KAUPÞING

Consolidated Financial Statements
22 October to 31 December 2008

New Kaupthing Bank hf.
Borgartún 19
105 Reykjavík
Iceland

Reg. no. 581008 - 0150

Contents

Endorsement and Statement by the Board of Directors and the CEO

The Consolidated Financial Statements of New Kaupthing Bank hf. for the period ended 31 December 2008 include the Financial Statements of New Kaupthing Bank hf. and its subsidiaries, together referred to as "the Bank".

The Bank is a group of financial undertakings which provide comprehensive services to companies, institutions and private customers. The Bank was established on the basis of the decision of the Icelandic Financial Supervisory Authority (FME) on 18 October 2008. In the financial crisis of 2008, the Board of Directors of Kaupthing Bank hf. requested the intervention of the FME on the basis of new legislation which was passed on 6 October 2008. This legislation authorised the Minister of Finance, on behalf of the state treasury, to provide the necessary funds to establish a new financial undertaking or to take over a financial undertaking or its bankruptcy estate, in whole or in part, in special or very unusual circumstances on the financial market.

The FME decided that New Kaupthing Bank hf. should take over the assets and liabilities of Kaupthing Bank hf. The transfer value of the FME defined assets, liabilities and contingent liabilities was negotiated during 2008 and 2009, and various agreements were signed in 2009 agreeing a net priority claim against Kaupthing Bank hf. of ISK 38,300 million. Contrary to the original expectation of the FME decision, the liabilities transferred to New Kaupthing Bank hf. exceeded assets transferred as specified in their decision, which meant that Kaupthing Bank hf. issued a compensating instrument to New Kaupthing Bank hf.

In other respects, reference is made to the aforementioned agreement, which contains provisions on the division of the possible appreciation in value of certain assets of New Kaupthing Bank hf., and to the shareholders' agreement on the management of New Kaupthing Bank hf. and the Kaupthing Bank hf.'s possibility of acquiring up to 87% of the share capital in New Kaupthing Bank hf. These aspects of the agreements are not reflected in the 2008 financial statements as they were not part of the original FME decision of 2008.

The fact that assets and liabilities had not been fully settled has severely restricted the Board's ability to have an influence on operating results. It should also be noted that the Bank's asset structure was determined by the size of Kaupthing Bank hf., which was considerably larger than New Kaupthing Bank hf. Risk exposures are therefore larger than the Board wished, and there is an FX imbalance between assets and liabilities owing to the unconventional way in which New Kaupthing Bank hf. was established.

The Balance Sheet as at 22 October 2008 is based on an agreed valuation of the transferred assets and liabilities. Such valuations are always subject to uncertainty, a fact which is complicated by the greater than usual instability in the global economy. The economic situation is critical in Iceland. Restrictions on foreign exchange also remain in place and it is therefore difficult to estimate the value of assets and liabilities in foreign currencies.

The mismatch in New Kaupthing Bank hf. foreign currency balance means that the financial statements is very sensitive to changes in the exchange rate. The ISK depreciated by 6.8% against a trade weighted currency basket from 22 October until 31 December 2008, which is the principal reason for the net foreign exchange gain of ISK 31,104 million and increased loan impairment during the period.

Endorsement and Statement by the Board of Directors and the CEO

Operations for the period

Consolidated net earnings amounted to ISK 4,817 million for the period 22 October to 31 December 2008. The Board of Directors proposes that no dividend will be paid. Consolidated total equity amounted to ISK 76,946 million at the end of the period, including share capital amounting to ISK 12,646 million. The capital adequacy ratio of the Bank, calculated according to the Act on Financial Undertakings, was 10.6%. This ratio may not be lower than 8.0%.

New Kaupthing Bank hf. is owned entirely by the Icelandic state.

Statement by the Board of Directors and the CEO

The Consolidated Financial Statements for the period ended 31. December 2008 have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU.

It is our opinion that the Consolidated Financial Statements give a true and fair view of the consolidated financial performance of the Bank for the period 22 October to 31 December 2008, its consolidated financial position as at 31 December 2008 and its consolidated cash flows for the period 22 October to 31 December 2008.

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

The Board of Directors and the CEO have today discussed the Consolidated Financial Statements of New Kaupthing Bank hf. for the period 22 October to 31 December 2008 and confirm them by means of their signatures. The Board of Directors and the CEO recommend that the Consolidated Financial Statements be approved at the Annual General Meeting of New Kaupthing Bank hf.

Reykjavík, 20 November 2009

Board of Directors

Erna Bjarnadóttir
Chairman

Drífa Sigfúsdóttir

Jónína A. Sanders

Helga Jónsdóttir

Theodór Sigurbergsson

Jóhannes Rúnar Jóhannsson

CEO

Finnur Sveinbjörnsson

Independent Auditors' Report

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

We have audited the accompanying Consolidated Financial Statements of New Kaupthing Bank hf. and its subsidiaries (the "Bank"), which comprise the Consolidated Balance Sheet as at 31 December 2008, the Consolidated Income Statement, Consolidated Statement of Comprehensive Income, Consolidated Statement of Changes in Equity and Consolidated Statement of Cash Flows for the period then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these Consolidated Financial Statements in accordance with International Financial Reporting Standards as adopted by the EU. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatements, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditors´ Responsibility

Our responsibility is to express an opinion on these Consolidated Financial Statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the Financial Statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the Financial Statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the Financial Statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the Financial Statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the Financial Statements.

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

Opinion

In our opinion, the Consolidated Financial Statements give a true and fair view of the consolidated financial position of New Kaupthing Bank hf. as at 31 December 2008, of its consolidated financial performance and its consolidated cash flows for the period then ended in accordance with International Financial Reporting Standards as adopted by the EU.

Matters of Emphasis

Without qualifying our opinion we draw your attention to:
Note 3 to the Consolidated Financial Statements concerning the Bank’s ability to continue as a going concern. The going concern assumption is dependent on the significant reduction of the acquired foreign currency, liquidity and interest rate mismatches, the availability of financing facilities and the successful implementation of the Bank’s restructuring initiatives. These conditions indicate the existence of material uncertainty which may cast doubt about the Bank’s ability to continue as a going concern.

Notes 2 d), 29 and 102 to the Consolidated Financial Statements concerning the sensitivity of the fair value calculations to changes in reasonably possible alternative assumptions and estimates given the illiquid financial markets. There is significant uncertainty over the recovery of assets in terms of value and the time of recovery.

Note 108 to the Consolidated Financial Statements concerning the significant uncertainty of the value and timing of the potential customer debt equalization in accordance with the FME Decision dated 22 October 2008 and the related terms of the netting agreement executed on 3 September 2009 with Kaupthing Bank hf.

Reykjavík, 20 November 2009

Ernst & Young hf.	National Audit Office
Jóhann Unnsteinsson, Partner	Sveinn Arason, Auditor General
Margrét Pétursdóttir, Partner	

Consolidated Income Statement
for the Period from 22 October to 31 December 2008

	Notes	22.10.2008-31.12.2008
Interest income		17,367
Interest expense		(13,169)
Net interest income	32	4,198
Fee and commission income		1,658
Fee and commission expense		(371)
Net fee and commission income	33	1,287
Net financial income	34-38	(6,060)
Net foreign exchange gain	39	31,104
Share of profit or loss of associates	66	498
Other operating income	40-41	418
Operating income		31,445
Salaries and related expense	43-44	(1,228)
Administration expense		(1,392)
Depositors' and investors´ guarantee fund	82	(2,969)
Depreciation and amortisation	68	(109)
Other operating expense	47-48	(441)
Impairment	46	(19,723)
Earnings before income tax		5,583
Income tax expense	49	(766)
Net earnings		4,817
Attributable to:		
Shareholder of New Kaupthing Bank hf.		4,817
Non-controlling interest		-
Net earnings		4,817
Earnings per share		
Basic and diluted earnings per share attributable to the shareholder of New Kaupthing Bank hf. (ISK)	50	0.38

The notes on pages 11 to 59 are an integral part of these Consolidated Financial Statements.

