates that would occur in one calendar year; and
- (ii) if “30/360” is specified in the applicable Final Terms, the number of days in the period from (and including) the most recent Interest Payment Date (or, if none, the Interest Commencement Date) to (but excluding) the relevant payment date (such number of days being calculated on the basis of a year of 360 days with 12 30-day months) divided by 360.

In these Terms and Conditions:

“**Determination Period**” means each period from (and including) a Determination Date to but excluding the next Determination Date (including, where either the Interest Commencement Date or the final Interest Payment Date is not a Determination Date, the period commencing on the first Determination Date prior to, and ending on the first Determination Date falling after, such date) ; and

“**sub-unit**” means, with respect to any currency other than euro, the lowest amount of such currency that is available as legal tender in the country of such currency and, with respect to euro, one cent.

(b) *Interest on Floating Rate Notes and Index Linked Interest Notes*

(i) *Interest Payment Dates*

Each Floating Rate Note and Index Linked Interest Note bears interest on its outstanding nominal amount (or, if it is a Partly Paid Note, the amount paid up) from (and including) the Interest Commencement Date and such interest will be payable in arrear on either:

- (A) the Specified Interest Payment Date(s) in each year specified in the applicable Final Terms; or
- (B) if no Specified Interest Payment Date(s) is/are specified in the applicable Final Terms, each date (each such date, together with each Specified Interest Payment Date, an “**Interest Payment Date**”) which falls the number of months or other period specified as the Specified Period in the applicable Final Terms after the preceding Interest Payment Date or, in the case of the first Interest Payment Date, after the Interest Commencement Date.

Such interest will be payable in respect of each Interest Period (which expression shall, in these Terms and Conditions, mean the period from (and including) an Interest Payment Date (or the Interest Commencement Date) to (but excluding) the next (or first) Interest Payment Date).

If a Business Day Convention is specified in the applicable Final Terms and (x) if there is no numerically corresponding day on the calendar month in which an Interest Payment Date should occur or (y) if any Interest Payment Date would otherwise fall on a day which is not a Business Day, then, if the Business Day Convention specified is:

- (1) in any case where Specified Periods are specified in accordance with Condition 5(b)(i)(B) above, the Floating Rate Convention, such Interest Payment Date (i) in the case of (x) above, shall be the last day that is a Business Day in the relevant month and the provisions of (B) below shall apply *mutatis mutandis* or (ii) in the case of (y) above, shall be postponed to the next day which is a Business Day unless it would thereby fall into the next calendar month, in which event (A) such Interest Payment Date shall be brought forward to the immediately preceding Business Day and (B) each subsequent Interest Payment Date shall be the last Business Day in the month which falls the Specified Period after the preceding applicable Interest Payment Date occurred; or
- (2) the Following Business Day Convention, such Interest Payment Date shall be postponed to the next day which is a Business Day; or
- (3) the Modified Following Business Day Convention, such Interest Payment Date shall be postponed to the next day which is a Business Day unless it would thereby fall into the next calendar month, in which event such Interest Payment Date shall be brought forward to the immediately preceding Business Day; or
- (4) the Preceding Business Day Convention, such Interest Payment Date shall be brought forward to the immediately preceding Business Day.

In these Terms and Conditions, “**Business Day**” means a day which is both:

- (A) a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in London and each Additional Business Centre specified in the applicable Final Terms; and
- (B) either (1) in relation to any sum payable in a Specified Currency other than euro, a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in the principal financial centre of the country of the relevant Specified Currency (if other than London and any Additional Business Centre and which if the Specified Currency is Australian dollars or New Zealand dollars shall be Sydney or Auckland, respectively) or (2) in relation to any sum payable in euro, a day on which the Trans-European Automated Real-Time Gross Settlement Express Transfer (TARGET) System (the “**TARGET System**”) is open.

(ii) *Rate of Interest*

The Rate of Interest payable from time to time in respect of Floating Rate Notes and Index Linked Interest Notes will be determined in the manner specified in the applicable Final Terms.

(A) *ISDA Determination for Floating Rate Notes*

Where ISDA Determination is specified in the applicable Final Terms as the manner in which the Rate of Interest is to be determined, the Rate of Interest for each Interest Period will be the relevant ISDA Rate plus or minus (as indicated in the applicable Final Terms) the Margin (if any). For the purposes of this sub-paragraph (A), “**ISDA Rate**” for an Interest Period means a rate equal to the Floating Rate that would be determined by the Agent under an interest rate swap transaction if the Agent were acting as Calculation Agent for that swap transaction under the terms of an agreement incorporating the 2000 ISDA Definitions, as published by the International Swaps and Derivatives Association, Inc. and as amended and updated as at the Issue Date of the first Tranche of the Notes (the “**ISDA Definitions**”) and under which:

- (1) the Floating Rate Option is as specified in the applicable Final Terms;
- (2) the Designated Maturity is a period specified in the applicable Final Terms; and
- (3) the relevant Reset Date is either (i) if the applicable Floating Rate Option is based on the London inter-bank offered rate (“**LIBOR**”) or on the Euro-zone inter-bank offered rate (“**EURIBOR**”), the first day of that Interest Period or (ii) in any other case, as specified in the applicable Final Terms.

For the purposes of this sub-paragraph (A), “**Floating Rate**”, “**Calculation Agent**”, “**Floating Rate Option**”, “**Designated Maturity**” and “**Reset Date**” have the meanings given to those terms in the ISDA Definitions.

(B) *Screen Rate Determination for Floating Rate Notes*

Where Screen Rate Determination is specified in the applicable Final Terms as the manner in which the Rate of Interest is to be determined, the Rate of Interest for each Interest Period will, subject as provided below, be either:

- (1) the offered quotation; or
- (2) the arithmetic mean (rounded if necessary to the fifth decimal place, with 0.000005 being rounded upwards) of the offered quotations,

(expressed as a percentage rate per annum) for the Reference Rate which appears or appear, as the case may be, on the Relevant Screen Page as at 11.00 a.m. (London time, in the case of LIBOR, or Brussels time, in the case of EURIBOR) on the Interest Determination Date in question plus or minus (as indicated in the applicable Final Terms) the Margin (if any), all as determined by the Agent. If five or more of such offered quotations are available on the Relevant Screen Page, the highest (or, if there is more than one such highest quotation, one only of such quotations) and the lowest (or, if there is more than one such lowest quotation, one only of such quotations) shall be disregarded by the Agent for the purpose of determining the arithmetic mean (rounded as provided above) of such offered quotations.

The Agency Agreement contains provisions for determining the Rate of Interest in the event that the Relevant Screen Page is not available or if, in the case of (1) above, no such offered quotation appears or, in the case of (2) above, fewer than three such offered quotations appear, in each case as at the time specified in the preceding paragraph.

If the Reference Rate from time to time in respect of Floating Rate Notes is specified in the applicable Final Terms as being other than LIBOR or EURIBOR, the Rate of Interest in respect of such Notes will be determined as provided in the applicable Final Terms.

(iii) *Minimum Rate of Interest and/or Maximum Rate of Interest*

If the applicable Final Terms specifies a Minimum Rate of Interest for any Interest Period, then, in the event that the Rate of Interest in respect of such Interest Period determined in accordance with the provisions of paragraph (ii) above is less than such Minimum Rate of Interest, the Rate of Interest for such Interest Period shall be such Minimum Rate of Interest.

If the applicable Final Terms specifies a Maximum Rate of Interest for any Interest Period, then, in the event that the Rate of Interest in respect of such Interest Period determined in accordance with the provisions of paragraph (ii) above is greater than such Maximum Rate of Interest, the Rate of Interest for such Interest Period shall be such Maximum Rate of Interest.

(iv) *Determination of Rate of Interest and calculation of Interest Amounts*

The Agent, in the case of Floating Rate Notes, and the Calculation Agent, in the case of Index Linked Interest Notes, will at or as soon as practicable after each time at which the Rate of Interest is to be determined, determine the Rate of Interest for the relevant Interest Period. In the case of Index Linked Interest Notes, the Calculation Agent will notify the Agent of the Rate of Interest for the relevant Interest Period as soon as practicable after calculating the same.

The Agent will calculate the amount of interest (the “**Interest Amount**”) payable on the Floating Rate Notes or Index Linked Interest Notes in respect of each Specified Denomination for the relevant Interest Period. Each Interest Amount shall be calculated by applying the Rate of Interest to each Specified Denomination, multiplying such sum by the applicable Day Count Fraction, and rounding the resultant figure to the nearest sub-unit of the relevant Specified Currency, half of any such sub-unit being rounded upwards or otherwise in accordance with applicable market convention.

“**Day Count Fraction**” means, in respect of the calculation of an amount of interest in accordance with this Condition 5(b):

- (i) if “Actual/365” or “Actual/Actual” is specified in the applicable Final Terms, the actual number of days in the Interest Period divided by 365 (or, if any portion of that Interest Period falls in a leap year, the sum of (A) the actual number of days in that portion of the Interest Period falling in a leap year divided by 366 and (B) the actual number of days in that portion of the Interest Period falling in a non-leap year divided by 365);
- (ii) if “Actual/365 (Fixed)” is specified in the applicable Final Terms, the actual number of days in the Interest Period divided by 365;
- (iii) if “Actual/365 (Sterling)” is specified in the applicable Final Terms, the actual number of days in the Interest Period divided by 365 or, in the case of an Interest Payment Date falling in a leap year, 366;
- (iv) if “Actual/360” is specified in the applicable Final Terms, the actual number of days in the Interest Period divided by 360;
- (v) if “30/360”, “360/360” or “Bond Basis” is specified in the applicable Final Terms, the number of days in the Interest Period divided by 360 (the number of days to be calculated on the basis of a year of 360 days with 12 30-day months (unless (a) the last day of the Interest Period is the 31st day of a month but the first day of the Interest Period is a day other than the 30th or 31st day of a month, in which case the month that includes that last day shall not be considered to be shortened to a 30-day month, or (b) the last day of the Interest Period is the last day of the month of February, in which case the month of February shall not be considered to be lengthened to a 30-day month)); and

(vi) if “30E/360” or “Eurobond Basis” is specified in the applicable Final Terms, the number of days in the Interest Period divided by 360 (the number of days to be calculated on the basis of a year of 360 days with 12 30-day months, without regard to the date of the first day or last day of the Interest Period unless, in the case of the final Interest Period, the Maturity Date is the last day of the month of February, in which case the month of February shall not be considered to be lengthened to a 30-day month).

(v) *Notification of Rate of Interest and Interest Amounts*

The Agent will cause the Rate of Interest and each Interest Amount for each Interest Period and the relevant Interest Payment Date to be notified to the Issuer and any stock exchange on which the relevant Floating Rate Notes or Index Linked Interest Notes are for the time being listed by no later than the first day of each Interest Period and notice thereof to be published in accordance with Condition 14 as soon as possible after their determination but in no event later than the first day of the relevant Interest Period. Each Interest Amount and Interest Payment Date so notified may subsequently be amended (or appropriate alternative arrangements made by way of adjustment) without prior notice in the event of an extension or shortening of the Interest Period. Any such amendment will be promptly notified to each stock exchange on which the relevant Floating Rate Notes or Index Linked Interest Notes are for the time being listed and to the Noteholders in accordance with Condition 14. For the purposes of this paragraph, the expression “**London Business Day**” means a day (other than a Saturday or a Sunday) on which banks and foreign exchange markets are open for general business in London.

(vi) *Certificates to be final*

All certificates, communications, opinions, determinations, calculations, quotations and decisions given, expressed, made or obtained for the purposes of the provisions of this Condition 5(b), whether by the Agent or, if applicable, the Calculation Agent, shall (in the absence of wilful default, bad faith or manifest error) be binding on the Issuer, the Agent, the Calculation Agent (if applicable), the other Paying Agents and all Noteholders, Receiptholders and Couponholders and (in the absence as aforesaid) no liability to the Issuer, the Noteholders, the Receiptholders or the Couponholders shall attach to the Agent or the Calculation Agent (if applicable) in connection with the exercise or non-exercise by it of its powers, duties and discretions pursuant to such provisions.

(c) *Interest on Dual Currency Interest Notes*

The rate or amount of interest payable in respect of Dual Currency Interest Notes shall be determined in the manner specified in the applicable Final Terms.

(d) *Interest on Partly Paid Notes*

In the case of Partly Paid Notes (other than Partly Paid Notes which are Zero Coupon Notes), interest will accrue as aforesaid on the paid-up nominal amount of such Notes and otherwise as specified in the applicable Final Terms.

(e) *Interest on Target Redemption Notes*

The rate or amount of interest payable in respect of Target Redemption Notes shall be determined in the manner specified in the applicable Final Terms.

(f) *Interest on Range Accrual Notes*

The rate or amount of interest payable in respect of Range Accrual Notes shall be determined in the manner specified in the applicable Final Terms.

(g) *Accrual of interest*

Each Note (or in the case of the redemption of part only of a Note, that part only of such Note) will cease to bear interest (if any) from the date for its redemption unless, upon due presentation thereof, payment of principal is improperly withheld or refused. In such event, interest will continue to accrue until whichever is the earlier of:

- (1) the date on which all amounts due in respect of such Note have been paid; and
- (2) five days after the date on which the full amount of the moneys payable in respect of such Note has been received by the Agent and notice to that effect has been given to the Noteholders in accordance with Condition 14.

(h) *Sufficiency of Available Distributable Funds in respect of Capital Notes*

- (1) Payments of interest on any Interest Payment Date may not exceed, taking into account all payments previously made in the fiscal year in which the Interest Payment Date falls in respect of the Capital Notes, other Capital Securities ranking *pari passu* with the Notes and Other Tier I Securities, the Available Distributable Funds. To the extent that, on any Interest Payment Date, Available Distributable Funds are insufficient to pay or provide for payment in full of all accrued but unpaid interest under the Capital Notes, other Capital Securities ranking *pari passu* with the Capital Notes and Other Tier I Securities (in each case falling due on that Interest Payment Date), the Issuer will make partial payment of all accrued but unpaid interest under the Capital Notes, such other Capital Securities and Other Tier I Securities *pro rata* to the extent of such Available Distributable Funds. If, and to the extent that Available Distributable Funds are insufficient or non-existent and the Issuer makes partial payment of, or does not pay, accrued but unpaid interest, the right of the Capital Noteholders to receive accrued but unpaid interest in respect of the relevant Interest Period will be deferred until the Deferral End Date. At the Deferral End Date the Issuer will make full or partial payment of all deferred but unpaid interest under these Capital Notes and such other Capital Securities and Other Tier 1 Securities *pro rata* to the extent the Issuer has accrued any Unallocated Distributable Profits, as determined by the Board of Directors of the Issuer after consultation with the Issuer's auditors, in such fiscal year. If, and to the extent that, any deferred payments remain unpaid after the applicable Deferral End Date, the right of the Capital Noteholders to receive such deferred payments will be lost. The Issuer will have no obligation to make such payments of unpaid deferred interest or to pay interest thereon, whether or not payments of interest in respect of subsequent Interest Periods are made, and such unpaid deferred interest will not be deemed to have "accrued" or been earned for any purpose.

Notwithstanding anything to the contrary herein, the Issuer will not make any payments of interest if the Issuer, following payment of such interest, would no longer meet the requirements with respect to Minimum Own Funds.

- (2) The Issuer covenants that, so long as any Capital Note is outstanding, if the most recent scheduled payments on the Capital Notes have not been made in full or utilisation of a Converted Amount has been made, as aforesaid:
 - (i) subject to sub-clause (1) above, it shall not declare (nor shall its Board of Directors propose the declaration of), pay or distribute interest, a dividend or any other amount on, or in respect of, any Other Tier I Securities or any Junior Securities or make any payment on a Tier I Guarantee (except, in the case of Capital Securities ranking *pari passu* with the Capital Notes, any payments made on a *pro rata* basis as contemplated above);
 - (ii) subject to sub-clause (1) above, it shall not redeem, purchase or otherwise acquire any Other Tier I Securities or Junior Securities or purchase or otherwise

acquire any security benefiting from a Tier I Guarantee (save where those shares or securities being redeemed, purchased or acquired are replaced contemporaneously by an issue of shares or securities of the same aggregate principal amount and the same ranking in an insolvency or a voluntary or involuntary liquidation of the Issuer to those shares or securities being redeemed, purchased or acquired); and

- (iii) it will procure that no payment is made, or any redemption, purchase or acquisition is effected, by any Subsidiary on any security (however named or designated) benefiting from a Tier I Guarantee,

in each case until the Dividend Stopper End Date or, as the case may be, until an amount equal to any Converted Amount has been reconverted and reinstated as an obligation in respect of the Capital Notes in full in the balance sheet of the Issuer, or such amount has been redeemed (such redemption having been approved by the FSA).

If the Issuer deems that it does not have sufficient Available Distributable Funds to pay accrued interest on the Capital Notes on the next Interest Payment Date, the Issuer shall, if reasonably practicable and if so permitted by the applicable regulations of any stock exchange upon which the Issuer's equity or debt is then listed, give not more than 14 nor less than five days' prior notice to the Capital Noteholders in accordance with Condition 14.

"Available Distributable Funds" means, in respect of each fiscal year of the Issuer, the aggregate amount, as calculated as of the end of the immediately preceding fiscal year in the individual financial statements of the Issuer, of accumulated retained earnings and any other reserves and surpluses capable under Icelandic law of being available for distribution as cash dividends to holders of Bank Share Capital, but before deduction of the amount of any dividend or other distribution declared on Bank Share Capital in respect of such prior fiscal year.

"Deferral End Date" means the earlier of (i) the date on which the Issuer accrues enough Unallocated Distributable Profits during the fiscal year of the Issuer in which such interest payments were otherwise due, as determined by the Board of Directors of the Issuer after consultation with the Issuer's auditors, to pay the entire deferred payment due under the Capital Notes and under other Capital Securities ranking *pari passu* with the Capital Notes and Other Tier I Securities, and makes such payments or (ii) 31st December of the fiscal year of the Issuer in which such payments were otherwise due.

"Dividend Stopper End Date" means the later of (a) if all such scheduled payments are paid on the Deferral End Date applicable to such payment, such Deferral End Date or (b) the date which is twelve calendar months after the earlier of the date (i) on which a full interest payment is not paid on the Capital Notes and (ii) on which a full scheduled dividend, interest payment or distribution on any Capital Security ranking *pari passu* with the Capital Notes has not been paid.

"Junior Securities" means (i) ordinary share capital of the Issuer, (ii) each class of preference share capital of the Issuer and any other instrument of the Issuer ranking *pari passu* herewith or junior hereto, and (iii) preference share capital or any other instrument of any Subsidiary of the Issuer subject to any guarantee or support agreement of the Issuer ranking junior to the obligations of the Issuer under the Capital Notes.

"Other Tier I Securities" means any securities which are Tier I Capital of the Issuer and which rank on an insolvency or a voluntary or involuntary liquidation of the Issuer *pari passu* with the Capital Notes.

“Subsidiary” means, in relation to the Issuer, any company (i) in which the Issuer holds a majority of the voting rights or (ii) of which the Issuer is a member and has the right to appoint or remove a majority of the board of directors or (iii) of which the Issuer is a member and controls a majority of the voting rights, and includes any company which is a Subsidiary of a Subsidiary of the Issuer.

“Tier I Guarantee” means any guarantee, indemnity or other contractual support arrangement entered into by the Issuer in respect of securities (regardless of name or designation) issued by a Subsidiary which constitutes Tier I Capital of the Issuer.

6. PAYMENTS

(a) *Method of payment*

Subject as provided below:

- (i) payments in a Specified Currency other than euro will be made by credit or transfer to an account in the relevant Specified Currency (which, in the case of a payment in Japanese yen to a non-resident of Japan, shall be a non-resident account) maintained by the payee with, or, at the option of the payee, by a cheque in such Specified Currency drawn on, a bank in the principal financial centre of the country of such Specified Currency (which, if the Specified Currency is Australian dollars or New Zealand dollars, shall be Sydney and Auckland, respectively); and
- (ii) payments in euro will be made by credit or transfer to a euro account (or any other account to which euro may be credited or transferred) specified by the payee or, at the option of the payee, by a euro cheque.

Payments will be subject in all cases to any fiscal or other laws and regulations applicable thereto in the place of payment, but without prejudice to the provisions of Condition 8.

(b) *Presentation of definitive Notes, Receipts and Coupons*

Payments of principal in respect of definitive Notes will (subject as provided below) be made in the manner provided in paragraph (a) above only against presentation and surrender (or, in the case of part payment of any sum due, endorsement) of definitive Notes, and payments of interest in respect of definitive Notes will (subject as provided below) be made as aforesaid only against presentation and surrender (or, in the case of part payment of any sum due, endorsement) of Coupons, in each case at the specified office of any Paying Agent outside the United States (which expression, as used herein, means the United States of America (including the States and the District of Columbia, its territories, its possessions and other areas subject to its jurisdiction)).

Payments of instalments of principal (if any) in respect of definitive Notes, other than the final instalment, will (subject as provided below) be made in the manner provided in paragraph (a) above against presentation and surrender (or, in the case of part payment of any sum due, endorsement) of the relevant Receipt in accordance with the preceding paragraph. Payment of the final instalment will be made in the manner provided in paragraph (a) above only against presentation and surrender (or, in the case of part payment of any sum due, endorsement) of the relevant Note in accordance with the preceding paragraph. Each Receipt must be presented for payment of the relevant instalment together with the definitive Note to which it appertains. Receipts presented without the definitive Note to which they appertain do not constitute valid obligations of the Issuer. Upon the date on which any definitive Note becomes due and repayable, unmatured Receipts (if any) relating thereto (whether or not attached) shall become void and no payment shall be made in respect thereof.

Fixed Rate Notes in definitive form (other than Dual Currency Notes, Index Linked Notes, Range Accrual Notes, Target Redemption Notes or Long Maturity Notes (as defined below)) should be presented for payment together with all unmatured Coupons appertaining thereto (which expression shall for this purpose include Coupons falling to be issued on exchange of matured Talons), failing which the amount of any missing unmatured Coupon (or, in the case of payment not being made in full, the same proportion of the amount of such missing unmatured Coupon as the sum so paid bears to the sum due) will be deducted from the sum due for payment. Each amount of principal so deducted will be paid in the manner mentioned above against surrender of the relative missing Coupon at any time before the expiry of 10 years after the Relevant Date (as defined in Condition 8) in respect of such principal (whether or not such Coupon would otherwise have become void under Condition 9) or, if later, five years from the date on which such Coupon would otherwise have become due, but in no event thereafter.

Upon any Fixed Rate Note in definitive form becoming due and repayable prior to its Maturity Date, all unmatured Talons (if any) appertaining thereto will become void and no further Coupons will be issued in respect thereof.

Upon the date on which any Floating Rate Note, Dual Currency Note, Index Linked Note, Range Accrual Note, Target Redemption Note or Long Maturity Note in definitive form becomes due and repayable, unmatured Coupons and Talons (if any) relating thereto (whether or not attached) shall become void and no payment or, as the case may be, exchange for further Coupons shall be made in respect thereof. A "**Long Maturity Note**" is a Fixed Rate Note (other than a Fixed Rate Note which on issue had a Talon attached) whose nominal amount on issue is less than the aggregate interest payable thereon provided that such Note shall cease to be a Long Maturity Note on the Interest Payment Date on which the aggregate amount of interest remaining to be paid after that date is less than the nominal amount of such Note.

If the due date for redemption of any definitive Note is not an Interest Payment Date, interest (if any) accrued in respect of such Note from (and including) the preceding Interest Payment Date or, as the case may be, the Interest Commencement Date shall be payable only against surrender of the relevant definitive Note.

(c) *Payments in respect of Global Notes*

Payments of principal and interest (if any) in respect of Notes represented by any Global Note will (subject as provided below) be made in the manner specified above in relation to definitive Notes and otherwise in the manner specified in the relevant Global Note against presentation or surrender, as the case may be, of such Global Note at the specified office of any Paying Agent outside the United States. A record of each payment made against presentation or surrender of any Global Note, distinguishing between any payment of principal and any payment of interest, will be made on such Global Note by the Paying Agent to which it was presented and such record shall be prima facie evidence that the payment in question has been made.

(d) *General provisions applicable to payments*

The holder of a Global Note shall be the only person entitled to receive payments in respect of Notes represented by such Global Note and the Issuer will be discharged by payment to, or to the order of, the holder of such Global Note in respect of each amount so paid. Each of the persons shown in the records of Euroclear or Clearstream, Luxembourg as the beneficial holder of a particular nominal amount of Notes represented by such Global Note must look solely to Euroclear or Clearstream, Luxembourg, as the case may be, for his share of each payment so made by the Issuer to, or to the order of, the holder of such Global Note.

Notwithstanding the foregoing provisions of this Condition, if any amount of principal and/or interest in respect of Notes is payable in U.S. dollars, such U.S. dollar payments of principal and/or interest in respect of such Notes will be made at the specified office of a Paying Agent in the United States if:

- (i) the Issuer has appointed Paying Agents with specified offices outside the United States with the reasonable expectation that such Paying Agents would be able to make payment in U.S. dollars at such specified offices outside the United States of the full amount of principal and interest on the Notes in the manner provided above when due;
- (ii) payment of the full amount of such principal and interest at all such specified offices outside the United States is illegal or effectively precluded by exchange controls or other similar restrictions on the full payment or receipt of principal and interest in U.S. dollars; and
- (iii) such payment is then permitted under United States law without involving, in the opinion of the Issuer, adverse tax consequences to the Issuer.

(e) *Payment Day*

If the date for payment of any amount in respect of any Note, Receipt or Coupon is not a Payment Day, the holder thereof shall not be entitled to payment until the next following Payment Day in the relevant place and shall not be entitled to further interest or other payment in respect of such delay. For these purposes, "**Payment Day**" means any day which (subject to Condition 9) is:

- (i) a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in:
 - (A) the relevant place of presentation;
 - (B) London;
 - (C) each Additional Financial Centre specified in the applicable Final Terms; and
- (ii) either (1) in relation to any sum payable in a Specified Currency other than euro, a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in the principal financial centre of the country of the relevant Specified Currency (if other than the place of presentation, London and any Additional Financial Centre and which if the Specified Currency is Australian dollars or New Zealand dollars shall be Sydney or Auckland, respectively) or (2) in relation to any sum payable in euro, a day on which the TARGET System is open.

(f) *Interpretation of principal and interest*

Any reference in these Terms and Conditions to principal in respect of the Notes shall be deemed to include, as applicable:

- (i) any additional amounts which may be payable with respect to principal under Condition 8;
- (ii) the Final Redemption Amount of the Notes;
- (iii) the Early Redemption Amount of the Notes;
- (iv) the Optional Redemption Amount(s) (if any) of the Notes;
- (v) in relation to Notes redeemable in instalments, the Instalment Amounts;

- (vi) in relation to Zero Coupon Notes, the Amortised Face Amount (as defined in Condition 7(f)); and
- (vii) any premium and any other amounts (other than interest) which may be payable by the Issuer under or in respect of the Notes.

Any reference in these Terms and Conditions to interest in respect of the Notes shall be deemed to include, as applicable, any additional amounts which may be payable with respect to interest under Condition 8.

7. REDEMPTION AND PURCHASE

(a) *Redemption at maturity*

Unless previously redeemed or purchased and cancelled as specified below, each Note (including each Index Linked Redemption Note, Dual Currency Redemption Note and Range Accrual Note but excluding each Target Redemption Note) will be redeemed by the Issuer at its Final Redemption Amount specified in, or determined in the manner specified in, the applicable Final Terms in the relevant Specified Currency on the Maturity Date. Capital Notes shall be undated, with no fixed date for redemption. Each Target Redemption Note will be redeemed by the Issuer at its Final Redemption Amount specified in, or determined in the manner specified in, the applicable Final Terms in the relevant Specified Currency on the date determined in accordance with the applicable Final Terms.

(b) *Redemption for tax reasons*

The Notes may, subject, in the case of Capital Notes, to the prior approval of the FSA (provided that such approval can validly be given in accordance with the applicable rules, regulations and policies of the FSA) and to Condition 7(l) below, be redeemed at the option of the Issuer in whole, but not in part, at any time (if this Note is neither a Floating Rate Note, an Index Linked Interest Note nor a Dual Currency Interest Note) or on any Interest Payment Date (if this Note is either a Floating Rate Note, an Index Linked Interest Note, a Dual Currency Interest Note, a Target Redemption Note or a Range Accrual Note), on giving not less than 30 nor more than 60 days' notice to the Agent and, in accordance with Condition 14, the Noteholders (which notice shall be irrevocable), if:

- (i) on the occasion of the next payment due under the Notes, the Issuer has or will become obliged to pay additional amounts as provided or referred to in Condition 8 as a result of any change in, or amendment to, the laws or regulations of a Tax Jurisdiction (as defined in Condition 8) or any change in the application or official interpretation of such laws or regulations, which change or amendment becomes effective on or after the date on which agreement is reached to issue the first Tranche of the Notes; and
- (ii) such obligation cannot be avoided by the Issuer taking reasonable measures available to it,

provided that no such notice of redemption shall be given earlier than 90 days prior to the earliest date on which the Issuer would be obliged to pay such additional amounts were a payment in respect of the Notes then due.