Amounts are in ISK millions

Consolidated Statement of Comprehensive Income
for the Period from 22 October to 31 December 2008

	Notes	22.10.2008-31.12.2008
Net earnings for the period reported via Income Statement		4,817
Exchange difference on translating foreign operations	80	129
Comprehensive income for the period, net of tax		4,946
Total comprehensive income for the period		4,946
Attributable to:		
Shareholder of New Kaupthing Bank hf.		4,946
Non-controlling interest		-
Total comprehensive income for the period		4,946

The notes on pages 11 to 59 are an integral part of these Consolidated Financial Statements.

Amounts are in ISK millions

Consolidated Balance Sheet
as at 31 December 2008

Assets	Notes	31.12.2008	22.10.2008*
Cash and balances with central bank	51	87,555	8,779
Loans and receivables to credit institutions	52-53	47,697	35,265
Loans and receivables to customers	54-59	337,014	324,727
Unpaid share capital	88	71,225	-
Bonds and debt instruments	62-63	10,761	7,939
Shares and equity instruments	62	6,609	8,826
Compensation instrument	62,64	41,156	38,300
Investment property	65	12,079	11,598
Investments in associates	66	2,843	2,345
Property and equipment	67-68	7,656	8,346
Intangible assets	69	2,432	2,441
Tax assets	72-75	551	578
Other assets	70-71	13,625	3,090
Total Assets		641,203	452,234
Liabilities			
Due to credit institutions and central bank	62	122,733	52,179
Deposits	62	421,341	389,756
Financial liabilities at fair value	62	2	38
Tax liabilities	72-75	1,031	274
Other liabilities	77	19,150	9,987
Total Liabilities		564,257	452,234
Equity			
Share capital	78-79	12,646	-
Share premium	79	59,354	-
Foreign currency translation reserve	80	129	-
Retained earnings		4,817	-
Total Shareholder's Equity		76,946	-
Non-controlling interest		-	-
Total Equity		76,946	-
Total Liabilities and Equity		641,203	452,234

The notes on pages 11 to 59 are an integral part of these Consolidated Financial Statements.

**The 22 October 2008 Balance Sheet reflects the fair value of the acquired assets, liabilities and contingent liabilities from Kaupthing Bank hf. in accordance with the FME decision on 22 October 2008 (see note 29). The information disclosed is in accordance with the IFRS3 "Business Combinations" and is not comparative information.*

Prior to the business combination, the Bank's Balance Sheet comprised ISK 72,000 million in equity, ISK 775 million in cash and balances with central bank and ISK 71,225 million in unpaid share capital.

Amounts are in ISK millions

Consolidated Statement of Changes in Equity
for the Period from 22 October to 31 December 2008

	Share capital and share premium	Foreign currency translation reserve	Retained earnings	**Total Share-holder's equity**	**Total equity**
Changes in equity from 22 October to 31 December 2008:					
Total comprehensive income for the period attributable to the shareholder of New Kaupthing Bank hf.		129	4,817	4,946	4,946
Issued share capital	72,000			72,000	72,000
Equity 31 December 2008	72,000	129	4,817	76,946	76,946

The notes on pages 11 to 59 are an integral part of these Consolidated Financial Statements.

Amounts are in ISK millions

Consolidated Statement of Cash Flows
for the Period from 22 October to 31 December 2008

	Notes	22.10.2008-31.12.2008
Cash flows from (used in) operating activities:		
Earnings before income tax		5,583
Adjustments to reconcile earnings before income tax cash flow from (used in) operating activities:		
Non-cash items included in net earnings before income tax and other adjustments	88	(5,708)
Changes in operating assets and liabilities	89	83,519
Net cash from (used in) operating activities		83,394
Cash flows from (used in) investing activities:		
Purchase of intangible assets		(3)
Purchase of property and equipment		(17)
Proceeds from sale of property and equipment		128
Net cash from (used in) investing activities		108
Cash flows from (used in) financing activities:		
Proceeds from shares issued		775
Net cash from (used in) financing activities		775
Net increase in cash and cash equivalents		84,277
Cash and cash equivalents at beginning of the period		13,581
Effect of exchange rate changes on cash and cash equivalents		2,520
Cash and cash equivalents at the end of the period	90	100,378

The notes on pages 11 to 59 are an integral part of these Consolidated Financial Statements.

Amounts are in ISK millions

Notes to the Consolidated Financial Statements

Contents

Notes to the Consolidated Financial Statements

General information

1. Reporting entity

New Kaupthing Bank hf., the Parent Company, was established 18 October 2008 and is incorporated and domiciled in Iceland. The address of New Kaupthing Bank hf.'s. registered office is Borgartún 19, Reykjavik. The Consolidated Financial Statements for the period 22 October (date of business combination) to 31 December 2008 comprise New Kaupthing Bank hf. and its subsidiaries (together referred to as "the Bank"). The Bank offers integrated financial services to companies, institutional investors and individuals. These services include corporate banking, retail banking, capital markets services, corporate financing, asset management and comprehensive wealth management for private banking clients.

2. Basis of preparation

a) *Statement of compliance*

The Consolidated Financial Statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as endorsed by the European Commission.

The Financial Statements were approved and authorised for issue by the Board of Directors of New Kaupthing Bank hf. on 20 November 2009.

b) *Basis of measurement*

The Consolidated Financial Statements are prepared on the historical cost basis except for the following:

- Financial assets/liabilities held for trading are measured at fair value
- Financial assets/liabilities designated at fair value through profit and loss are measured at fair value
- Investment properties are measured at fair value

Non-current assets (or disposal groups) classified as held for sale are stated at the lower of their carrying amount and fair value less costs to sell. Immediately before the initial classification, or where the assets and liabilities are not within the scope of IFRS 5, the carrying amounts are measured in accordance with applicable IFRSs.

c) *Functional and presentation currency*

The Consolidated Financial Statements are presented in Icelandic krona (ISK), which is the Parent Company´s functional currency.

d) *Use of estimates and judgements*

The preparation of the Financial Statements requires management to make judgements, estimates and assumptions that affect the reported amounts of assets, liabilities, contingent liabilities as well as income and expenses in the Financial Statements presented. Use of available information and application of judgement are inherent in the formation of estimates. Actual results in the future could differ from such estimates and the differences may be material to the Financial Statements.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

Judgements made by management that have a significant effect on the Financial Statements and estimates with a significant risk of material adjustment within the next financial year are discussed in notes 28, 29, 97, 101 and 102.

Significant accounting policies

The accounting policies set out below have been applied consistently in these Consolidated Financial Statements.

3. Going concern assumption

The Bank's management has made an assessment of the Bank's ability to continue as a going concern and is satisfied that the Bank has the resources to continue. The Balance Sheet of the Bank presents significant uncertainty due to the asset-liability mismatches of significant risks as described in the Risk Management disclosures. A considerable portion of the transferred assets from Kaupthing Bank hf. are denominated in low interest rate foreign currencies and are funded with on-demand deposits denominated in Icelandic krona, a high interest rate currency. Liquidity risk, as well as risks related to imbalances in currency, duration and interest rate base are outlined in the Risk Management disclosures from page 40. Whilst the Bank's stress testing has resulted in the Bank management's assessing that it is sufficiently capitalised to deal with market shocks, significant market shocks during the realignment period of the Bank's risk profile, poses some uncertainty. Of critical importance is the Bank's access to funding to fulfill the maturity of existing short-term liabilities and continue to finance the assets of the Bank. The Bank's management has considered the execution of the agreements outlined in note 111 as important to their future business.

The Bank is making progress in adapting to the new economic reality in Iceland with a focus on strengthening the infrastructure and internal control. The main focus has been on safeguarding the value of the Bank's assets through the recovery process and a team of specialists has been put together to work with defaulting customers. A favorable outcome from this process will strengthen the Bank's business.

4. Principles underlying the consolidation

a) *Subsidiaries*
Subsidiaries are entities controlled by the Bank. Control exists when the Bank has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Control usually exists when the Bank holds more than 50% of the voting power of the subsidiary. In assessing control, potential voting rights that are currently exercisable or convertible are taken into account. The Financial Statements of subsidiaries are included in the Consolidated Financial Statements from the date that control commences until the date that control ceases.