Prior to the publication of any notice of redemption pursuant to this Condition, the Issuer shall deliver to the Agent a certificate signed by two Directors of the Issuer stating that the Issuer is entitled to effect such redemption and setting forth a statement of facts showing that the conditions precedent to the right of the Issuer so to redeem have occurred, and an opinion of independent legal advisers of recognised standing to the effect that the Issuer has or will become obliged to pay such additional amounts as a result of such change or amendment.

Notes redeemed pursuant to this Condition 7(b) will be redeemed at their Early Redemption Amount referred to in paragraph (f) below together (if appropriate) with interest accrued to (but excluding) the date of redemption.

(c) *Redemption at the option of the Issuer (Issuer Call)*

If Issuer Call is specified in the applicable Final Terms, the Issuer may, subject, in the case of Capital Notes, to the prior approval of the FSA (provided that such approval can validly be given in accordance with the applicable rules regulations and policies of the FSA) and to Condition 7(l) below, having given:

- (i) not less than 15 nor more than 30 days' notice to the Noteholders in accordance with Condition 14; and
- (ii) not less than 15 days before the giving of the notice referred to in (i), notice to the Agent;

(which notices shall be irrevocable and shall specify the date fixed for redemption), redeem all or (other than in respect of Capital Notes) some only of the Notes then outstanding on any Optional Redemption Date and at the Optional Redemption Amount(s) specified in, or determined in the manner specified in, the applicable Final Terms together, if appropriate, with interest accrued to (but excluding) the relevant Optional Redemption Date. Any such redemption must be of a nominal amount not less than the Minimum Redemption Amount and not more than the Maximum Redemption Amount, in each case as may be specified in the applicable Final Terms. In the case of a partial redemption of Notes, the Notes to be redeemed ("**Redeemed Notes**") will be selected individually by lot, in the case of Redeemed Notes represented by definitive Notes, and in accordance with the rules of Euroclear and/or Clearstream, Luxembourg, (to be reflected in the records of Euroclear and Clearstream, Luxembourg as either a pool factor or a reduction in nominal amount, at their discretion) in the case of Redeemed Notes represented by a Global Note, not more than 30 days prior to the date fixed for redemption (such date of selection being hereinafter called the "**Selection Date**"). In the case of Redeemed Notes represented by definitive Notes, a list of the serial numbers of such Redeemed Notes will be published in accordance with Condition 14 not less than 15 days prior to the date fixed for redemption. The aggregate nominal amount of Redeemed Notes represented by definitive Notes shall bear the same proportion to the aggregate nominal amount of all Redeemed Notes as the aggregate nominal amount of definitive Notes outstanding bears to the aggregate nominal amount of the Notes outstanding, in each case on the Selection Date, provided that such first mentioned nominal amount shall, if necessary, be rounded downwards to the nearest integral multiple of the Specified Denomination, and the aggregate nominal amount of Redeemed Notes represented by a Global Note shall be equal to the balance of the Redeemed Notes. No exchange of the relevant Global Note will be permitted during the period from (and including) the Selection Date to (and including) the date fixed for redemption pursuant to this paragraph (c) and notice to that effect shall be given by the Issuer to the Noteholders in accordance with Condition 14 at least five days prior to the Selection Date.

(d) *Redemption at the option of the Noteholders (Investor Put)*

If Investor Put is specified in the applicable Final Terms, upon the holder of any Note giving to the Issuer in accordance with Condition 14 not less than 15 nor more than 30 days' notice the Issuer will, upon the expiry of such notice, redeem, subject to, and in accordance with, the terms specified in the applicable Final Terms, such Note on the Optional Redemption Date and at the Optional Redemption Amount together, if appropriate, with interest accrued to (but excluding) the Optional Redemption Date.

To exercise the right to require redemption of this Note the holder of this Note must, if this Note is in definitive form and held outside Euroclear and Clearstream, Luxembourg, deliver,

at the specified office of any Paying Agent at any time during normal business hours of such Paying Agent falling within the notice period, a duly completed and signed notice of exercise in the form (for the time being current) obtainable from any specified office of any Paying Agent (a "**Put Notice**") and in which the holder must specify a bank account (or, if payment is required to be made by cheque, an address) to which payment is to be made under this Condition accompanied by, if this Note is in definitive form, this Note or evidence satisfactory to the Paying Agent concerned that this Note will, following delivery of the Put Notice, be held to its order or under its control. If this Note is represented by a Global Note or is in definitive form and held through Euroclear or Clearstream, Luxembourg, to exercise the right to require redemption of this Note the holder of this Note must, within the notice period, give notice to the Agent of such exercise in accordance with the standard procedures of Euroclear and Clearstream, Luxembourg (which may include notice being given on his instruction by Euroclear or Clearstream, Luxembourg or any common depository for them to the Agent by electronic means) in a form acceptable to Euroclear and Clearstream, Luxembourg from time to time and, if this Note is represented by a Global Note, at the same time present or procure the presentation of the relevant Global Note to the Agent for notation accordingly.

Any Put Notice given by a holder of any Note pursuant to this paragraph shall be irrevocable except where prior to the due date of redemption an Event of Default shall have occurred and be continuing in which event such holder, at its option, may elect by notice to the Issuer to withdraw the notice given pursuant to this paragraph and instead to declare such Note forthwith due and payable pursuant to Condition 10.

(e) *Redemption upon the occurrence of a Special Event*

Subject as provided in Condition 7(l) below, and in the case of Capital Notes only, upon the occurrence of a Special Event (as defined in Condition 7(l) below), the Issuer may, subject to the prior approval of the FSA (provided that such approval can validly be given in accordance with applicable rules, regulations and policies of the FSA), at its option, having given not less than 30 days' nor more than 60 days' notice to the holders of the Capital Notes in accordance with Condition 14 (which notice shall be irrevocable), redeem all (but not some only) of the Capital Notes on any Special Event Redemption Date (as specified in the applicable Final Terms) at an amount equal to the Special Event Redemption Amount (as specified in the applicable Final Terms).

(f) *Early Redemption Amounts*

For the purpose of paragraph (b) above and Condition 10, each Note will be redeemed at its Early Redemption Amount calculated as follows:

- (i) in the case of a Note with a Final Redemption Amount equal to the Issue Price, at the Final Redemption Amount thereof;
- (ii) in the case of a Note (other than a Zero Coupon Note but including an Instalment Note and a Partly Paid Note) with a Final Redemption Amount which is or may be less or greater than the Issue Price or which is payable in a Specified Currency other than that in which the Note is denominated, at the amount specified in, or determined in the manner specified in, the applicable Final Terms or, if no such amount or manner is so specified in the applicable Final Terms, at its nominal amount; or
- (iii) in the case of a Zero Coupon Note, at an amount (the "**Amortised Face Amount**") calculated in accordance with the following formula:

$$\text{Early Redemption Amount} = \text{RP} \times (1 + \text{AY})^y$$

where:

“**RP**” means the Reference Price;

“**AY**” means the Accrual Yield expressed as a decimal; and

“**y**” is a fraction the numerator of which is equal to the number of days (calculated on the basis of a 360-day year consisting of 12 months of 30 days each) from (and including) the Issue Date of the first Tranche of the Notes to (but excluding) the date fixed for redemption or (as the case may be) the date upon which such Note becomes due and repayable and the denominator of which is 360,

or on such other calculation basis as may be specified in the applicable Final Terms.

(g) *Instalments*

Instalment Notes will be redeemed in the Instalment Amounts and on the Instalment Dates. In the case of early redemption, the Early Redemption Amount will be determined pursuant to paragraph (f) above.

(h) *Partly Paid Notes*

Partly Paid Notes will be redeemed, whether at maturity, early redemption or otherwise, in accordance with the provisions of this Condition and the applicable Final Terms.

(i) *Purchases*

The Issuer or any Subsidiary of the Issuer may (subject, in the case of Capital Notes, to the prior approval of the FSA and provided that such approval can validly be given in accordance with the rules, regulations and policies of the FSA) at any time purchase Notes (provided that, in the case of definitive Notes, all unmatured Receipts, Coupons and Talons appertaining thereto are purchased therewith) at any price in the open market or otherwise. If purchases are made by tender, tenders must be available to all Noteholders alike. Such Notes may be held, reissued, resold or, at the option of the Issuer, surrendered to any Paying Agent for cancellation.

(j) *Cancellation*

All Notes which are redeemed will forthwith be cancelled (together with all unmatured Receipts, Coupons and Talons attached thereto or surrendered therewith at the time of redemption). All Notes so cancelled and any Notes purchased and cancelled pursuant to paragraph (i) above (together with all unmatured Receipts, Coupons and Talons cancelled therewith) shall be forwarded to the Agent and cannot be reissued or resold.

(k) *Late payment on Zero Coupon Notes*

If the amount payable in respect of any Zero Coupon Note upon redemption of such Zero Coupon Note pursuant to paragraph (a), (b), (c) or (d) above or upon its becoming due and repayable as provided in Condition 10 is improperly withheld or refused, the amount due and repayable in respect of such Zero Coupon Note shall be the amount calculated as provided in paragraph (f)(iii) above as though the references therein to the date fixed for the redemption or the date upon which such Zero Coupon Note becomes due and payable were replaced by references to the date which is the earlier of:

- (i) the date on which all amounts due in respect of such Zero Coupon Note have been paid; and
- (ii) five days after the date on which the full amount of the moneys payable in respect of such Zero Coupon Notes has been received by the Agent and notice to that effect has been given to the Noteholders in accordance with Condition 14.

(l) *Redemption of Converted Amounts*

Save as provided in Condition 10, where any principal amount has been converted into Converted Amounts as described in Condition 2(d), the Issuer shall not redeem the Capital Notes until all Converted Amounts have been reconverted and reinstated as debt in full as an obligation in respect of the Capital Notes.

A “**Special Event**” means the occurrence of any of a Tax Event or a Capital Event.

A “**Tax Event**” means the receipt by the Issuer of an opinion of counsel in Iceland (experienced in such matters) to the effect that, as a result of (i) any amendment to, clarification of, or change (including any announced prospective change) in, the laws or treaties (or any regulations thereunder) of Iceland or any political subdivision or taxing authority thereof or therein affecting taxation, (ii) any governmental action or (iii) any amendment to, clarification of, or change in the official position or the interpretation of such governmental action or any interpretation or pronouncement that provides for a position with respect to such government action that differs from the theretofore generally accepted position, in each case, by any legislative body, court, governmental authority or regulatory body, irrespective of the manner in which such amendment, clarification or change is made known, which amendment, clarification or change is effective or such pronouncement or decision is announced on or after the Issue Date of the Capital Notes, there is more than an insubstantial risk that the Issuer is, or will be, subject to more than a *de minimis* amount of other taxes, duties or other governmental charges or civil liabilities with respect to the Capital Notes or any amount payable in respect of the Capital Notes.

8. TAXATION

All payments of principal and interest in respect of the Notes, Receipts and Coupons by the Issuer will be made without withholding or deduction for or on account of any present or future duties of whatever nature imposed or levied by or on behalf of any Tax Jurisdiction unless such withholding or deduction is required by law. In such event, the Issuer will pay such additional amounts as shall be necessary in order that the net amounts received by the holders of the Notes, Receipts or Coupons after such withholding or deduction shall equal the respective amounts of principal and interest which would otherwise have been receivable in respect of the Notes, Receipts or Coupons, as the case may be, in the absence of such withholding or deduction; except that no such additional amounts shall be payable with respect to any Note, Receipt or Coupon:

- (i) presented for payment by or on behalf of a holder who is liable for such taxes or duties in respect of such Note, Receipt or Coupon by reason of his having some connection with a Tax Jurisdiction other than the mere holding of such Note, Receipt or Coupon; or
- (ii) presented for payment more than 30 days after the Relevant Date (as defined below) except to the extent that the holder thereof would have been entitled to an additional amount on presenting the same for payment on such thirtieth day assuming that day to have been a Payment Day (as defined in Condition 6(e)); or
- (iii) where such withholding or deduction is imposed on a payment to an individual and is required to be made pursuant to European Council Directive 2003/48/EC or any law implementing or complying with, or introduced in order to conform to, such Directive; or
- (iv) presented for payment by or on behalf of a holder who would have been able to avoid such withholding or deduction by presenting the relevant Note, Receipt or Coupon to another Paying Agent in a Member State of the European Union.

As used herein:

- (A) “**Tax Jurisdiction**” means Iceland or any political subdivision or any authority thereof or therein having power to tax or any other jurisdiction or any political subdivision or any authority thereof or therein having power to tax to which the Issuer becomes subject in respect of payments made by it of principal and interest on the Notes, Receipts and Coupons; and
- (B) “**Relevant Date**” means the date on which such payment first becomes due, except that, if the full amount of the moneys payable has not been duly received by the Agent on or prior to such due date, it means the date on which, the full amount of such moneys having been so received, notice to that effect is duly given to the Noteholders in accordance with Condition 14.

9. PRESCRIPTION

The Notes, Receipts and Coupons will become void unless presented for payment within a period of 10 years (in the case of principal) and five years (in the case of interest) after the Relevant Date (as defined in Condition 8) therefor.

There shall not be included in any Coupon sheet issued on exchange of a Talon any Coupon the claim for payment in respect of which would be void pursuant to this Condition or Condition 6(b) or any Talon which would be void pursuant to Condition 6(b).

10. EVENTS OF DEFAULT

(a) *Events of Default relating to Senior Notes*

If any one or more of the following events (each an “**Event of Default**”) shall occur with respect to any Senior Note:

- (i) if default is made in the payment of any principal, premium (if any) or interest due in respect of the Notes or any of them and the default continues for a period of three days in the case of principal or premium (if any) and seven days in the case of interest; or
- (ii) if the Issuer fails to perform or observe any of its other obligations under these Conditions and (except in any case where the failure is incapable of remedy when no such continuation or notice as is hereinafter mentioned will be required) the failure continues for the period of 30 days next following the service by a Noteholder on the Issuer of notice requiring the same to be remedied; or
- (iii) if any borrowed money of the Issuer or any of its Principal Subsidiaries is not paid when due or becomes (whether by declaration or automatically in accordance with the relevant agreement or instrument constituting the same) due and payable by reason of any default (however described) prior to the date when it would otherwise have become due or any creditor of the Issuer or any of its Principal Subsidiaries becomes entitled to declare any such Borrowed Money due and payable by reason of any default (however described) or any facility or commitment available to the Issuer or any of its Principal Subsidiaries relating to Borrowed Money is withdrawn, suspended or cancelled by reason of any default (however described) of the company concerned, provided that, for the purposes of this sub-clause (iii), the Borrowed Money must, when aggregated with all other Borrowed Money to which any part of this Condition 10(a)(iii) applies, exceed U.S.\$15,000,000 (or its equivalent in any other currency); or
- (iv) if any order is made by any competent court or resolution passed for the winding up or dissolution of the Issuer or any of its Principal Subsidiaries, save for the purposes of reorganisation on terms approved by an Extraordinary Resolution of the Noteholders; or

- (v) if the Issuer or any of its Principal Subsidiaries ceases or threatens to cease to carry on the whole or a substantial part of its business, save for the purposes of reorganisation on terms approved by an Extraordinary Resolution of the Noteholders, or the Issuer or any of its Principal Subsidiaries stops or threatens to stop payment of, or is unable to, or admits inability to, pay, its debts (or any class of its debts) as they fall due, or is deemed unable to pay its debts pursuant to or for the purposes of any applicable law, or is adjudicated or found bankrupt or insolvent; or
- (vi) if (A) proceedings are initiated against the Issuer or any of its Principal Subsidiaries under any applicable liquidation, insolvency, composition, reorganisation or other similar laws, or an application is made for the appointment of an administrative or other receiver, manager, administrator or other similar official, or an administrative or other receiver, manager, administrator or other similar official is appointed, in relation to the Issuer or any of its Principal Subsidiaries or, as the case may be, in relation to the whole or a part of the undertaking or assets of any of them, or an encumbrancer takes possession of the whole or a part of the undertaking or assets of any of them, or a distress, execution, attachment, sequestration or other process is levied, enforced upon, sued out or put in force against the whole or a part of the undertaking or assets of any of them and (B) in any case (other than the appointment of an administrator) the same is not discharged within 14 days; or
- (vii) if the Issuer or any of its Principal Subsidiaries initiates or consents to judicial proceedings relating to itself under any applicable liquidation, insolvency, composition, reorganisation or other similar laws or makes a conveyance or assignment for the benefit of, or enters into any composition or other arrangement with, its creditors generally (or any class of its creditors) or any meeting is convened to consider a proposal for an arrangement or composition with its creditors generally (or any class of its creditors),

then any holder of a Senior Note may, by written notice to the Issuer at the specified office of the Agent, effective upon the date of receipt thereof by the Agent, declare any Senior Notes held by the holder to be forthwith due and payable whereupon the same shall become forthwith due and payable at their Early Redemption Amount (as described in Condition 7(f)), together with accrued interest (if any) to the date of repayment, without presentment, demand, protest or other notice of any kind.

For the purposes of this Condition:

“Principal Subsidiary” at any time shall mean a Subsidiary of the Issuer *inter alia*:

- (A) whose gross revenues (consolidated in the case of a Subsidiary which itself has Subsidiaries) or whose total assets (consolidated in the case of a Subsidiary which itself has Subsidiaries) represent not less than five per cent. of the consolidated gross revenues, or, as the case may be, consolidated total assets, of the Issuer and its Subsidiaries taken as a whole, all as calculated respectively by reference to the then latest audited accounts (consolidated or, as the case may be, unconsolidated) of the Subsidiary and the then latest audited consolidated accounts of the Issuer and its Subsidiaries; or
- (B) to which is transferred the whole or substantially the whole of the undertaking and assets of a Subsidiary of the Issuer which immediately before the transfer is a Principal Subsidiary,

all as more particularly defined in the Agency Agreement.

A report by the Auditors of the Issuer that in their opinion a Subsidiary of the Issuer is or is not or was or was not at any particular time or throughout any specified period a Principal Subsidiary shall, in the absence of manifest error, be conclusive and binding on all parties.

(b) *Enforcement relating to Subordinated Notes*

- (i) If the Issuer fails to meet its obligations under the Subordinated Notes, any holder of a Subordinated Note may, at its own discretion and without further notice, institute proceedings in Iceland for the compulsory winding-up of the Issuer in accordance with Act No. 161/2002 on Financial Undertakings.
- (ii) Any holder of a Subordinated Note may at its discretion and without further notice institute such proceedings against the Issuer as it may think fit to enforce any obligation, condition or provision binding on the Issuer under the Subordinated Notes provided that the Issuer shall not by virtue of the institution of any such proceedings be obliged to pay any sum or sums sooner than the same would otherwise have been payable by it.
- (iii) If an order is made or an effective resolution is passed for the winding-up or liquidation of the Issuer, then the Subordinated Notes shall become due and payable at their Early Redemption Amount together with interest accrued to the date of repayment, without presentment, demand, protest or other notice of any kind.

(c) *Events of Default relating to Capital Notes*

- (1) The following events or circumstances (each an “**Event of Default**”) shall be an event of default in relation to the Capital Notes:
 - (i) the Issuer shall default in the payment of principal for a period of three days in respect of any Capital Note which has become due and payable in accordance with the Conditions; or
 - (ii) the Issuer shall, to the extent that it is obliged to pay interest under Condition 5(h), default for a period of seven days in the payment of interest due on any Capital Note in accordance with the Conditions; or
 - (iii) a court or agency or supervisory authority in Iceland (having jurisdiction in respect of the same) shall have instituted a proceeding or entered a decree or order for the appointment of a receiver or liquidator in any insolvency, rehabilitation, readjustment of debt, marshalling of assets and liabilities or similar arrangements involving the Issuer or all or substantially all of its property, and such proceedings, decree or order shall not have been vacated or shall have remained in force undischarged or unstayed for a period of 14 days; or
 - (iv) the Issuer shall file a petition to take advantage of any insolvency statute or shall voluntarily suspend payment of its obligations.
- (2) If any Event of Default shall have occurred and shall be continuing, any holder of a Capital Note may give notice to the Issuer that the Capital Note is, and it shall accordingly, subject to this Condition 10(c), forthwith become, immediately due and repayable whether or not the whole or any part of any Converted Amount has been reconverted and reinstated as debt at an amount equal to the principal amount (construed as provided above) of the Capital Notes, together with interest (if any) on the principal amount accrued to, but excluding, the due date for redemption (provided that the Issuer is obliged to make such payment of interest in accordance with Condition 5(h) or would be so obliged were the due date for repayment an Interest Payment Date).
- (3) If a Capital Note has been declared due and payable under this Condition 10(c), the holder of the Capital Note may claim payment in respect of the Capital Notes only in the insolvency or voluntary or involuntary liquidation of the Issuer and may therefore institute such steps, including the obtaining of a judgment against the Issuer for any

amount due in respect of the Capital Notes, as it thinks desirable with a view to having the Issuer declared insolvent or put into liquidation.

- (4) A holder of Capital Notes may institute such proceedings against the Issuer as it may think fit to enforce any obligation, condition, undertaking or provision binding on the Issuer under the Capital Notes (other than, without prejudice to sub paragraphs (2) and (3) above, any obligation for the payment of any principal or interest in respect of the Capital Notes) provided that the Issuer shall not by virtue of the institution of any such proceedings be obliged to pay any sum or sums sooner than the same would otherwise have been payable by it.

A provider of any Converted Amount may institute such proceedings against the Issuer as it may think fit to enforce any obligation, condition, undertaking or provision binding on the Issuer under Condition 2(c) or 2(d) provided that the Issuer shall not by virtue of the institution of such proceedings be obliged to pay any sum or sums sooner than the same would otherwise have been payable by it.

- (5) No remedy against the Issuer, other than as provided in sub paragraphs (2), (3) and (4) above, or proving or claiming in the insolvency or voluntary or involuntary liquidation of the Issuer in Iceland or elsewhere, shall be available to the holders of Capital Notes, whether for the recovery of amounts owing in respect of the Capital Notes or in respect of any breach by the Issuer of any of its obligations or undertakings with respect to the Capital Notes.

11. REPLACEMENT OF NOTES, RECEIPTS, COUPONS AND TALONS

Should any Note, Receipt, Coupon or Talon be lost, stolen, mutilated, defaced or destroyed, it may be replaced at the specified office of the Agent upon payment by the claimant of such costs and expenses as may be incurred in connection therewith and on such terms as to evidence and indemnity as the Issuer may reasonably require. Mutilated or defaced Notes, Receipts, Coupons or Talons must be surrendered before replacements will be issued.

12. PAYING AGENTS

The names of the initial Paying Agents and their initial specified offices are set out below.

The Issuer is entitled to vary or terminate the appointment of any Paying Agent and/or appoint additional or other Paying Agents and/or approve any change in the specified office through which any Paying Agent acts, provided that:

- (a) there will at all times be an Agent; and
- (b) so long as the Notes are listed on any stock exchange, there will at all times be a Paying Agent with a specified office in such place as may or admitted to listing by any other relevant authority be required by the rules and regulations of the relevant stock exchange (or other relevant authority); and
- (c) the Issuer undertakes that it will maintain a paying agent in a Member State of the European Union that is not obliged to withhold or deduct tax pursuant to European Council Directive 2003/48/EC or any law implementing or complying with, or introduced in order to conform to, such Directive.

In addition, the Issuer shall forthwith appoint a Paying Agent having a specified office in New York City in the circumstances described in Condition 6(d). Any variation, termination, appointment or change shall only take effect (other than in the case of insolvency, when it shall be of immediate effect) after not less than 30 nor more than 45 days' prior notice thereof shall have been given to the Noteholders in accordance with Condition 14.

In acting under the Agency Agreement, the Paying Agents act solely as agents of the Issuer and do not assume any obligation to, or relationship of agency or trust with, any Noteholders, Receiptholders or Couponholders. The Agency Agreement contains provisions permitting any entity into which any Paying Agent is merged or converted or with which it is consolidated or to which it transfers all or substantially all of its assets to become the successor paying agent.

13. EXCHANGE OF TALONS

On and after the Interest Payment Date on which the final Coupon comprised in any Coupon sheet matures, the Talon (if any) forming part of such Coupon sheet may be surrendered at the specified office of the Agent or any other Paying Agent in exchange for a further Coupon sheet including (if such further Coupon sheet does not include Coupons to (and including) the final date for the payment of interest due in respect of the Note to which it appertains) a further Talon, subject to the provisions of Condition 9.

14. NOTICES

All notices regarding the Notes will be deemed to be validly given if published (i) in a leading English language daily newspaper of general circulation in London, and (ii) if and for so long as the Notes are admitted to trading on, and listed on the Official List of, the Luxembourg Stock Exchange, in a daily newspaper of general circulation in Luxembourg and/or on the Luxembourg Stock Exchange's website (www.bourse.lu). It is expected that any such publication in a newspaper will be made in the *Financial Times* in London and *d'Wort* or the *Tageblatt* in Luxembourg. The Issuer shall also ensure that notices are duly published in a manner which complies with the rules of any stock exchange (or any other relevant authority) on which the Notes are for the time being listed or by which they have been admitted to trading. Any such notice will be deemed to have been given on the date of the first publication or, where required to be published in more than one newspaper, on the date of the first publication in all required newspapers.

Until such time as any definitive Notes are issued, there may, so long as any Global Notes representing the Notes are held in their entirety on behalf of Euroclear and/or Clearstream, Luxembourg, be substituted for such publication in such newspaper(s) the delivery of the relevant notice to Euroclear and/or Clearstream, Luxembourg for communication by them to the holders of the Notes and, in addition, for so long as any Notes are listed on a stock exchange or are admitted to trading by another relevant authority and the rules of that stock exchange or relevant authority so require, such notice will be published in a daily newspaper of general circulation in the place or places required by those rules. Any such notice shall be deemed to have been given to the holders of the Notes on the seventh day after the day on which the said notice was given to Euroclear and/or Clearstream, Luxembourg.

Notices to be given by any Noteholder shall be in writing and given by lodging the same, together (in the case of any Note in definitive form) with the relative Note or Notes, with the Agent. Whilst any of the Notes are represented by a Global Note, such notice may be given by any holder of a Note to the Agent through Euroclear and/or Clearstream, Luxembourg, as the case may be, in such manner as the Agent and Euroclear and/or Clearstream, Luxembourg, as the case may be, may approve for this purpose.

15. MEETINGS OF NOTEHOLDERS, MODIFICATION AND WAIVER

The Agency Agreement contains provisions for convening meetings of the Noteholders to consider any matter affecting their interests, including the sanctioning by Extraordinary Resolution of a modification of the Notes, the Receipts, the Coupons or any of the provisions of the Agency Agreement although any modification in relation to Capital Notes cannot be made without the prior approval of the FSA (provided that such approval can be validly given

in accordance with the rules, regulations and policies of the FSA). Such a meeting may be convened by the Issuer or Noteholders holding not less than five per cent. in nominal amount of the Notes for the time being remaining outstanding. The quorum at any such meeting for passing an Extraordinary Resolution is one or more persons holding or representing not less than 50 per cent. in nominal amount of the Notes for the time being outstanding, or at any adjourned meeting one or more persons being or representing Noteholders whatever the nominal amount of the Notes so held or represented, except that at any meeting the business of which includes the modification of certain provisions of the Notes, the Receipts or the Coupons (including modifying the date of maturity of the Notes or any date for payment of interest thereon, reducing or cancelling the amount of principal or the rate of interest payable in respect of the Notes or altering the currency of payment of the Notes, the Receipts or the Coupons), the quorum shall be one or more persons holding or representing not less than two-thirds in nominal amount of the Notes for the time being outstanding, or at any adjourned such meeting one or more persons holding or representing not less than one-third in nominal amount of the Notes for the time being outstanding. An Extraordinary Resolution passed at any meeting of the Noteholders shall be binding on all the Noteholders, whether or not they are present at the meeting, and on all Receiptholders and Couponholders.

The Agent and the Issuer may agree, without the consent of the Noteholders, Receiptholders or Couponholders, to:

- (a) any modification (except as mentioned above) of the Notes, the Receipts, the Coupons or the Agency Agreement which is not prejudicial to the interests of the Noteholders; or
- (b) any modification of the Notes, the Receipts, the Coupons or the Agency Agreement which is of a formal, minor or technical nature or is made to correct a manifest error or to comply with mandatory provisions of the law.

Any such modification shall be binding on the Noteholders, the Receiptholders and the Couponholders and any such modification shall be notified to the Noteholders in accordance with Condition 14 as soon as practicable thereafter.