The purchase method of accounting is used to account for the acquisition of businesses and subsidiaries by the Bank. The cost of an acquisition is measured as the fair value, at the date of exchange, of the assets given, liabilities incurred or assumed, contingent liabilities assumed and equity instruments issued, plus cost directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Bank's share of the net identifiable assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the business/subsidiary acquired, the difference is recognised directly in the Income Statement.

b) *Funds management*
The Bank manages and administers assets held in investment vehicles on behalf of investors. The Financial Statements of these entities are not included in these Consolidated Financial Statements except when the Bank controls the entity.

c) *Transactions eliminated on consolidation*
Intragroup balances, income and expenses arising from intragroup transactions, are eliminated in preparing the Consolidated Financial Statements.

5. Associates

Associates are those entities over which the Bank has significant influence, i.e. the power to participate in the financial and operating policy decisions of the associates but not control or joint control over those policies. Significant influence generally exists when the Bank holds between 20% and 50% of the voting power, including potential voting rights. Investments in associates are initially recognised at cost. The carrying amount of investments in associates includes intangible assets and accumulated impairment loss.

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

If an investment in an associate is classified as held for sale the equity method is no longer applied and the investment is accounted for, as a non-current asset held for sale.

6. Foreign currency

a) *Functional currencies*
Items included in the Financial Statements of each of the Bank's subsidiaries are measured using the functional currency of the respective entity.

b) *Foreign currency transactions*
Transactions in foreign currencies are translated to the respective functional currencies of Bank entities at exchange rates at the dates of transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated to the functional currency at the exchange rate at that date. The foreign currency gain or loss on monetary items is the difference between amortised cost in the functional currency at the beginning of the period, and the amortised cost in foreign currency translated at the exchange rate at the end of the period. Non-monetary assets and liabilities denominated in foreign currencies are reported at historic cost.

c) *Foreign operations*
The assets and liabilities of foreign operations are translated to Icelandic krona, at exchange rates at the reporting date. The income and expenses of foreign operations are translated to Icelandic krona at average exchange rates approximating the exchange rates current at the dates of the transactions.

Foreign exchange differences arising on translation are recognised in comprehensive income. When a foreign operation is disposed of, in part or in full, the cumulative amount of the exchange differences relating to that foreign operation which is recorded in comprehensive income and accumulated in the separate component of equity, is transferred to the Income Statement when the gain or loss on disposal is recognised.

7. Income and Expense

a) *Interest income and expense*

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

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

Interest income and expense presented in the Income Statement include:
- Interest on financial assets and liabilities at amortised cost on an effective interest rate basis,
- Interest on trading assets and liabilities on an accrual basis,
- Interest on financial assets and financial liabilities designated at fair value through profit or loss on an accrual basis,
- Interest on derivatives on an accrual basis.

Interest income on non-performing assets are recognised in the Income Statement using the effective interest method. The Bank recognises losses for impaired loans to off-set the recognised interest income when appropriate.

b) *Fee and commission income and expense*

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

c) *Net financial income*

Net financial income comprises Dividend income, Net gain on financial assets and liabilities at fair value through profit or loss and Net gain on disposal of financial assets and liabilities not at fair value.

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

ii) Net gain on financial assets and liabilities at fair value through profit or loss comprises: Net gain on trading portfolio, Net gain on assets and liabilities designated at fair value through profit or loss.

Net gain on trading portfolio

Net gains on financial instruments held for trading comprise gains and losses related to financial assets and financial liabilities held for trading, and includes all realised and unrealised fair value changes, except for interest (which is included in "Interest income" and "Interest expense") and foreign exchange gains and losses (which are included in "Net foreign exchange gains" as described below).

Net gain on assets and liabilities designated at fair value through profit or loss

Net gains on financial instruments designated at fair value through profit or loss comprise gains and losses related to financial assets and financial liabilities designated at fair value through profit or loss, and includes all realised and unrealised fair value changes, except for interest (which is included in "Interest income" and "Interest expense") and foreign exchange gains and losses (which are included in "Net foreign exchange gains" as described below).

iii) Net foreign exchange gains comprise all foreign exchange differences arising on the settlement of foreign currency monetary assets and liabilities and on translating foreign currency monetary assets and liabilities at rates different from those at which they were translated on initial recognition during the period or in previous financial statements.

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

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

7. cont.

d) *Income tax*

Income tax comprises current and deferred tax. Income tax is recognised in the Income Statement except to the extent that it relates to items recognised directly in comprehensive income or equity, in which case it is recognised in comprehensive income or equity.

Current tax is the expected tax payable on the taxable income for the period, using tax rates enacted or substantially enacted at the reporting date.

The deferred income tax asset / liability has been calculated and entered in the Balance Sheet. The calculation is based on the difference between Balance Sheet items as presented in the tax return on the one hand, and in the Financial Statements on the other. This difference is due to the fact that tax assessments are based on premises that differ from those governing the Financial Statements, mostly because revenues and settlement is expected at the same time. A deferred tax asset is only offset against income tax liability if they are due to tax assessment from the same tax authorities.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reviewed at each reporting date and reduced to the extent that it is no longer probable that the related tax benefit will be realised.

8. Impairment of financial assets

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

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

a) *Impairment on loans and receivables*

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

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

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

i) Significant financial difficulty of the borrower;

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

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

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

v) Deterioration in collateral to loan ratio; or

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

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

Individually assessed loans

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

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

8. cont.

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

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

The collective impairment loss is determined after taking into account:

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

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

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

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

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

In some cases, financial assets are acquired at a deep discount that reflects incurred credit losses. The Bank includes such incurred credit losses in the estimated cash flows when computing the effective interest rate. If the Bank revises its estimate of payments or receipts, the Bank adjusts the carrying amount of the financial asset to reflect actual and revised estimated cash flows. The Bank recalculates the carrying amount by computing the present value of estimated future cash flows at the financial instrument´s original effective interest rate. The adjustment is recognised as income or expense in profit or loss.

Assets acquired in exchange for loans
Assets acquired in exchange for loans are recorded as non-current assets held for sale in the Balance Sheet if its sale is highly probable and management is committed to a plan to sell the asset, and an active programme to locate a buyer and complete the plan have been initiated. The non-current asset held for resale is recorded at the lower of its fair value less costs to sell, and the carrying amount of the loan, net of impairment allowance amounts, at the date of exchange. No depreciation is provided in respect of assets held for sale. Any subsequent write-down of the acquired asset to fair value less costs to sell is recorded as an impairment loss and included in the Income Statement. Any subsequent increase in the fair value less costs to sell, to the extent this does not exceed the cumulative impairment loss, is recognised in the Income Statement.

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

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

9. Impairment of non-financial assets

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

An impairment loss is recognised if the carrying amount of an asset exceeds its recoverable amount. Impairment losses are recognised in profit or loss.

The recoverable amount of an asset is the greater of its value in use and its fair value less cost to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

An impairment loss in respect of other assets, where impairment losses have been recognised in prior periods, are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

10. Derivatives

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

Derivatives are recognised at fair value. Fair value changes are recognised in the Income Statement. Changes in fair values of derivatives are split into interest income, foreign exchange differences and other gains and losses. Interest income is recognised on an accrual basis. Derivatives with positive fair values are recognised as Derivatives among Financial assets and derivatives with negative fair values are recognised as Financial liabilities at fair value.

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

11. Cash and cash equivalents

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

12. Loans and receivables

Loans and receivables are financial instruments with fixed or determinable payments that are not quoted in an active market and that the Bank does not intend to sell immediately or in the near term. Loans include loans provided by the Bank to credit institutions and to its customers, participation in loans from other lenders and purchased loans.

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

Loans and receivables are initially measured at fair value plus incremental direct transaction costs, and subsequently measured at their amortised cost using the effective interest method. Accrued interest is included in the carrying amount of the loans and receivables.

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

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

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

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

The assets classified according to the above-mentioned conditions consist of equity and debt instruments which are acquired by the Bank with a view to profiting from their total return and which are managed and evaluated on a fair value basis.

Interest and dividend income that arises from these assets are included in Interest income and Net financial income, respectively.

14. Determination of fair value

The determination of fair value of financial assets and financial liabilities that are quoted in an active market is based on quoted prices. A market is considered active if quoted prices are readily and regularly available and those prices represent actual and regularly occurring market transactions on an arm's length basis. For all other financial instruments fair value is determined by using valuation techniques. Valuation techniques include net present value techniques, the discounted cash flow method, comparison to similar instruments for which market observable prices exist, and valuation models. The Bank uses widely recognised valuation models for determining the fair value of common and more simpler financial instruments like options and interest rate and currency swaps. For these financial instruments, inputs into models are market observable.

The value produced by a model or other valuation technique is adjusted to allow for a number of factors as appropriate, because valuation techniques cannot appropriately reflect all factors market participants take into account when entering into a transaction. Valuation adjustments are recorded to allow for model risks, bid-ask spreads, liquidity risks, as well as other factors. Management believes that these valuation adjustments are necessary and appropriate to fairly state financial instruments carried at fair value on the Balance Sheet.

15. Recognition and derecognition of financial assets and financial liabilities

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

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

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

16. Offsetting financial assets and financial liabilities

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

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

17. Amortised cost measurement of financial assets and financial liabilities

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

18. Intangible assets

Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is fair value as at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses. Internally generated intangible assets are not capitalised and expenditure is reflected in the Income Statement in the year in which the expenditure is incurred.

a) *Subsequent expenditure*
Subsequent expenditure on capitalised intangible assets is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred.

b) *Amortisation*
Amortisation is recognised in the Income Statement on a straight-line basis over the estimated useful lives of intangible assets. Intangible assets are amortised from the date they are available for use. The estimated useful lives are as follows:

Software.. 5 years

19. Investment property

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

20. Property and equipment

a) *Recognition and measurement*
Items of property and equipment are measured at cost less accumulated depreciation and impairment losses. When parts of an item of property and equipment have different useful lives, they are accounted for as separate items of property and equipment.

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

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

Real estate	33 years
Machinery and equipment	3-5 years

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

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

Immediately before classification as held for sale, the measurement of the qualifying assets and all assets and liabilities in a disposal group is brought up-to-date in accordance with applicable IFRS. Then, on initial classification as held for sale, non-current assets and disposal groups are recognised at the lower of carrying amount and fair value less costs to sell. Impairment losses on initial classification as held for sale are included in the Income Statement, even when there is a revaluation. The same applies to gains and losses on subsequent remeasurement.

Non-current assets and disposal groups held for sale are mainly mortgages foreclosed and disposal entities.

22. Deposits

Deposits are initially measured at fair value plus transaction costs, and subsequently measured at their amortised cost using the effective interest method.

23. Financial liabilities at fair value

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

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

24. Other assets and other liabilities

Other assets and other liabilities are stated at cost less impairment.

25. Earnings per share

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

26. New standards and interpretations

a) New standards and interpretations adopted early

IFRS 8 *Operating Segments* introduces the "management approach" to segment reporting. IFRS 8, which becomes mandatory for the Bank's 2009 financial statements has been early adopted by management, requires the disclosure of segment information based on the internal reports regularly reviewed by the Bank's Chief Operating Decision Maker in order to assess each segment's performance and to allocate resources to them.

IAS 1 Presentation of Financial Statements (revised in 2007) replaces IAS 1 Presentation of Financial Statements (revised in 2003) as amended in 2005 has been early adopted by management. IAS 1 (Revised 2007) sets the overall requirements for the presentation of financial statements, guidelines for their structure and minimum requirements for their content. The main change in revised IAS 1 is a requirement to present all non-owner changes in equity (changes in equity not resulting from transactions with owners in their capacity as owners) in one or two statements: either in a single statement of comprehensive income, or in an income statement plus in a statement of comprehensive income. The Bank has elected to prepare two statements. Unlike under current IAS 1, it is not permitted to present components of comprehensive income in the Statement of changes in equity.

b) New standards and interpretations not yet adopted

A number of new standards, amendments to standards and interpretations are not yet effective for the period ended 31 December 2008, and have not been applied in preparing these Consolidated Financial Statements. Relevant to the Bank's reporting are:

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

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

IFRS 3 (revised in 2008) and amended IAS 27 will become mandatory for the Bank's 2010 Financial Statements. The carrying amounts of any assets and liabilities that arose under business combinations prior to the application of IFRS 3 (revised in 2008) are not adjusted while most of the amendments to IAS 27 must be applied retrospectively. The Bank has determined that the IFRS 3 and IAS 27 amendments will not have a material impact on the consolidated financial position and have not set an implementation date yet.

Improvements to IFRS

In May 2008 the IASB issued its first annual set of non-urgent amendments to standards, primarily with a view to removing inconsistencies and clarifying wording. The Bank has decided not to early adopt the amendments and does not expect that their application to have significant effect.

Amendments to IFRS 7 financial instruments: Disclosures - Improving disclosures about financial instruments.

The amendments to IFRS 7 were issued in March 2009. The amendments are intended to enhance fair value and liquidity disclosures.

With respect to fair value, the amendments require disclosure of a three-level fair value hierarchy, by class, for all financial instruments recognised at fair value and specific disclosures related to the transfers between levels in the hierarchy and detailed disclosures related to level 3 of the fair value hierarchy.

In addition, the amendments modify the required liquidity disclosures with respect to derivative transactions and assets used for liquidity management.

The Bank has disclosed alternative information about financial instruments in the risk management notes which it considers to be more relevant to the users of the financial statements given the unusual risk profile and level of estimates of assumptions in the preparation of the financial statements in 2008. Management will adopt the amendments to IFRS 7 in the 2009 financial statements.

27. Segment reporting

The Bank's segmental reporting is based on the management and internal reporting structure.The Bank comprises the following main business segments: Corporate banking, Retail banking, Treasury and Capital Markets, Corporate Finance, Asset Management and Private banking, and cost centres.

28. Critical accounting estimates and judgements in applying accounting policies

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

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

Key sources of estimation uncertainty

i) Impairment losses on loans and receivables
The Bank reviews its loan portfolios to assess impairment at least on a quarterly basis. In determining whether an impairment loss should be recorded in the Income Statement, the Bank makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

ii) Fair value of financial instruments
The fair value of financial instruments that are not quoted in active markets are determined by using valuation techniques. Where valuation techniques (for example, models) are used to determine fair values, they are validated and periodically reviewed by qualified personnel independent of the area that created them. All models are certified before they are used, and models are calibrated to ensure that outputs reflect actual data and comparative market prices. To the extent practical, models use only observable data, however areas such as credit risk (both own and counterparty), volatilities and correlations require management to make estimates. Changes in assumptions about these factors could affect reported fair value of financial instruments.

iii) Fair value of Investment Property
Investment properties are stated at fair value, which reflects market conditions at the balance sheet date. Gains or losses arising from change in the fair values of investment properties are included in the Income Statement in the period they arise.

iv) Intangible assets
The value of intangible assets with indefinite useful lives is not amortised, but the assets are tested for impairment at least once a year.

v) Assets held for resale

New Kaupthing Bank hf. classifies assets as held for resale and disposal groups if such assets or disposal groups are available for immediate sale in their present condition subject to terms that are usual and customary for sales of such assets or disposal groups, management is committed to a plan to sell such assets and is actively looking for a buyer, the assets are being actively marketed at a reasonable sales price in relation to their fair value, the sale is expected to be completed within one year, and their sale is considered highly probable. These assets are measured at the lower of their carrying amount and fair value less costs to sell and presented in Other assets (see notes 70 and 71).

Due to the illiquid markets for assets acquired in exchange for loans, the Bank may not be able to dispose of all assets acquired within 12 months as prescribed by IFRS. The Bank´s classification of assets acquired as non-current assets held for sale is considered to be reflective of existing banking industry application of IFRS 5.