16. FURTHER ISSUES

The Issuer shall be at liberty from time to time without the consent of the Noteholders, the Receiptholders or the Couponholders to create and issue further notes having terms and conditions the same as the Notes or the same in all respects save for the amount and date of the first payment of interest thereon and so that the same shall be consolidated and form a single Series with the outstanding Notes.

17. CONTRACTS (RIGHTS OF THIRD PARTIES) ACT 1999

Except as provided herein in relation to providers of any Converted Amount and as provided in the Global Notes in relation to Accountholders (as defined therein) no person shall have any right to enforce any term or condition of this Note under the Contracts (Rights of Third Parties) Act 1999, but this does not affect any right or remedy of any person which exists or is available apart from that Act.

18. GOVERNING LAW AND SUBMISSION TO JURISDICTION

- (a) *Governing law*

The Agency Agreement, the Deed of Covenant, the Notes (other than Conditions 2(b), 2(c), 2(d), 2(e), 5(h), 7(e) and 7(l)), the Receipts and the Coupons are governed by, and shall be

construed in accordance with, English law. Conditions 2(b), 2(c), 2(d), 2(e), 5(h), 7(e) and 7(l) of the Notes is governed by, and shall be construed in accordance with, Icelandic law.

(b) *Submission to jurisdiction*

The Issuer agrees, for the exclusive benefit of the Noteholders, the Receiptholders and the Couponholders, that the courts of England are to have jurisdiction to settle any disputes which may arise out of or in connection with the Notes, the Receipts and/or the Coupons and that accordingly any suit, action or proceedings (together referred to as “**Proceedings**”) arising out of or in connection with the Notes, the Receipts and the Coupons may be brought in such courts.

The Issuer hereby irrevocably waives any objection which it may have now or hereafter to the laying of the venue of any such Proceedings in any such court and any claim that any such Proceedings have been brought in an inconvenient forum and hereby further irrevocably agrees that a judgment in any such Proceedings brought in the English courts shall be conclusive and binding upon it and may be enforced in the courts of any other jurisdiction.

Nothing contained in this Condition shall limit any right to take Proceedings against the Issuer in any other court of competent jurisdiction, nor shall the taking of Proceedings in one or more jurisdictions preclude the taking of Proceedings in any other jurisdiction, whether concurrently or not.

(c) *Appointment of Process Agent*

The Issuer appoints Kaupthing Limited of One Hanover Street, London W1S 1AX, United Kingdom as its agent for service of process, and undertakes that, in the event that Kaupthing Limited ceases so to act or ceases to be registered in England, it will appoint another person as its agent for service of process in England in respect of any Proceedings. Nothing herein shall affect the right to serve proceedings in any other manner permitted by law.

(d) *Waiver of immunity*

The Issuer hereby irrevocably and unconditionally waives with respect to Notes, the Receipts and the Coupons any right to claim sovereign or other immunity from jurisdiction or execution and any similar defence and irrevocably and unconditionally consents to the giving of any relief or the issue of any process, including without limitation, the making, enforcement or execution against any property whatsoever (irrespective of its use or intended use) of any order or judgment made or given in connection with any proceedings.

(e) *Other documents*

The Issuer has in the Agency Agreement and the Deed of Covenant submitted to the jurisdiction of the English courts and appointed an agent for service of process in terms substantially similar to those set out above.

USE OF PROCEEDS

The net proceeds from each issue of Notes will be applied by the Issuer for its general corporate purposes, which include making a profit. If, in respect of any particular issue, there is a particular identified use of proceeds, this will be stated in the applicable Final Terms.

DESCRIPTION OF THE ISSUER

All references to “we”, “us” and “our” under this “Description of the Issuer” are references to the Issuer.

Overview

We are a Northern European bank with shares listed on the Iceland Stock Exchange (“**ICEX**”) and the Stockholm Stock Exchange. We operate in 10 countries, including all the Nordic countries, the United Kingdom, Luxembourg, Switzerland and the United States and two of the world’s main business centres, London and New York. We hold banking licenses in six countries: Iceland, the United Kingdom, Denmark, Sweden, Finland and Luxembourg. In the United States, we operate through our subsidiary Kaupthing Securities Inc., a licensed broker-dealer. The United Kingdom, Iceland and Scandinavia currently are our most important markets, generating 34 per cent., 30 per cent. and 26 per cent., respectively, of our net operating income in 2005.

We offer integrated financial services to companies, institutional investors and individuals. Our services include investment banking, corporate banking, capital markets services and asset management and comprehensive wealth management for private banking clients. In addition, we operate a retail banking franchise in Iceland, where we have our headquarters and, to a lesser extent, in Sweden.

We currently are one of the eight largest banks in the Nordic region in terms of market capitalisation. We have expanded through organic growth and strategic acquisitions, such as the acquisition of FIH Erhvervsbank A/S (“**FIH**”) in July of 2004 for ISK 85,868 million (DKK 7,292 million) and the more recent acquisition of UK-based bank Singer & Friedlander Group plc (“**Singer & Friedlander**”) in July of 2005 for ISK 63,708 million. We believe that these acquisitions have improved the quality of our loan portfolio and increased the diversification of our operations. However, FIH, being a wholesale commercial bank, generates lower interest margins than other of our banking operations.

We believe that our results for 2005 reflect our focus on Northern Europe, which we consider to be our home market. Approximately 70 per cent. of our income in 2005 was generated outside Iceland. We expect this percentage to increase in 2006, as we seek to expand our activities in Finland, Luxembourg and the United Kingdom. We currently have senior long-term debt ratings of ‘A1’ from Moody’s and ‘A’ from Fitch. As of 31st December, 2005, our total assets were ISK 2,540,811 million, our Tier 1 ratio was at 9.4 per cent. and our Capital Adequacy Directive (“**CAD**”) ratio was 12.2 per cent. Our net earnings for 2005 were ISK 49,260 million (\$780 million), an increase of 178 per cent. from 2004.

We operate across five core business segments:

- Investment Banking;
- Banking;
- Capital Markets;
- Treasury; and
- Asset Management and Private Banking.

In addition, we operate a number of ancillary units such as Risk Management, Information Technology, Finance and Sales and Marketing.

History

We were created in our present form by the merger of two of Iceland's foremost banks, Kaupthing Bank hf. and Búnadarbanki Islands hf. ("**Búnadarbanki**"), both of which enjoyed a strong market position in Iceland. Búnadarbanki dates back to 1929, when the Icelandic parliament, the Althing, passed a law on the founding of Búnadarbanki. At the beginning of 1998, Búnadarbanki became a limited liability company and the government began to sell its holdings in the bank. The bank was privatised in stages and this process was completed at the beginning of 2003. Búnadarbanki was listed on the Main List of the Iceland Stock Exchange in December 1998.

Kaupthing hf. was established in Reykjavík in 1982, coinciding with the launch of the free capital market in Iceland. Kaupthing hf. later became an investment bank and changed its name to Kaupthing Bank hf. in 2002. In September 2000, Kaupthing Bank hf. was listed on the ICEX and, in December 2002, it was listed on the O-list of the Stockholm Stock Exchange.

In May 2003, Kaupthing Bank hf. and Búnadarbanki merged under the name Kaupthing Búnadarbanki hf., which later became Kaupthing Bank hf. Kaupthing Bank hf. acquired the assets and liabilities of Búnadarbanki and shareholders in Búnadarbanki received 48.23 per cent. of the total share capital in Kaupthing Bank in exchange for their shares.

In recent years, we have strengthened our position abroad by acquiring financial companies and establishing subsidiaries. We believe that the most important developments so far have been the acquisition in 2002 of the Swedish bank, JP Nordiska AB (now Kaupthing Bank Sverige AB), the acquisition in September 2004 of the Danish bank FIH and the acquisition in July 2005 of the UK-based bank Singer & Friedlander. The acquisition of JP Nordiska AB significantly strengthened our position in the Nordic countries, an area which we consider to be our home market. Our acquisition of FIH, a Danish corporate lending bank, approximately doubled the size of our balance sheet and further diversified our loan portfolio. We continue to evaluate potential acquisition opportunities that could further expand our international banking operations.

Recent Developments

On 31st May, 2006 we sold our 24 per cent. stake in VÍS eignarhaldsfélag hf. (Iceland Insurance Company – "**VÍS**") in a transaction where the owners of over 80 per cent. of the share capital in VÍS, including us, accepted Exista's bid for their holdings. Exista previously held nearly 20 per cent. of the share capital. The sale price of our holding in VÍS totals ISK 15.9 billion and of this total we will book ISK 7.0 billion as profit from the sale in the second quarter of 2006.

On 1st August, 2006 we sold 6.1 per cent. of Exista's total share capital to nine Icelandic pension funds. As a result of the sale we hold 14.8 per cent. of the share capital in Exista. We have realized a profit of ISK 5.7 billion from the sale, which will be booked in the third quarter of 2006. The sale of these shares is part of a process meant to reduce our holdings in Exista to an insubstantial level, as was announced in our annual general meeting in March 2006.

We also intend to sell shares in Exista to institutional investors in connection with the listing of Exista's shares on the Iceland Stock Exchange, expected to take place in September 2006. The sale will be carried out through a book-building process. At a shareholders' meeting in late 2006 the Board of Kaupthing Bank will also propose that approximately half of the shares in Exista, held by Kaupthing Bank before this transaction, be paid to Kaupthing Bank's shareholders in the form of an extra dividend payment.

We sold our remaining 8.75 per cent. stake in Baugur Group hf. on 7th March, 2006 to the investment company Gaumur and Eignarhaldsfélagid ISP, from which we realised capital gains of approximately ISK 3.3 billion. The sale ended an investment project which began in 2003 with the acquisition and delisting of Baugur Group hf. from the ICEX and that entity's subsequent division into the investment company Baugur Group hf. and the retail company Hagar hf. We originally advised on, provided financing for and acquired almost 20 per cent. of Baugur Group hf.

We have reached an agreement with Glitnir Bank hf. ("**Glitnir**", formerly Íslandsbanki hf.) to acquire from Glitnir an 18.45 per cent. interest in Greidslumidlun hf., an Icelandic payment service company holding the VISA franchise in Iceland, principally in exchange for our 16.00 per cent. interest in Kreditkort hf., an Icelandic payment service company holding the MasterCard franchise in Iceland. Following the transactions described above, we will hold a 39.45 per cent. interest in Greidslumidlun hf. and a 4.0 per cent. interest in Kreditkort hf., and Glitnir will hold a 0.05 per cent. interest in Greidslumidlun hf. and a 51.0 per cent. interest in Kreditkort hf. This transaction is contingent on the approval of both the Icelandic Financial Supervisory Authority and the Icelandic Competition Authority. In addition, we have granted to Glitnir a call option with respect to almost all of our remaining interest in Kreditkort hf. We do not believe that this transaction will have a material effect on our financial condition or results of operations.

Legal Status and Legislative Background

The Issuer is a public limited company incorporated in Iceland in 1982 for an unlimited duration and operating under Icelandic law. It is registered with the registrar of companies in Iceland and its registration number is 560882-0419. The registered office of the Issuer is at Borgartun 19, 105 Reykjavik, Iceland, tel. +354 444 6000. The operations of the Issuer are, among other things, subject to the provisions of Act no. 2/1995 on Public Limited Companies, as amended, and Act no. 161/2002 on Financial Undertakings, as amended. The Issuer is subject to the supervision of the Icelandic Financial Supervisory Authority.

Under the Issuer's constitutional documents, its legal name is Kaupthing Bank hf. (Kaupthing banki hf. in Icelandic, previously Kaupthing Búnadarbanki hf.). Prior to 28th April, 2004, the Issuer issued Notes under the Programme using the legal name Kaupthing Bunadarbanki hf. On and after 28th April, 2004, the Issuer has used the legal name Kaupthing Bank hf. for all purposes under the Programme, since it became the policy of the Issuer to use the legal name Kaupthing Bank hf. abroad instead of the English spelling of the previous Icelandic legal name, Kaupthing Bunadarbanki hf.

SOURCES OF FUNDS

The Issuer's principal sources of funding are customer deposits and borrowing in the capital markets. Other sources of funding include capital markets and financial institutions.

The table below provides a breakdown of the Group's sources of funding as at 31st December, 2005 and 1st January, 2005 in accordance with IFRS:

	<i>31/12/2005</i>	<i>01/01/2005</i>
	<i>(ISK millions)</i>	
Equity	194,183	149,370
Minority interest	8,329	9,539
Subordinated loans	102,688	57,623
Deposits	555,819	234,681
Core funding	861,019	451,213
Borrowings	1,556,567	968,512
Financial liabilities	60,273	68,011
Other liabilities	44,494	62,309
Tax liabilities	18,458	4,408
Finance in the market	1,679,792	1,103,240
Total funds	2,540,811	1,554,453

The composition of the Group's funding has changed significantly in recent years as the Issuer's business has moved from primarily serving individuals, small businesses and clients in the agricultural sector to serving larger corporations in the domestic and Nordic markets. As a result, intermediations of borrowing has grown rapidly.

Equity

The table below sets out the 10 largest shareholders of the Issuer as of 31st December, 2005.

	<i>Shares</i>	<i>%</i>
Exista B.V	140,214,493	21.10%
Egla hf	71,883,352	10.82%
Vátryggingafélag Íslands hf	26,806,419	4.03%
Lífeyrissjóur verslunarmanna	22,442,476	3.38%
Gildi –lífeyrissjóður	19,930,204	3.00%
Lífeyrissjóður Bankastræti 7.. .. .	19,256,304	2.90%
Norvest ehf	16,449,589	2.48%
Íslandsbanki hf	14,463,031	2.18%
FL Investment ehf	12,705,757	1.91%
Landsbanki Íslands hf	8,850,580	1.33%

Capital Adequacy

According to the provisions of Art. 84 and 85 of the Law no. 161/2002 on Financial Undertakings, a bank's subordinated loans and equity capital, after subtraction of the book value of shares held in other financial institutions, may not at any time fall below 8.0 per cent. of its risk-adjusted asset base, as defined by law. The risk-adjusted asset base of a bank is comprised of total assets as well as guarantees issued and calculated risk factors after the deduction of various figures in the balance sheet, according to the rules of the Financial Supervisory Authority. At 31st December, 2005, the Issuer complies with all statutory ratios in accordance with the provisions of Art. 28 and 83 of the Act on Financial Undertakings. Together with subordinated loans, total capital and

reserves amounted to ISK 236,862 million as at 31st December, 2005 of which ISK 182,029 million consisted of Tier 1 capital. It is the Issuer's policy to seek to maintain a 11 per cent. capital ratio for the Group with a minimum Tier 1 ratio of 8 per cent.