Changes within the Bank

29. Changes within the Bank

On 21 October 2008, the Financial Supervisory Authority in Iceland (FME) decided:

- All assets of Kaupthing Bank hf. of any type, such as property, liquid assets, cash, shares in other companies and claims, were immediately allocated to New Kaupthing Bank hf. Excluded from this transfer were the assets and entitlements specified in the Annex to their decision. New Kaupthing Bank hf. also took over contractual rights of use of property and liquid assets, except in instances where they were specifically excluded in the compilation accompanying the new opening Balance Sheet. Rights and obligations according to derivative contracts were not transferred to the New Kaupthing Bank hf.
- New Kaupthing Bank hf. took over all rights used to secure the performance of obligations of the debtors of Kaupthing Bank hf., including all liens, guarantees and other comparable rights connected to the claims of the Bank. New Kaupthing Bank hf. shall, however, be accountable to Kaupthing Bank hf. for specific collaterals of customers, as applicable, due to claims and derivatives which are not transferred to New Kaupthing Bank hf. according to this decision or according to agreement hereinafter.
- New Kaupthing Bank hf. took over all intangible assets and rights, including trademarks, registered and unregistered, co-brands, databases, software and related licenses, as well as all comparable rights whether based on a contract, registration, public permits or other, except to the extent to which such rights are specifically excluded in the compilation accompanying the new opening Balance Sheet.
- New Kaupthing Bank hf. took over the operations which had been under the auspices of Kaupthing Bank hf. and were connected to the transferred assets, including the participation of Kaupthing Bank hf. in any type of payment system. Furthermore, New Kaupthing Bank hf. took over the rights and obligations according to contracts on custodianship and asset management with the customers of Kaupthing Bank hf. in Iceland.
- New Kaupthing Bank hf. took over obligations of the branches of Kaupthing Bank hf. in Iceland due to deposits from financial undertakings, the Icelandic Central Bank and other customers.
- New Kaupthing Bank hf. took over obligations according to import and export guarantees due to discharge of contract by companies and individuals regarding regular activities. New Kaupthing Bank hf. did not take over obligations of Kaupthing Bank hf. due to: a) obligations of subsidiaries abroad, b) companies under moratorium, composition or in bankruptcy, c) obligations of those owning a qualifying holding in Kaupthing Bank hf., and connected parties, d) obligations to Icelandic financial undertakings; e) other specifically identified liabilities according to the compilation accompanying the new opening Balance Sheet.
- Debt backed by collateral which rests upon appropriated assets transferred to New Kaupthing Bank hf. was taken over.

The acquired assets included the subsidiaries reflected in note 112 to the financial statements. There have been no changes in the percentage of the voting interest since their acquisition.

An agreement on settlement was based on management valuation on assets and liabilities made by the management of New Kaupthing Bank hf. Following this valuation, a settlement was made whereby Kaupthing Bank hf. paid New Kaupthing Bank hf. the difference between the worth of assets and liabilities. Kaupthing Bank hf. issued a bond to New Kaupthing Bank hf. as payment of the difference. The bond had a fair value on issue of ISK 38,300 million.

In accordance with IFRS 3 “Business Combinations”, the cost of the business combination has been allocated by recognising the acquired identifiable assets, liabilities and contingent liabilities from Kaupthing Bank hf. (that satisfy the recognition criteria) at their fair values at that date, except for non-current assets (or disposal groups) that are classified as held for sale in accordance with IFRS 5 Non-current Assets Held for Sale and Discontinued Operations, which have been recognised at fair value less costs to sell. The fair value of the acquired assets, liabilities and contingent liabilities from Kaupthing Bank hf in accordance with the FME decision on 22 October 2008 is shown on the Balance Sheet.

Due to the length of time taken to agree the transfer value of assets, liabilities and contingent liabilities acquired in the business combination, there is a likelihood that the benefit of hindsight has been reflected in the fair values in the business combination. It is difficult to determine whether appropriate due diligence at the transfer date would have foreseen any subsequent events which have been reflected in the transfer value of assets, liabilities and contingent liabilities.

29. cont.

Management valuation guidelines:

The methodology can be split into three general areas: (a) Loans to customers – Corporate loans; (b) Loans to customers – Retail loans; and (c) Other assets.

a) Loans to customers - Corporate loans

New Kaupthing Bank hf. prepared and carried out a fair value assessment of all assets transferred to the Bank. The largest asset class is the corporate loan portfolio. There are extraordinary conditions in the Icelandic economy and great uncertainty concerning the recovery of the corporate loan portfolio, both in terms of value and time of recovery. A large portion of corporate loans are either in default or are having payment holiday. The ability of corporate borrowers to service their debt has deteriorated due to the fact that Icelandic companies generally had a high level of leverage and a large share of their borrowings was in foreign currencies. The collapse of the Icelandic krona has therefore dramatically increased corporate debt levels but at the same time the level of interest rates has increased and other economic conditions, such as a sharp decrease in demand, have made the operating environment in Iceland extremely challenging. In the next 12 to 18 months, the portfolio has to a large degree to be restructured, new terms and conditions agreed with borrowers, debt to equity swaps made and loans redenominated from foreign currencies to ISK. New Kaupthing Bank hf. calculations are still in line with fair value calculation reflecting a medium term recovery instead of valuing companies in line with current market situation which is illiquid and depressed. New Kaupthing Bank hf. does though take into account that revenues and margins are likely to decrease, that some sectors will never return to previous activity and operational recovery will be slow and most likely in line with the macro economic projections made by the Central Bank.

Different valuation methods were used depending on the nature of the underlying assets and collateral. The loan portfolio has been categorized in accordance with the following methods:

i) Higher discount factor

A provision based on net present value is made when no or limited provision is necessary due to inability to service debt. This category therefore includes loans which are not expected to require restructuring but might have deteriorated in value due to mispricing of the loan. Interest on these loans is below current market rates as credit spreads were at a historic low when the loans were granted. The funding cost of the Bank has increased and in order to estimate the value of the loans, the contractual cash flows are discounted at the market interest rates which the Bank would be able to grant those companies the loans today. In order to minimise the discount applied, it is assumed that the interest charge is raised at the first available opportunity.

ii) Collateral value

This method is used to value loans where the underlying collateral value is greater than the value of future expected cash flows. The reason this method is used for a large portion of the loan book can in part be traced to the fact that Kaupthing Bank hf. made a lot of loans to holding companies with shares in Icelandic financial companies as underlying collateral. Those assets are now in many instances worthless and hence the low expected recoverability. Examples of other common types of collateral are fishing quotas, properties, inventory and receivables.

iii) Real estate

Real estate companies are facing considerable uncertainty over future rental rates. Vacancy rates have been increasing rapidly and it is difficult to estimate a normalised occupancy and rental rate going forward. Many tenants are in default and corporate bankruptcies are increasing. Due to this uncertainty New Kaupthing Bank hf. uses the Icelandic Property Registry (FMR) rates with a 8% discount as a prime method to value real estate properties. The Central Bank of Iceland has issued a forecast assuming FMR prices to reduce by 30% in nominal terms by the end of 2011, which supports the estimated reduction in real estate prices. For most of the real estate properties, New Kaupthing Bank hf. also used discounted cash flow calculations and predicted vacancy and rental rates. Combining the two methods resulted in a discount of approximately 8% from FMR rates for those properties.

It is stated in the Land Registry Act (no. 6/2001) that tax values should be based on the market value of the property. The FMR rates are therefore estimated market values, updated every year taking into account the price-level changes for registered sales contracts. The values used by New Kaupthing Bank hf. are market prices according to FMR from November 2008.

iv) EV/EBITDA multiples

The EV/EBITDA multiples method was used for operating companies that generate positive cash flows and the estimated value is greater than the underlying collateral value. The enterprise value of the borrower in question is estimated by looking at average EV/EBITDA multiples of comparable companies across Europe, sourced from Bloomberg as there is no active stock market in Iceland. The multiples were adjusted to capture the fact that Icelandic companies have a much higher weighted cost of capital than their peers in Europe due to higher interest rate and a country specific risk. The valuation of the four largest companies in this category (which make up over 50% of the value of all loans valued using the EV/EBITDA method), was however increased to reflect their market leading positions and resilient operations as they could as such be estimated to be trading at the upper range of their respective peer group. No discount or premium was applied due to illiquidity or control for the purpose of this valuation exercise as they were assumed to offset each other.

29. cont.

v) Recovery

The loan book has been analysed and specific cases have been formally submitted to the recovery process by the appropriate credit committee within the Bank. This category only includes those companies which were already in the recovery process at the time of the valuation, and where a valuation had been performed by the recovery team. Each company has been valued on a case by case basis and the valuation methods vary from company to company. The fair value estimate can therefore be based on market value, discounted cash flows, assessment of collateral value, break-up value and other methods.

b) Loans to customers - Retail loans

Retail loans to individuals and small and medium enterprices (SMEs) were valued on a homogenous pool basis. The pools were divided into segments based on product type and sector, and for each segment a fair value pricing simulation was performed. The simulation uses the Bank's funding cost as a discount rate and a segment-average Probability of Default (PD) and Loss Given Default, to take into account the credit risk inherent in the portfolio. The PDs are found using the Bank's internal models whereas LGDs are based on Loan-To-Value for mortgage loans and standard Basel II values for other types. For each time-period the cash flow is divided into a performing and non-performing part using the segment-average PD. A fraction of the non-performing cash flow is assumed recovered at the end of the period, added to the performing cash flow and the result discounted. After summing up the discounted cash flows for each period we arrive at the fair value of the segment. For all segments, except mortgage loans in ISK, the valuation was done for the following 3 years – the assumption being that at that point the loans will have been negotiated onto sustainable terms and rates. For ISK mortgages, the valuation was extended to maturity.

c) Other assets

Other assets were valued with a combination of various methods. Financial assets and loans to credit institutions were valued with many of the same methods as the corporate loans. Associates were valued on an enterprise value basis. Property and equipment were valued in accordance with independent valuer or FMR valuations.