Equity at the end of the period amounts to ISK 202,512 million. The capital adequacy ratio, calculated in accordance to Article 84 of the Act on Financial Undertakings, was 12.2 per cent. According to the law the ratio may not go below 8.0 per cent. The ratio is calculated as follows:

	<i>Book value</i>	<i>31/12/2005 Weighted value</i>
	<i>(ISK millions)</i>	
Risk base:		
Assets recorded in the Financial Statements	2,540,811	1,841,833
Assets deducted from equity		-62,590
Guarantees and other items not included in the Balance Sheet ..		166,029
		<u>1,945,272</u>
Capital:		
Tier I capital:		
Equity		202,512
Intangible assets		-54,943
Assets subtracted from equity		-6,741
Subordinated loans		41,201
Tier II capital:		
Subordinated loans		61,285
Investment in credit institutions		-6,451
Total equity base		<u>236,862</u>
Equity ratio		12.2%
Thereof Tier I ratio		9.4%

Deposits

As at 31st December, 2005, the Issuer had approximately 274,814 deposit accounts, including current accounts, savings accounts and currency accounts. As at the same date, the Issuer's total deposits amounted to 25 per cent. of the total deposits in all of Iceland's commercial banks and savings banks. The deposits from customers are well diversified, with a majority of the customers having relatively low deposits. Deposit accounts bear interest at a floating rate.

The table below sets out a breakdown of the Issuer's deposits as at 31st December, 2005 and 1st January, 2005 in accordance with IFRS:

	<u>31/12/2005</u>	<u>01/01/2005</u>
	<i>(ISK millions)</i>	
Deposits from credit institutions and central banks by maturity:		
Deposits on demand	11,176	18,017
Up to 3 months	52,820	3,252
Over 3 months and up to a year	3,890	6,838
Over 1 year and up to 5 years	0	2,118
Over 5 years	1,757	2,263
Deposits from credit institutions and central banks	<u>69,643</u>	<u>32,488</u>
Other deposits by maturity:		
On demand	163,426	80,084
Up to 3 months	253,963	82,980
Over 3 months and up to a year	18,156	8,773
Over 1 year and up to 5 years	39,834	23,922
Over 5 years	10,797	6,434
Other deposits	<u>486,176</u>	<u>202,193</u>

Other Funding

The majority of the Issuer's funding derives from international capital markets i.e. bond markets and syndicated loans, commercial paper and money markets.

The following table sets out a breakdown of the Issuer's borrowings from bonds and notes issued, as well as borrowings from other credit institutions, as at 31st December, 2005 and 1st January, 2005 in accordance with IFRS.

	<u>31/12/2005</u>	<u>01/01/2005</u>
	<i>(ISK millions)</i>	
Borrowings are specified as follows:		
Bonds issued	1,158,806	779,931
Bills issued	164,910	35,726
Money market loans	200,581	111,901
Other loans	32,270	40,954
Total	<u>1,556,567</u>	<u>968,512</u>
Borrowings mature as follows:		
On demand	10,684	9,685
Up to 3 months	300,885	145,277
Over 3 months and up to a year	214,935	125,907
Over 1 year and up to 5 years	862,240	581,107
Over 5 years	167,823	106,536
Total	<u>1,556,567</u>	<u>968,512</u>

Uses of Funds

The table below sets out a breakdown of the Issuer's uses of funds as at 31st December, 2005 and 1st January, 2005 in accordance with IFRS:

	<u>31/12/2005</u>	<u>01/01/2005</u>
	<i>(ISK millions)</i>	
Cash and cash balances with central banks	34,877	6,290
Loans and advances	1,739,294	1,154,416
Financial assets measured at fair value	612,366	304,454
Financial assets available-for-sale	167	1,507
Investments in associates	13,888	3,649
Intangible assets	54,943	35,098
Investment property	24,156	19,155
Property and equipment	22,433	6,092
Tax assets	5,004	1,092
Non-current assets and disposal groups classified as held-for-sale	2,302	3,631
Other assets.. .. .	31,380	19,069
Total assets.. .. .	<u>2,540,811</u>	<u>1,554,453</u>

The predominant lending activity of the Issuer is making loans to an extensive range of corporate customers and private individuals.

The Issuer provides services to all sectors and has sought to establish a diversified portfolio of marketable securities and loans in order to minimise its lending risks. The Issuer believes that its portfolio of loans and marketable securities is well distributed between economic sectors.

The table below sets out the breakdown of the Issuer's total loans and marketable securities by customer categories as at 31st December, 2005:

	<u>31/12/2005</u>
Industry	19%
Services	27%
Real estate	13%
Individuals	17%
Trade.. .. .	12%
Holding companies	10%
Transportation	2%
	<u>100%</u>

The table below sets out a breakdown by remaining maturity of the Group's loans to customers and leasing agreements as at 31st December, 2005 and 1st December, 2005:

	<u>31/12/2005</u>	<u>01/01/2005</u>
	<i>(ISK millions)</i>	
On demand	69,543	36,199
Up to 3 months	296,268	129,117
Over 3 months and up to a year	161,068	114,062
Over 1 year and up to 5 years	515,101	367,876
Over 5 years	514,673	345,146
Loans to customers	<u>1,556,653</u>	<u>992,400</u>

The Issuer's exposure to market risk in bonds, derivatives included, amounts to ISK 187,410 million. The bond portfolio is predominantly comprised of AAA bonds. Kaupthing Bank hf. has entered into derivative transactions amounting to ISK 53,388 million against its position in shares.

Risk Management

The Issuer faces various types of risks related to its business as a financial institution, which arise from its day to day operations. The most significant of these risks are listed below. Management devotes a significant portion of its time to the management of risk. Effective risk management involves the identification of the significant risks, the quantification of the Issuer's exposure to these risks and taking appropriate action to limit these risks including constantly monitoring them. Among other risk management techniques, the Issuer has established a range of limits, has sought to ensure that these limits are complied with and has sought to quantify its exposures to different risks. It is management's responsibility to identify where established limits have been exceeded and to take the appropriate action. The Issuer has documented these responsibilities and limits.

Approval and Revision of Risk Policy

The Issuer's Risk Policy has been adopted and approved by its Board of Directors. It is reviewed and revised at least annually. Amendments or minor changes can be made more frequently but each change needs the approval of the Issuer's chief executive officers ("**CEOs**") before it is effective and then needs to be approved by the Board of the Issuer as soon as practicable thereafter.

Types of Risks

Credit Risk

Credit risk is managed on a Group-wide level by the Group Credit Committee and the Group Credit Manager (or Head of Credit Risk). The role of the Credit Manager is to manage the process and make sure all the requirements set out by the Credit Committee such as requirements on documentation and collateral are satisfied. The value of collateral is adjusted for volatility (called a "haircut"); such adjustments are different for each asset class depending on its estimated liquidation quality. The Credit Manager monitors collateral quality on a daily basis and reacts to any deficiencies identified. The collateral system integrates loan, foreign exchange and derivative information with custody data and the values of pledged securities in the clients' portfolios and calculates the collateral value daily. The Group Credit Manager ensures that an exposure to a single customer within the group does not exceed certain limits set by the Group Credit Committee.

Credit and collateral risk is managed on a local level in the Issuer's subsidiaries according to the same rules and in accordance with any further requirements of local regulation. The local credit committees and credit managers receive their credit limits from the Group Credit Committee and all larger credits require approval from the Group Credit Committee.

Security market risk

Trading departments are only permitted to trade certain listed stocks on certain exchanges within prescribed limits and in some cases on an intra-day basis only.

Currency risk

Currency risk is the risk associated with fluctuations in assets and liabilities denominated in different currencies due to movements in exchange rates. Currency risk is controlled by the Issuer's Treasury, is subject to limits and is estimated using the risk models referred to below.

Interest rate risk

Interest rate risk arises due to the maturity or interest rate reset periods of assets and liabilities not coinciding. Fluctuations in market interest rates cause fluctuations in interest income. Short to medium term interest rate risk is controlled by the Issuer's Treasury using limits on mismatch in expected in- and-outgoing payments as well as limits on interest rate sensitivity of overall interest bearing assets and liabilities. The Issuer's Trading Department is responsible for positions in long term bonds and interest rate risk is further controlled using position limits and estimated using various risk models referred to below.

Liquidity risk

The Issuer is subject to the risk of being unable to repay its depositors on demand, or as and when due, through holding insufficient cash or near-cash assets. This risk is measured by constant monitoring of liquidity ratios. The Issuer's Treasury is responsible for maintaining liquidity by maintaining a sufficiently high ratio of liquid assets and available funding to near term liabilities and possible payment outflows. The liquidity measures are calculated at the end of each trading day and monitored by the Head of Risk and reported to the CEOs.

Operational risk

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, human and system error, or from external events that affect the Issuer's operations. These operational risks are monitored through a system of internal control set up at different levels in the Group (including daily controls, supervisory controls and management controls).

Risk Monitoring

At least twice a year the risk management department submits to the Board of Directors an overview of at least the 10 largest credits of the Issuer. The overview includes long- and short-term obligations, stock holdings, collateral and major financial information. At least twice a year a list of the largest credits in doubt is also presented to the Board of Directors.

Market Risk Limits

Position limits and any changes to them are proposed by the Issuer's Head of Trading and accepted by the Issuer's Head of Risk Management ("**Head of Risk**") and reviewed by the CEOs. Each position limit size is based on, among other things, underlying liquidity, the Issuer's risk appetite as well as legal limitations on individual positions stipulated by relevant authorities. The Head of Risk maintains a document detailing current limits and a journal of changes to them. Final approval of all position limits is required from the CEOs. All trades outside of position limits are prohibited and the penalty will be decided by Head of Risk and paid by the relevant Trading Department from its profit and loss account. The penalty amount is, in general, based on the profit or loss generated by the unauthorised trades and is twice that amount or 1 per cent. per day of the limit overrun, whichever is larger. Disputes on breaches of position limits or amounts can be referred to the CEOs. All violations of this risk policy need to be documented in the journal maintained by Head of Risk and made available to the CEOs.

Monitoring

The Issuer monitors the different risks incurred carefully. The different types of risks (excluding credit risk) are specified above. The overall responsibility of complying with the established limits lies with the Board of Directors. Management is, however, responsible for the day-to-day routines aimed at controlling the different risk parameters. The positions are continuously monitored against the limits where possible and otherwise daily.

Risk Reporting

Intra-Day Reports

All trades and intra-day profit or loss is reported continuously to the Head of Risk through a position monitoring system. The Head of Risk appoints a person and a backup person whose responsibility it is to monitor the intra-day positions and alert the Head of Risk to any deviations or exceptions observed.

Daily Reports

The Issuer's Risk Management sends a daily report on profit and loss and turnover to the Head of Risk, Head of Trading and the CEOs.

Monthly Reports

The Risk Management department sends a monthly risk assessment report to the Head of Trading, the CEOs and the Board of Directors detailing volatility based and scenario based measures such as Value-at-Risk, Earnings-at-Risk and stress tests based on current position limits.

Quarterly Reports

The Head of Trading sends a quarterly report to the Head of Risk and the CEOs on activities, profit and loss and general observations on the market and his view on future prospects for the trading operations.

Risk Models

Risk models employed are position based (risk limits), volatility based (i.e. based on the volatility of market variables and their related co-variance) and scenario based (i.e. based on a prescribed scenario which is likely to cause severe drawdown in profits).

Risk measures are generated by proprietary systems that utilise counter party and market data and trade databases generated and used by the Issuer's trade systems. Additionally the risk management systems are augmented by a number of third party solutions.

PROVISIONS AND NON-PERFORMING LOANS

The Issuer evaluates non-performing loans as aggregated exposures of customers for which its has made specific provisions in part or in full. Non-performing loans amounted at year end 2005 to ISK 15,078 million, 0.98 per cent. of total loans to customers.

Provisions for losses on the loan portfolio have been made each year by the Issuer to meet the estimated risk attached to these assets. These provisions do not represent a final write-off. Certain risk factors are evaluated in addition to a regular contribution for this purpose. The Issuer uses specific provisions as well as general provisions to meet the general risk of lending operations.

The table below sets out changes in the Issuer's provisions as at 31st December, 2005.

Changes in the provision for losses are specified as follows:

	<u>31/12/2005</u> <i>(ISK millions)</i>
Balance at the beginning of the year	12,294
Acquisition through business combination	1,765
Impairment on loans and advances during the year	2,450
Exchange rate difference on translation	-518
Write offs during the year	-3,212
Payment of loans previously written off	174
Provision on loans and advances	12,953

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

BOARD OF DIRECTORS OF THE ISSUER

The Issuer's Board of Directors consists of nine members and nine alternates.

Board

Sigurdur Einarsson – Chairman of the Board of Directors. Born in 1960. Graduated as an economist from the University of Copenhagen in 1987. Joined Kaupthing Bank in 1994 and was appointed Executive Chairman in May 2003.

Hjorleifur Thor Jakobsson – Deputy Chairman of the Board of Directors. Born in 1957. Graduated from the Mechanical and Industrial Engineering department of the University of Iceland in 1981 and received his MSc in engineering from Oklahoma State University in 1982. CEO of Oliufelagid hf. Elected to the board in 2003.

Finnur Ingolfsson. Born in 1954. Graduated with a degree in economics from the University of Iceland in 1984. Executive Chairman of Vatryggingafelag Islands hf. Elected to the board in 2003.

Gunnar Pall Palsson. Born in 1961. Graduated with a degree in business administration from the University of Iceland in 1987. CEO of Commercial Worker's Union of Reykjavik (VR). Elected to the board in 2001.

Brynja Halldorsdottir. Born in 1957. Graduated with a degree in business administration from the University of Iceland in 1981. CFO of Norvik hf. Elected to the board in 2004.

Tommy Persson. Born in 1948. CEO of Lansforsakringar AB and Chairman of the Swedish Insurance Federation and the Swedish Insurance Employers' Association. Elected to the board in 2002.

Asgeir Thoroddsen. Born in 1942. Graduated with a Cand. Jur. Degree from the University of Iceland in 1967 and received a degree in public administration from New York University in 1971. Attorney to the Supreme Court of Iceland. Elected to the board in 2003.

Niels de Coninck-Smith. Born in 1956. Graduated with a MSc in 1980 from the Copenhagen School of Economics and later received a masters in business administration from the Wharton School of the University of Pennsylvania in 1982. CEO of Ferrosan A/S. Elected to the board in 2005.

Bjarnfredur H. Olafsson. Born in 1967. Graduated with a Cand. Jur. Degree from the University of Iceland in 1993 and received 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. Attorney to the District Court of Iceland. Elected to the board in 2003.

The business address of each of the above persons is Borgartun 19, 105 Reykjavik, Iceland.

Senior Management

Hreidar Mar Sigurdsson – Chief Executive Officer (CEO). Born in 1970. Graduated with a degree in business administration from the University of Iceland in 1994 and joined Kaupthing Bank later that year. Appointed CEO in 2003.

Gudny Arna Sveinsdottir – Chief Financial Officer (CFO). Born in 1966. Graduated with a degree in business administration from the University of Iceland in 1991 and received a MSc in finance and accounting from the University of Uppsala in 1996. Joined Kaupthing Bank in 2001.

Steingrimur Karason – Chief Risk Officer. Born in 1968. Graduated with a degree in mechanical engineering from the University of Iceland in 1991 and received a MSc in engineering in 1993 and a Ph.D. in 1997, both from the Massachusetts Institute of Technology. Joined Kaupthing Bank in 1997.

Asgrimur Skarphedinsson – Chief Information Officer. Born in 1958. Graduated with a degree in electrical engineering from Odense Teknikum in Denmark in 1982. Joined Kaupthing Bank in 1997.

Gudni Niels Adalsteinsson – Group Treasurer. Born in 1967. Graduated with a degree in economics from the University of Iceland in 1991 and received a MSc in business administration from Cambridge University in 1998. Joined Kaupthing Bank in 2005.

Jonas Sigurgeirsson – Chief Communications Officer. Born in 1968. Graduated with a degree in history from the University of Iceland in 1992 and received a MSc in business administration from the University of Tampa in 2000. Joined Kaupthing Bank in 2000.

The business address of each of the above persons is Borgartun 19, 105 Reykjavik, Iceland.

No director has any actual or potential conflict of interest between his or her duties to the Issuer and his or her private interests or other duties.

Internal Auditor

Gudjon Johannesson – Internal Auditor. Born in 1969. Graduated with a degree in Business Administration from the University of Iceland in 1995. He joined Bunadarbanki Islands hf. in 1999.

State Authorised Public Accountants

The state authorised public accountants of Kaupthing Bank are KPMG Endurskodun hf. and on their behalf, Saemundur Valdimarsson.

Saemundur Valdimarsson. Born in 1963. State Authorised Public Accountant. Accountant of Kaupthing Bank from 2006.

SUMMARY CONSOLIDATED FINANCIAL INFORMATION

Set out on the following pages are a five year summary consolidated profit and loss account, balance sheet and key ratios for the Group prepared in accordance with IRFS (although certain IFRS balance sheet information for years prior to 2004 is not available) and a reconciliation of the Group's 2005 profit and loss account and balance sheet between Icelandic GAAP and IFRS.

FIVE YEAR SUMMARY – THE GROUP

	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>
	<i>(ISK millions)</i>				
Profit and Loss					
Net interest income	32,710	18,259	10,124	6,998	5,811
Other operating income	68,692	31,687	21,656	14,414	8,039
Net operating income	<u>101,402</u>	<u>49,946</u>	<u>31,780</u>	<u>21,412</u>	<u>13,850</u>
Other operating expenses	-34,729	-23,625	-18,493	-12,455	-10,565
Impairment	-4,389	-3,825	-3,894	-2,794	-1,691
Taxes	-11,228	-4,237	-1,486	-764	321
Net earnings	<u>51,056</u>	<u>18,258</u>	<u>7,907</u>	<u>5,399</u>	<u>1,915</u>
Net shareholders' earnings	49,260	17,707	7,520	5,363	1,915
Minority interest	1,796	552	387	36	–
Balance Sheet					
Assets					
Cash balance with central banks	34,877	6,290	–	–	–
Loans and advances	1,739,294	1,154,416	–	–	–
Mortgage loans at FV	12,033	31,754	–	–	–
Trading assets	337,157	205,185	–	–	–
Financial assets at FV through P/L	258,717	63,695	–	–	–
Financial assets AFS	167	1,507	–	–	–
Derivatives used for hedging	4,459	3,820	–	–	–
Investment in associates	13,888	3,649	–	–	–
Intangible assets	54,943	35,098	–	–	–
Investment property	24,156	19,155	–	–	–
Property and equipment	22,433	6,092	–	–	–
Current & deferred tax assets	5,004	1,092	–	–	–
Non-current assets HFS	2,302	3,631	–	–	–
Reinsurers' share	136	107	–	–	–
Other assets	31,244	18,962	–	–	–
Total assets	<u>2,540,811</u>	<u>1,554,453</u>	<u>558,569</u>	<u>432,412</u>	<u>317,563</u>
Liabilities and equity					
Deposits	486,176	202,193	182,497	164,570	83,473
Other liabilities	1,749,436	1,135,728	308,837	222,339	203,349
Minority interest	8,329	9,539	10,603	1,114	223
Subordinated loans	102,688	57,623	10,704	11,010	8,364
Shareholders' equity	194,183	149,370	45,928	33,379	22,154
Total liabilities and equity	<u>2,540,811</u>	<u>1,554,453</u>	<u>558,569</u>	<u>432,412</u>	<u>317,563</u>

	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>
			<i>(ISK millions)</i>		
Key Ratios					
Cost / income ratio	34.1%	47.3%	58.2%	58.2%	76.3%
Return on shareholders' equity	34.0%	25.5%	23.0%	18.7%	-
Impairment/Loans and advances	0.1%	0.4%	1.1%	1.0%	0.8%
Total credit reserves	0.7%	1.4%	2.4%	2.1%	2.0%
Price / earnings	9.9	12.4	12.2	8.8	20.5
Earnings per share, ISK	75.2	35.6	18.5	14.8	6.1
Earnings per share diluted, ISK	73.9	35.1	18.4	14.7	6.1
Average no. of shares outstanding, million	655	497	406	362	314
Avg. no. of shares outstanding diluted, million	666	505	411	364	315
No. of shares at end of period, million	664	652	438	409	356
No. of shares at end of period diluted, million	675	660	443	411	358
Share price at end of period	746	442	225	130	125

Profit and Loss account for 2005, change from previous GAAP to IFRS

<i>According to previous GAAP</i>		<i>Change in valuation</i>	<i>Change in presentation</i>	<i>According to IFRS</i>	
Net interest income	18,900	0	-641	18,259	Net interest income
Fees, commissions and other service charges	15,645	0	-2,337	13,308	Net fee and commission income
Fees, commissions and other service charges, paid	-2,348	0	2,348	0	
Dividends from shares and other holdings	4,216	0	-244	3,972	Dividend income
Trading gains	11,290	0	-10,798	492	Net gain on financial assets/liabilities not at fair value
		0	12,755	12,755	Net gain on financial assets/liabilities at fair value
		670	-1,562	-892	Foreign exchange differences
		0	240	240	Share of profit of associates
Other operating income	866	0	968	1,834	Other operating income
Salaries and salary related expenses	-12,652	0	-199	-12,851	Salaries and related expenses
Other administrative expenses	-9,108	0	-320	-9,428	Administration expenses
Depreciation and amortisation	-2,642	1,289	6	-1,347	Depreciation and amortisation
Provision for losses	-3,819	0	-6	-3,825	Impairment on loans and advances
		0	-22	-22	Loss from non current assets held for sale
Income tax	-4,040	-12	-184	-4,236	Income tax
	<u>16,308</u>	<u>1,947</u>	<u>4</u>	<u>18,259</u>	Net earnings
Minority interest	-548	0	-4	-552	Minority interest
Net earnings according to previous GAAP	<u>15,760</u>	<u>1,947</u>	<u>0</u>	<u>17,707</u>	Net earnings attributable to shareholders of Kaupthing Bank

Balance Sheet, change from previous GAAP to IFRS

<u>According to previous GAAP</u>		<u>Change in</u>	<u>Change in</u>		<u>According to IFRS</u>
			<i>presentation</i>		
Cash and amounts due from credit institutions	113,543	0	-107,253	6,290	Cash and cash balances with central bank
Loans, lease contracts	1,088,346	11,704	54,366	1,154,416	Loans and advanced
Bonds, shares and other securities	248,352	5,352	50,750	304,454	Financial assets measured at fair value
–		-28	1,535	1,507	Financial assets available-for-sale
Shares in associated companies	8,266	-461	-4,156	3,649	Investment in associates
Goodwill	34,208	-11	901	35,098	Intangible assets
–		377	18,778	19,155	Investment property
Fixed assets	6,467	12	-387	6,092	Property and equipment
Deferred tax assets	1,039	0	53	1,092	Tax assets
-		-61	3,692	3,631	Non-current assets and disposal groups classified as held for sale
Other assets	33,799	109	-14,839	19,069	Other assets
Total Assets	1,534,020	16,993	3,440	1,554,453	Total Assets
Amounts owed to credit institutions	147,455	0	-114,967	32,488	Deposits from credit institutions and Central bank
Savings deposits	202,038	0	155	202,193	Other deposits
Borrowings	884,219	2,862	81,431	968,512	Borrowings
Subordinated loans	57,627	0	-4	57,623	Subordinated loans
–		13,475	54,536	68,011	Financial liabilities measured at fair value
–		0			Insurance liabilities
–		0		0	Trading liabilities
–		0		0	Derivatives used for hedging
Provision for deferred income-tax liability	9,165	392	-5,149	4,408	Tax liabilities
-		0	1,402	1,402	Liabilities included in disposal groups classified as held for sale
Other liabilities	74,767	337	-14,197	60,907	Other liabilities
Equity	149,443	-73	0	149,370	Shareholders' equity
Minority interest in subsidiaries' equity	9,306	0	233	9,539	Minority interest
Total Liabilities and Equity	1,534,020	16,993	3,440	1,554,453	Total Liabilities and Equity

TAXATION

1. Icelandic Taxation

The comments below are of a general nature based on the understanding of the Issuer of current law and practice in Iceland. They should not be construed as providing specific advice as to Icelandic taxation and are subject to changes as to the applicable rules in the future. They relate only to the position of persons who are the absolute beneficial owners of the Notes. They may not apply to certain classes of persons, such as dealers. Prospective holders of the Notes who are in any doubt as to their personal tax position or who may be subject to tax in any other jurisdiction, should consult their professional advisers.

Non-Icelandic tax residents

There are no taxes or other governmental charges payable under the laws of Iceland or any authority of, or in, Iceland in respect of the principal, interest or any other amount payable on the Notes paid to a holder who is not a tax resident of Iceland.

There are no estate or inheritance taxes, succession duties, gift taxes or capital gains taxes imposed by Iceland or any authority of, or in, Iceland in respect of the Notes if, at the time of the death of the holder or the transfer of the Notes, such holder or transferor is not a tax resident of Iceland.

Unless resident, domiciled (or registered in the case of a legal person), or engaged in trade or business through a permanent establishment in Iceland, holders of the Notes are not liable for tax on payments of interest under the Notes, and can apply with the Icelandic Revenue Commissioner (RSK) for a formal confirmation of their tax status in this respect (RSK 5.35). The absence of such applications has not resulted in actions by Icelandic tax authorities. In the case of payments of interest to holders of the Notes which are liable for tax on payments of interest, the Issuer is liable to withhold such tax.

In the event the Issuer is required to withhold tax in respect of any Note, then the Issuer will pay such additional amounts as shall be necessary in order that the net amounts received by the holder of such Note after such withholding shall equal the respective amounts of principal and interest which would otherwise have been receivable in respect of such Note, in the absence of such withholding. In the event that the Issuer will need to pay additional amounts to investors due to withholding tax, the Issuer is entitled to any refund that might be claimable from the tax authorities.

Icelandic tax residents

Beneficial owners of the Notes that are resident in Iceland for tax purposes are subject to income tax in Iceland on their interest income in accordance with Icelandic tax law. The rate depends on their tax status.

Subject to certain exemptions (which apply, *inter alia*, to most banks and pension funds), the Issuer is required to withhold a 10% tax on the interest paid to the holders of Notes who are Icelandic residents. Such withholding is considered a preliminary tax payment but does not necessarily constitute the final tax liability of the holder.

2. EU Savings Directive

Under EC Council Directive 2003/48/EC on the taxation of savings income, Member States are required, from 1st July, 2005, to provide to the tax authorities of another Member State details of payments of interest (or similar income) paid by a person within its jurisdiction to an individual resident in that other Member State. However, for a transitional period, Belgium, Luxembourg and Austria are instead required (unless during that period they elect otherwise) to operate a withholding system in relation to such payments (the ending of such transitional period being

dependent upon the conclusion of certain other agreements relating to information exchange with certain other countries). A number of non-EU countries and territories including Switzerland have agreed to adopt similar measures (a withholding system in the case of Switzerland) with effect from the same date.

3. Luxembourg Taxation

The following summary is of a general nature and is included herein solely for information purposes. It is based on the laws presently in force in Luxembourg, though it is not intended to be, nor should it be construed to be, legal or tax advice. Prospective investors in the Notes should therefore consult their own professional advisers as to the effects of state, local or foreign laws, including Luxembourg tax law, to which they may be subject.

Withholding Tax

(i) Non-resident holders of Notes

Under Luxembourg general tax laws currently in force and subject to the laws of 21 June 2005 (the "Laws") mentioned below, there is no withholding tax on payments of principal, premium or interest made to non-resident holders of Notes, nor on accrued but unpaid interest in respect of the Notes, nor is any Luxembourg withholding tax payable upon redemption or repurchase of the Notes held by non-resident holders of Notes.

Under the Laws implementing the EC Council Directive 2003/48/EC of 3 June 2003 on taxation of savings income in the form of interest payments and ratifying the treaties entered into by Luxembourg and certain dependent and associated territories of EU Member States (the "**Territories**"), payments of interest or similar income made or ascribed by a paying agent established in Luxembourg to or for the immediate benefit of an individual beneficial owner or a residual entity, as defined by the Laws, which is a resident of, or established in, an EU Member State (other than Luxembourg) or one of the Territories will be subject to a withholding tax unless the relevant recipient has adequately instructed the relevant paying agent to provide details of the relevant payments of interest or similar income to the fiscal authorities of his/her/its country of residence or establishment, or, in the case of an individual beneficial owner, has provided a tax certificate issued by the fiscal authorities of his/her country of residence in the required format to the relevant paying agent. Where withholding tax is applied, it will be levied at a rate of 15 per cent. during the first three-year period starting 1 July 2005, at a rate of 20 per cent. for the subsequent three-year period and at a rate of 35 per cent. thereafter. Responsibility for the withholding of the tax will be assumed by the Luxembourg paying agent. Payments of interest under the Notes coming within the scope of the Laws would at present be subject to withholding tax of 15 per cent.