Management have considered that the following disclosure requirements of IFRS 3 would be impracticable to compile and could potentially result in misleading information given the significant changes in the business environment in which these acquired companies operate,

- the amounts recognized at the acquisition date for each of the assets and liabilities in the acquiree´s pre-acquisition balance sheet.
- the revenue/profit of the combined entity for the period as though the acquisition date for all business combinations effected during the period had been the beginning of that period.

Operating Segment Reporting

30. Segment information is presented in respect of the Bank's operating segments based on the Bank´s management and internal reporting structure.

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

Segment capital expenditure is the total cost incurred during the period to acquire property and equipment and intangible assets.

Business segments

The Bank comprises the following main business segments:

Corporate Banking provides general banking services to large companies in Iceland.

Retail Banking provides general banking services to retail customers and medium-sized companies.

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

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

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

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

31. Summary of the Bank's business segments:

22.10. - 31.12.2008	Corporate Banking	Retail Banking	Treasury and Capital Markets	Corporate Finance	Asset Managem. and Private Banking	Elimination and Cost Centres	Total
Net interest income	2,981	1,309	(319)	186	401	(360)	4,198
Net fee and commission income	75	340	109	121	505	137	1,287
Net financial income	-	33	(5,855)	(134)	(42)	(62)	(6,060)
Net foreign exchange gain	13,203	3,533	14,315	10	50	(7)	31,104
Other income	23	633	-	-	-	260	916
Operating income	16,282	5,848	8,250	183	914	(32)	31,445
Operating expense	(866)	(2,196)	(699)	(22)	(654)	(1,702)	(6,139)
Impairment	(15,116)	(3,357)	(896)	(10)	-	(344)	(19,723)
Total expense	(15,982)	(5,553)	(1,595)	(32)	(654)	(2,046)	(25,862)
Earnings before cost allocation	300	295	6,655	151	260	(2,078)	5,583
Allocated cost	(40)	(46)	(72)	(14)	(14)	186	-
Earnings before income tax	260	249	6,583	137	246	(1,892)	5,583
Net segment revenue from external customers	20,434	482	11,056	208	(1,294)	559	31,445
Net segment revenue/expense from other segments	(4,152)	5,366	(2,806)	(25)	2,208	(591)	-
Operating income	16,282	5,848	8,250	183	914	(32)	31,445
Depreciation and amortisation	-	38	-	-	-	71	109
Total assets	265,434	199,493	87,713	1,407	73,422	13,735	641,203
Total liabilities	233,582	188,983	57,686	1,238	68,373	14,395	564,257
Allocated equity	31,852	10,510	30,027	169	5,048	(660)	76,946
Total liabilities and equity	265,434	199,493	87,713	1,407	73,422	13,735	641,203

The majority of the revenues from external customers was attributable to Iceland.

New Kaupthing Bank hf. Consolidated Financial Statements for the period 22 October to 31 December 2008 25 Amounts are in ISK millions

Notes to the Consolidated Income Statement

Net interest income

32. Interest income and expense is specified as follows:

22.10. - 31.12.2008	Interest income	Interest expense	Net interest income
Cash and balances with central bank	2,346	-	2,346
Loans, receivables and deposits	12,367	13,168	(801)
Securities	344	-	344
Other	2,310	1	2,309
Interest income and expense	17,367	13,169	4,198
Interest income and expense from assets and liabilities at fair value	344	-	344
Interest income and expense from assets and liabilities not at fair value through profit or loss	17,023	13,169	3,854
Interest income and expense	17,367	13,169	4,198

Net fee and commission income

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

22.10. - 31.12.2008	At fair value through profit or loss	Not at fair value through profit or loss	Trust and other fiduciary activity	Total
Fee and commission income				
Securities trading	-	-	29	29
Derivatives	108	-	-	108
Lending and guarantees	-	86	-	86
Asset management fees	-	-	599	599
Other fee and commission income - banking activities	-	-	387	387
Other fee and commission income	-	-	449	449
Fee and commission income	108	86	1,464	1,658
Fee and commission expense				
Securities trading	-	-	37	37
Asset management fees	-	-	95	95
Other fee and commission income - banking activities	-	-	183	183
Other fee and commission expense	-	-	56	56
Fee and commission expense	-	-	371	371
Net fee and commission income	108	86	1,093	1,287

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

Net financial income

34. Net financial income is specified as follows:

	22.10. - 31.12.2008
Dividend income	3
Net (loss) gain on financial assets and liabilities designated at fair value through profit or loss	(101)
Net (loss) gain on financial assets and liabilities classified as held for trading	(5,962)
Net financial income	(6,060)

New Kaupthing Bank hf. Consolidated Financial Statements for the period 22 October to 31 December 2008 26 Amounts are in ISK millions

Dividend income

35. Dividend income is specified as follows:

	22.10. - 31.12.2008
Dividend income on trading assets	3
Dividend income	**3**

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

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

Net (loss) gain on trading portfolio	(5,962)
Net (loss) gain on assets designated at fair value through profit or loss	(101)
Net (loss) gain on financial assets and liabilities designated at fair value through profit or loss	**(6,063)**

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

Net (loss) gain on equity instruments and related derivatives	(215)
Net (loss) gain on interest rate instruments and related derivatives	(5,773)
Net (loss) gain on other derivatives	26
Net (loss) gain on trading portfolio	**(5,962)**

38. Net (loss) gain on assets/liabilities designated at fair value through profit or loss are specified as follows:

Net (loss) gain on interest rate instruments designated at fair value	(99)
Net (loss) gain on equity instruments designated at fair value	(2)
Net (loss) gain on assets/liabilities designated at fair value through profit and loss	**(101)**

39. Net gain (loss) on foreign exchange are specified as follows:

FX gain on loans and receivables	11,351
FX gain on loans and receivables from ISK income customers	16,906
FX gain on bank accounts	2,510
FX loss from deposits	(2,681)
FX gain on bonds and equity	877
FX gain on other assets and liabilities	2,141
Net gain (loss) on foreign exchange	**31,104**

Other operating income

40. Other operating income is specified as follows:

Gain on disposals of assets other than held for sale	10
Earned premiums, net of reinsurance	122
Rental income from investment properties	156
Other income	130
Other operating income	**418**

41. Earned premiums, net of reinsurance:

Premium written	164
Change in the gross provision for unearned premiums	(42)
Earned premiums, net of reinsurance	**122**

New Kaupthing Bank hf. Consolidated Financial Statements for the period 22 October to 31 December 2008 27 Amounts are in ISK millions

Personnel

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

	31.12.2008
Average number of full time equivalent positions during the period	1,036
Full time equivalent positions at the end of the period	1,012

43. Salaries and related expense are specified as follows:

	22.10. - 31.12.2008
Salaries	1,035
Salary related expense	193
Salaries and related expense	1,228

44. Compensation to the key management personnel:

Salaries and related cost:

	Position	Period	
Finnur Sveinbjörnsson	CEO	22.10. - 31.12.2008	4.1
Auður Finnbogadóttir	Director	10.11. - 31.12.2008	0.2
Drífa Sigfúsdóttir	Director	10.11. - 31.12.2008	0.2
Erna Bjarnadóttir	Director	10.11. - 31.12.2008	0.2
Helga Jónsdóttir	Director	10.11. - 31.12.2008	0.3
Magnús Gunnarsson, Chairman	Director	10.11. - 31.12.2008	0.5
Einar Gunnarsson	Director	22.10. - 10.11.2008	0.1
Helga Óskarsdóttir	Director	22.10. - 10.11.2008	0.1
Jónína B. Bjarnadóttir	Director	22.10. - 10.11.2008	0.1
Ólafur Hjálmarsson, Chairman	Director	22.10. - 10.11.2008	0.2
Sigurður Þórðarson	Director	22.10. - 10.11.2008	0.1
Bjarki H. Diego	Head of Corporate Banking	22.10. - 29.12.2008	3.0
Kristján Arason	Head of Retail Banking	22.10. - 31.12.2008	3.0

The remuneration of the Chairman of the Board and the other directors of the Board was decided by a Shareholder´s meeting on 4 December 2008. Remuneration to the Chairman of the Board, CEO and other key management personnel consist of salary and other benefits.

Auditor's fee

45. Auditor's fee is specified as follows:

22.10. - 31.12.2008	National Audit	Ernst & Young	KPMG	Total
Audit of the Financial Statements and other related audit service	15	104	8	127
Other service	-	-	2	2
Auditor's fee	15	104	10	129

Impairment

46. Impairment is specified as follows:

	22.10. - 31.12.2008
Impairment on loans and receivables to credit institutions	44
Impairment for unrealisable FX gains from FX-denominated loans to borrowers with ISK income	16,906
Impairment on loans and receivables to customers	1,999
Impairment on receivables and other assets	774
Impairment	19,723

Further information about the unrealisable FX gains from FX-denominated loans to borrowers with ISK income are in note 102 a).

New Kaupthing Bank hf. Consolidated Financial Statements for the period 22 October to 31 December 2008 28 Amounts are in ISK millions

Other operating expense

47. Other operating expenses:

	22.10. - 31.12.2008
Direct operating expenses (including repairs and maintenance) arising on rental-earning investment properties	11
Claims incurred, net of reinsurance	46
Other operating expenses	384
Other operating expenses	**441**

48. Claims incurred, net of reinsurance:

Claims paid	66
Change in the provision for claims	(27)
Claims paid, net of reinsurers share	(21)
Change in the provision for claims, reinsurers' share	29
Claims incurred, net of reinsurance	**46**

Income tax expense

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

Current tax expense	
Current period	516
Deferred tax expense	
Changes in temporary differences	250
Total income tax expense	766

Reconciliation of effective tax rate:

Earnings before income tax		5,583
Income tax using the Icelandic corporation tax rate	15.0%	837
Non-deductible expenses	0.2%	12
Tax exempt revenues	(1.3%)	(75)
Other changes	(0.1%)	(8)
Effective tax rate	13.7%	766

Earnings per share

50. Earnings per share are specified as follows:

Net earnings attributable to the shareholders of Kaupthing Bank hf.	4,817
Weighted average share capital:	
Weighted average number of outstanding shares for the period, million	12,646
Basic earnings per share	0.38
Diluted earnings per share	0.38
Number of outstanding shares at the end of the period, million	12,646
Number of total shares at the end of the period, million, diluted	12,646

New Kaupthing Bank hf. Consolidated Financial Statements for the period 22 October to 31 December 2008 29 Amounts are in ISK millions

Notes to the Consolidated Balance Sheet

Cash and balances with central bank

51. Cash and balances with central bank are specified as follows:

	31.12.2008	22.10.2008*
Cash on hand	2,102	1,754
Cash with central bank	85,453	7,025
Cash and balances with central bank	87,555	8,779

Loans and receivables to credit institutions

52. Loans and receivables to credit institutions specified by types of loans:

	31.12.2008	22.10.2008*
Bank accounts	12,823	4,802
Money market loans	27,832	25,256
Overdrafts	1,942	1,202
Other loans	5,100	4,005
Loans and receivables to credit institutions	47,697	35,265

53. Changes in the provision for losses on loans and receivables to credit institutions are specified as follows:

	Total
Provision for losses during the period	44
Balance at 31 December	44
Specific	44
	44

Loans and receivables to customers

54. Loans and receivables to customers specified by types of loans:

	31.12.2008	22.10.2008*
Overdrafts	17,687	15,555
Subordinated loans	8,055	6,894
Other loans and receivables	330,177	302,278
Provision on loans and receivables	(18,905)	-
Loans and receivables to customers	337,014	324,727

55. Loans and receivables to customers specified by sectors:

	31.12.2008	22.10.2008*
Individuals	11.0%	11.9%
Holding companies	19.7%	19.8%
Industry	32.9%	30.5%
Real estate	13.6%	14.5%
Service	17.6%	18.0%
Trade	5.0%	5.0%
Transportation	0.3%	0.3%
Loans and receivables to customers	100.0%	100.0%

Amounts are in ISK millions

56. Changes in the provision for losses on loans and receivables to customers are specified as follows:

	Total
Provision for losses during the period	2,002
Provision for unrealisable FX gains from FX-denominated loans to borrowers with ISK income	16,906
Payment of loans previously written off	(3)
Balance at 31 December	18,905
Specific	18,905
	18,905

Further information about the unrealisable FX gains from FX-denominated loans to borrowers with ISK income are in note 102 a).

57. Impaired loans and receivables to customers by sector:

31.12.2008	Impaired amount	Impaired loans
Individuals	1,087	7,461
Holding companies	4,439	19,065
Industry	3,997	35,962
Real estate	3,981	43,549
Service	4,516	49,822
Trade	882	6,987
Transportation	3	23
Impairment on loans and receivables	18,905	162,869

58. Status of monitoring of loans and receivables to customers:

The Bank acquired its assets at fair value on 22 October 2008. The fair value of the assets assumed full impairment. Only limited additional provisions have been taken for specific impairment from 22 October to 31 December 2008.

31.12.2008

	Individuals	Companies	Total	%Total
Performing loans	28,915	230,136	259,051	77%
Stressed loans	1,972	28,008	29,979	9%
Non-performing loans	6,185	41,798	47,984	14%
Total	37,072	299,942	337,014	100%

Specific provisions of the fair value loan book are ISK 18,905 million.

For definition for performing loans, stressed loans and non-performing loans see note 101 b).

59. Loans and receivables to customers that are past due but not impaired:

The majority of the loans have been acquired at discount and are in process of being restructured or in a recovery process. Information on past due but not impaired loans to customers are not cosidered to be informative under these circumstances.

There has been no material changes in the fair value of the loans and receivables to customers during the period.

New Kaupthing Bank hf. Consolidated Financial Statements for the period 22 October to 31 December 2008 31 Amounts are in ISK millions

Additional information on loans and receivables

60. Additional information about loans and receivables to credit institutions and to customers:

	Nominal value	Deep discount	Subsequent impairment	Fair value
Balance at 22 October 2008	1,114,326	(754,334)	-	359,992
FX gain/loss, accrued interest and repayments	108,686	(72,408)	-	36,278
New loans	7,390	-	-	7,390
Releases	(117)	117	-	-
Impairment	-	-	(18,949)	(18,949)
Balance at 31 December 2008	1,230,285	(826,625)	(18,949)	384,711
Loans and receivables to credit institutions	77,995	(30,254)	(44)	47,697
Loans and receivables to customers	1,152,290	(796,371)	(18,905)	337,014
Balance at 31 December 2008	1,230,285	(826,625)	(18,949)	384,711

Renegotiated loans

61. Soon after New Kaupthing Bank hf. acquired its loan book on 22 October 2008 the Icelandic state mandated that borrowers be granted payment holidays for principal and/or interest, a practice which could be regarded as term renegotiations. Many borrowers took advantage of this opportunity, which was not predicated on the borrower demonstrating an inability to service the loan. Information about this influential factor on market price of the loans was available during the valuation process and was accounted for in the 22 October fair value, as possible. Loan renegotiations are not a factor in a change in fair value between 22 October and 31 December 2008.

Another potential source of loan renegotiations bears mentioning, the restructuring of impaired loans. Although this will be a significant factor in loan value development during 2009, no restructuring activity had occurred before 31 December.