(ii) Resident holders of Notes

Under Luxembourg general tax laws currently in force and subject to the law of 23 December 2005 (the "**Law**") mentioned below, there is no withholding tax on payments of principal, premium or interest made to Luxembourg resident holders of Notes, nor on accrued but unpaid interest in respect of Notes, nor is any Luxembourg withholding tax payable upon redemption or repurchase of Notes held by Luxembourg resident holders of Notes.

Under the Law payments of interest or similar income made or ascribed by a paying agent established in Luxembourg to or for the immediate benefit of an individual beneficial owner who is a resident of Luxembourg will be subject to a withholding tax of 10 per cent. Such withholding tax will be in full discharge of income tax if the beneficial owner is an individual acting in the course of the management of his/her private wealth. Responsibility for the withholding of the tax will be assumed by the Luxembourg paying agent. Payments of interest under the Notes coming within the scope of the Law would be subject to withholding tax of 10 per cent.

SUBSCRIPTION AND SALE

The Dealers have, in an amended and restated programme agreement (the “**Programme Agreement**”) dated 31st August, 2006, agreed with the Issuer a basis upon which they or any of them may from time to time agree to purchase Notes. Any such agreement will extend to those matters stated under “*Form of the Notes*” and “*Terms and Conditions of the Notes*”. In the Programme Agreement, the Issuer has agreed to reimburse the Dealers for certain of their expenses in connection with the establishment of the Programme and the issue of Notes under the Programme and to indemnify the Dealers against certain liabilities incurred by them in connection therewith.

United States

The Notes have not been and will not be registered under the Securities Act and may not be offered or sold within the United States or to, or for the account or benefit of, U.S. persons except in certain transactions exempt from the registration requirements of the Securities Act. Terms used in this paragraph have the meanings given to them by Regulation S under the Securities Act.

The Notes are subject to U.S. tax law requirements and may not be offered, sold or delivered within the United States or its possessions or to a United States person, except in certain transactions permitted by U.S. tax regulations. Terms used in this paragraph have the meanings given to them by the U.S. Internal Revenue Code of 1986 and regulations thereunder.

Each Dealer has represented and agreed, and each further Dealer appointed under the Programme will be required to represent and agree, that it will not offer, sell or deliver Notes (i) as part of their distribution at any time or (ii) otherwise until 40 days after the completion of the distribution, as determined and certified by the relevant Dealer or, in the case of an issue of Notes on a syndicated basis, the relevant lead manager, of all Notes of the Tranche of which such Notes are a part, within the United States or to, or for the account or benefit of, U.S. persons. Each Dealer has further agreed, and each further Dealer appointed under the Programme will be required to agree, that it will send to each dealer to which it sells any Notes during the distribution compliance period a confirmation or other notice setting forth the restrictions on offers and sales of the Notes within the United States or to, or for the account or benefit of, U.S. persons. Terms used in this paragraph have the meanings given to them by Regulation S under the Securities Act.

Until 40 days after the commencement of the offering of any Series of Notes, an offer or sale of such Notes within the United States by any dealer (whether or not participating in the offering) may violate the registration requirements of the Securities Act if such offer or sale is made otherwise than in accordance with an available exemption from registration under the Securities Act.

Each issuance of Index Linked Notes or Dual Currency Notes shall be subject to such additional U.S. selling restrictions as the Issuer and the relevant Dealer may agree as a term of the issuance and purchase of such Notes, which additional selling restrictions shall be set out in the applicable Final Terms.

European Economic Area

In relation to each Member State of the European Economic Area which has implemented the Prospectus Directive (each, a “**Relevant Member State**”), each Dealer has represented and agreed, and each further Dealer appointed under the Programme will be required to represent and agree, that with effect from and including the date on which the Prospectus Directive is implemented in that Relevant Member State (the “**Relevant Implementation Date**”) it has not made and will not make an offer of Notes to the public in that Relevant Member State except that it may, with effect from and including the Relevant Implementation Date, make an offer of Notes to the public in that Relevant Member State:

- (a) in (or in Germany, where the offer starts within) the period beginning on the date of publication of a prospectus in relation to those Notes which has been approved by the competent authority in that Relevant Member State or, where appropriate, approved in another Relevant Member State and notified to the competent authority in that Relevant Member State, all in accordance with the Prospectus Directive and ending on the date which is 12 months after the date of such publication;
- (b) at any time to legal entities which are authorised or regulated to operate in the financial markets or, if not so authorised or regulated, whose corporate purpose is solely to invest in securities;
- (c) at any time to any legal entity which has two or more of (1) an average of at least 250 employees during the last financial year; (2) a total balance sheet of more than €43,000,000 and (3) an annual net turnover of more than €50,000,000, as shown in its last annual or consolidated accounts; or
- (d) at any time in any other circumstances which do not require the publication by the Issuer of a prospectus pursuant to Article 3 of the Prospectus Directive.

For the purposes of this provision, the expression an “offer of Notes to the public” in relation to any Notes in any Relevant Member State means the communication in any form and by any means of sufficient information on the terms of the offer and the Notes to be offered so as to enable an investor to decide to purchase or subscribe the Notes, as the same may be varied in that Member State by any measure implementing the Prospectus Directive in that Member State and the expression “**Prospectus Directive**” means Directive 2003/71/EC and includes any relevant implementing measure in each Relevant Member State.

United Kingdom

Each Dealer has represented and agreed, and each further Dealer appointed under the Programme will be required to represent and agree, that:

- (i) in relation to any Notes having a maturity of less than one year, (a) it is a person whose ordinary activities involve it in acquiring, holding, managing or disposing of investments (as principal or agent) for the purposes of its business and (b) it has not offered or sold and will not offer or sell any Notes other than to persons whose ordinary activities involve them in acquiring, holding, managing or disposing of investments (as principal or as agent) for the purposes of their businesses or who it is reasonable to expect will acquire, hold, manage or dispose of investments (as principal or agent) for the purposes of their businesses where the issue of the Notes would otherwise constitute a contravention of Section 19 of the FSMA by the Issuer;
- (ii) it has only communicated or caused to be communicated and will only communicate or cause to be communicated an invitation or inducement to engage in investment activity (within the meaning of Section 21 of the FSMA) received by it in connection with the issue or sale of any Notes in circumstances in which Section 21(1) of the FSMA does not apply to the Issuer; and
- (iii) it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to any Notes in, from or otherwise involving the United Kingdom.

Japan

The Notes have not been and will not be registered under the Securities and Exchange Law of Japan (the “**Securities and Exchange Law**”) and each Dealer has agreed and each further Dealer appointed under the Programme will be required to agree that it will not offer or sell any Notes, directly or indirectly, in Japan or to, or for the benefit of, any resident of Japan (which term as used

herein means any person resident in Japan, including any corporation or other entity organised under the laws of Japan), or to others for re-offering or resale, directly or indirectly, in Japan or to a resident of Japan except pursuant to an exemption from the registration requirements of, and otherwise in compliance with, the Securities and Exchange Law and any other applicable laws, regulations and ministerial guidelines of Japan.

The Republic of Italy

The offering of the Notes has not been cleared by CONSOB (the Italian Securities Exchange Commission) pursuant to Italian securities legislation and, accordingly, no Notes may be offered, sold or delivered, nor may copies of the Base Prospectus or any documentation relating to the Notes be distributed, in the Republic of Italy, except:

- (i) to professional investors (“*operatori qualificati*”), as defined in Article 31, second paragraph, of CONSOB Regulation No. 11522 of 1st July, 1998, as amended; or
- (ii) in circumstances which are exempted from the rules on solicitation of investments pursuant to Article 100 of Legislative Decree No. 58 of 24th February, 1998 (the “Financial Services Act”) and Article 33, first paragraph, of CONSOB Regulation No. 11971 of 14th May, 1999, as amended.

Any offer, sale or delivery of the Notes or distribution of copies of the Base Prospectus or any other document relating to the Notes in the Republic of Italy under (i) or (ii) above must be:

- (a) made by an investment firm, bank or financial intermediary permitted to conduct such activities in the Republic of Italy in accordance with the Financial Services Act and Legislative Decree No. 385 of 1st September, 1993 (the “**Banking Act**”), as amended;
- (b) in compliance with Article 129 of the Banking Act and the implementing guidelines of the Bank of Italy pursuant to which the issue or the offer of securities in the Republic of Italy may need to be preceded and followed by an appropriate notice to be filled with the Bank of Italy depending, *inter alia*, on the aggregate value of the securities issued or offered in the Republic of Italy and their characteristics; and
- (c) in compliance with any other applicable laws and regulations.

Iceland

Each Dealer has agreed and each further Dealer appointed under the Programme will be required to agree that it will not offer Notes to the public in Iceland, except in compliance with the Icelandic Act on Securities Transactions (No. 33/2003) and any applicable laws or regulations of Iceland.

General

Each Dealer has agreed and each further Dealer appointed under the Programme will be required to agree that it will (to the best of its knowledge and belief) comply with all applicable securities laws and regulations in force in any jurisdiction in which it purchases, offers, sells or delivers Notes or possesses or distributes this Base Prospectus and will obtain any consent, approval or permission required by it for the purchase, offer, sale or delivery by it of Notes under the laws and regulations in force in any jurisdiction to which it is subject or in which it makes such purchases, offers, sales or deliveries and neither the Issuer nor any of the other Dealers shall have any responsibility therefor.

None of the Issuer and the Dealers represents that Notes may at any time lawfully be sold in compliance with any applicable registration or other requirements in any jurisdiction, or pursuant to any exemption available thereunder, or assumes any responsibility for facilitating such sale.

With regard to each Tranche, the relevant Dealer will be required to comply with such other restrictions as the Issuer and the relevant Dealer shall agree and as shall be set out in the applicable Final Terms.

GENERAL INFORMATION

Authorisation

The establishment of the Programme and the issue of Notes was duly authorised by a resolution of the Board of Directors of the Issuer dated 13th June, 2003. Subsequent increases in the amount of the Programme were duly authorised by resolutions of the Board of Directors of the Issuer dated 27th March, 2004, 23rd November, 2004 and 27th May, 2005. The update of the programme on 31st August, 2006 was duly authorised by a resolution of the Board of Directors of the Issuer dated 25th July, 2006.

Listing of Notes

Application has been made to the CSSF to approve this document as a Base Prospectus. Application has also been made to the Luxembourg Stock Exchange for Notes issued under the programme to be admitted to trading on the Luxembourg Stock Exchange's regulated market and to be listed on the Official List of the Luxembourg Stock Exchange. The Stock Exchange's regulated market is a regulated market for the purposes of the Investment Services Directive (Directive 93/22/EEC).

Documents Available

For the period of 12 months following the date of this Base Prospectus, copies of the following documents will, when published, be available free of charge from the registered office of the Issuer and from the specified offices of the Paying Agent for the time being in Luxembourg:

- (i) the articles of association (with an English translation thereof) of the Issuer;
- (ii) the audited financial statements of the Issuer in respect of the financial years ended 31st December, 2004 and 31st December, 2003 in each case together with the audit reports prepared in connection therewith;
- (iii) the most recently published audited annual financial statements of the Issuer and the most recently published unaudited interim financial statements of the Issuer (with an English translation thereof) in each case together with any audit or review reports prepared in connection therewith;
- (iv) the Programme Agreement, the Agency Agreement, the Deed of Covenant and the forms of the Global Notes, the Notes in definitive form, the Receipts, the Coupons and the Talons;
- (v) a copy of this Base Prospectus;
- (vi) any future Base Prospectuses, prospectuses, information memoranda and supplements (including Final Terms save that a Final Terms relating to a Note which is neither admitted to trading on a regulated market in the European Economic Area nor offered in the European Economic Area in circumstances where a prospectus is required to be published under the Prospectus Directive will only be available for inspection by a holder of such Note and such holder must produce evidence satisfactory to the Issuer and the Paying Agent as to its holding of Notes and identity) to this Base Prospectus and any other documents incorporated herein or therein by reference; and
- (vii) in the case of each issue of Notes admitted to trading on the Luxembourg Stock Exchange's regulated market subscribed pursuant to a subscription agreement, the subscription agreement (or equivalent document).

In addition, copies of this Base Prospectus, each Final Terms relating to Notes which are admitted to trading on the Luxembourg Stock Exchange's regulated market and each document

incorporated by reference are available on the Luxembourg Stock Exchange's website (www.bourse.lu).

Clearing Systems

The Notes have been accepted for clearance through Euroclear and Clearstream, Luxembourg (which are entities in charge of keeping the records). The appropriate Common Code and ISIN for each Tranche of Notes allocated by Euroclear and Clearstream, Luxembourg will be specified in the applicable Final Terms. The address of Euroclear is 1 Boulevard du Roi Albert II, B-1210 Brussels and the address for Clearstream, Luxembourg is 42 Avenue JF Kennedy, L-1855, Luxembourg. If the Notes are to clear through an additional or alternative clearing system the appropriate information will be specified in the applicable Final Terms.

Conditions for determining price

The price and amount of Notes to be issued under the Programme will be determined by the Issuer and the relevant Dealer at the time of issue in accordance with prevailing market conditions.

Significant or Material Change

There has been no significant change in the financial or trading position of the Issuer or the Issuer and its subsidiaries, taken as a whole, since 30th June, 2006 and there has been no material adverse change in the prospects of the Issuer or the Issuer and its subsidiaries, taken as a whole, since 31st December, 2005.

Litigation

Neither the Issuer nor any of its subsidiaries is or has been involved in any governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened of which the Issuer is aware) in the 12 months preceding the date of this document which may have or have in such period had a significant effect on the financial position or profitability of the Issuer or the Group.

Auditors

The auditors of the Issuer are KPMG Endurskodun hf., chartered accountants and a member of The Institute of State Authorised Public Accountants in Iceland, who have audited the Issuer's accounts, without qualification, in accordance with generally accepted auditing standards in Iceland for each of the two financial years ended on 31st December, 2005. The auditors of the Issuer have no material interest in the Issuer.

The reports of the auditors of the Issuer are included or incorporated in the form and context in which they are included or incorporated, with the consent of the auditors who have authorised the contents of that part of this Base Prospectus.

Post-Issuance Information

Except to the extent required by applicable law and regulation, the Issuer does not intend to provide any post-issuance information in relation to any assets underlying issues of Notes constituting derivative securities.

Dealers transacting with the Issuer

Certain of the Dealers and their affiliates have engaged, and may in the future engage, in investment banking and/or commercial banking transactions with, and may perform services to the Issuer and its affiliates in the ordinary course of business.

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