New Kaupthing Bank hf. Consolidated Financial Statements for the period 22 October to 31 December 2008 32 Amounts are in ISK millions

Financial assets and liabilities

62. Financial assets and liabilities are specified as follows:

31.12.2008	Loans and receivables	Trading	Designated at fair value	Financial assets/ liabilities at amort. cost	Total
Loans and receivables					
Cash and balances with central bank	87,555	-	-	-	87,555
Loans to credit institutions	47,697	-	-	-	47,697
Loans to customers	337,014	-	-	-	337,014
Loans and receivables	472,266	-	-	-	472,266
Bonds and debt instruments					
Listed	-	8,627	470	-	9,097
Unlisted	-	1,510	154	-	1,664
Bonds and debt instruments	-	10,137	624	-	10,761
Shares and instruments with variable income					
Listed	-	808	328	-	1,136
Unlisted	-	2,333	508	-	2,841
Bond funds with variable income	-	783	1,849	-	2,632
Shares and equity instruments	-	3,924	2,685	-	6,609
Compensation instrument	-	-	-	41,156	41,156
Other financial assets	-	-	-	9,460	9,460
Financial assets	472,266	14,061	3,309	50,616	540,252
Liabilities at amortised cost					
Due to credit institutions and central bank	-	-	-	122,733	122,733
Deposits	-	-	-	421,341	421,341
Liabilities at amortised cost	-	-	-	544,074	544,074
Financial liabilities at fair value					
Derivatives held for trading	-	2	-	-	2
Financial liabilities at fair value	-	2	-	-	2
Other financial liabilities	-	-	-	698	698
Financial liabilities	-	2	-	544,772	544,774

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

	31.12.2008
Financial institutions	10
Governments	440
Corporates	158
Other	16
Bonds and debt instruments designated at fair value	624

Compensation instrument

64. The compensation instrument is originated due to the difference in the fair value of the transferred assets, liabilities and contingent liabilities from Kaupthing Bank hf. To New Kaupthing Bank hf. In accordance with the FME Decision. The compensation instrument amounted to ISK 38,300 million and was denominated 50% in ISK and 50% in EUR and is subject to floating rates of interest. The maturity of this instrument is 30 June 2012 and is a priority claim against Kaupthing Bank hf.

Amounts are in ISK millions

Investment property

65. Investment property are specified as follows:

	31.12.2008
Acquisition through business combination	11,598
Transferred from property and equipment	481
Investment property	**12,079**

The Bank's investment properties were revalued at period-end by independent professionally qualified valuers which have recent experience in the location and category of the investment property being valued. Valuations were based on current prices in an active market for all properties.

Investments in associates

66. Investment in associates are specified as follows:

	31.12.2008
Carrying amount at 22 October 2008	2,345
Share of profit (loss)	498
Carrying amount at the end of the period	**2,843**

Main associates are specified as follows:

	Currency	Total assets	Total liabilities	Owner-ship	Share of profit or loss	Nominal value	Book value
Auðkenni hf. Engjateig 3, 105 Rvk, Iceland	ISK	449	56	25.0%	(3)	408	98
Ekort ehf. Vegmúla 2, 108 Rvk, Iceland	ISK	14	7	49.0%	-	3	3
KB ráðgjöf ehf. Hlíðarsmára 17, 201 Kóp, Iceland	ISK	179	161	43.1%	(4)	-	8
Reiknistofa Bankanna Kalkofnsv. 1, 150 Rvk, Iceland	ISK	2	-	17.3%	10	-	265
Valitor hf. Laugarvegi 77, 101 Rvk, Iceland	ISK	34	30	39.5%	495	400	2,460
Other associates					(0)		9
					498		2,843

Property and equipment

67. Property and equipment are specified as follows:

	Real estate	Machinery and equipm.	Total 31.12.2008
Acquisitions through business combination	6,158	2,188	8,346
Additions during the period	-	16	16
Disposals during the period	(37)	(92)	(129)
Transfers to investment properties	(481)	-	(481)
Gross carrying amount at the end of the period	5,640	2,112	7,752
Depreciation during the period	29	68	97
Disposals during the period	(1)	-	(1)
Total depreciation at the end of the period	28	68	96
Property and equipment	**5,612**	**2,044**	**7,656**

The FMR value of the real estates amounts to ISK 6,941 million at period end. The insurance value of fixed assets amounts to ISK 9,997 million at period end.

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

	22.10. - 31.12.2008
Depreciation of property and equipment	97
Amortisation of intangible assets	12
Depreciation and amortisation	**109**

Amounts are in ISK millions

Intangible assets

69. The intangible assets are related to different business segments in the Bank's operation. They comprise insurance contract agreements, Assets under Management and custody contracts. The value of intangible assets with indefinite useful lives is not amortised, but the assets are tested for impairment at least once a year.

Intangible assets are specified as follows:	Indefinite life intangible assets	Software	Total
Acquisition through business combination	2,075	366	2,441
Additions during the period	-	3	3
Amortisation	-	(12)	(12)
Intangible assets	2,075	357	2,432

Other assets

70. Other assets are specified as follows:	31.12.2008	22.10.2008*
Unsettled securities trading	117	900
Accounts receivables	9,460	117
Accrued income	2,867	443
Prepaid expense	289	148
Non-current assets and disposal groups classified as held for sale:		
Real estate	709	533
Other assets	263	36
Sundry assets	(80)	913
Other assets	13,625	3,090

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

71. Provision for other assets

During the period impairment on accounts receivables and accrued income was made, amounting to ISK 774 million.

Tax assets and tax liabilities

72. Tax assets and liabilities are specified as follows:

22.10. - 31.12.2008

	Assets	Liabilities
Current tax	-	585
Deferred tax	551	446
Tax assets and liabilities	551	1,031

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

22.10. - 31.12.2008

	Assets	Liabilities	Net
Acquisition through business combination	578	(227)	351
Income tax recognised in profit or loss	(42)	(208)	(250)
Other changes	15	(11)	4
Net tax assets and (liabilities)	551	(446)	105

Amounts are in ISK millions

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

22.10. - 31.12.2008	At 22.10.08	Exchange rate and other adjustment	Recognised in profit or loss	At 31.12.08
Foreign currency denominated assets and liabilities	-	-	(136)	(136)
Investment property and property and equipment	115	(6)	(91)	18
Other assets and liabilities	(23)	10	10	(3)
Tax loss carry forward	259	-	(33)	226
Change in deferred tax	351	4	(250)	105

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

	31.12.2008		22.10.2008*	
	Assets	Liabilities	Assets	Liabilities
Foreign currency denominated assets and liabilities	-	(136)	-	-
Investment property and property and equipment	283	(296)	354	(204)
Other assets and liabilities	-	(14)	-	(23)
Tax loss carry forward	268	-	224	-
Deferred tax assets and liabilities at the end of the period	551	(446)	578	(227)

Derivatives

76. Derivatives remaining maturity date of nominal and book value are specified as follows:

31.12.2008	Nominal				Book value	
	Up to 3 months	Over 3 months and up to a year	Over 1 year	Total	Assets	Liabilities
Currency and interest rate derivatives, agreements unlisted:						
Forward exchange rate agreements	254	-	-	254	-	2
Derivatives	254	-	-	254	-	2

Other liabilities

77. Other liabilities are specified as follows:

	31.12.2008	22.10.2008*
Unsettled securities trading	2,401	6,026
Accounts payable	698	29
Withholding tax	2,641	-
Deposit and investor guarantee fund	2,969	-
Insurance claim	1,713	1,762
Sundry liabilities	8,728	2,170
Other liabilities	19,150	9,987

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

Amounts are in ISK millions

Equity

Share capital

78. According to the Parent Company's Articles of Association, total share capital amounts to ISK 12,646 million. The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at Shareholders' meetings of the Bank.

79. Movement in share capital during the period segregates as follows:

18.10. - 31.12.2008	Share capital	Share premium	Total
Addition	12,646	59,354	72,000
Balance 31 December 2008	12,646	59,354	72,000

The Icelandic state committed to fund New Kaupthing Bank hf. in 2008. The finalization of the equity contribution of ISK 72,000 million was agreed in the Government Capitalisation Agreement as outlined in note 111.

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

Foreign currency translation reserve

80. The foreign currency translation reserve comprises all foreign exchange differences arising from the translation of the financial statements of foreign operations, amounting to ISK 129 million.

Off Balance Sheet information

Obligations

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

	31.12.2008	22.10.2008*
Guarantees	18,644	22,128
Unused overdrafts	40,273	37,147
Loan commitments	4,210	-

The Bank estimates possible loss of ISK 2,920 million in relation to guarantees transferred from Kaupthing Bank hf. Should any of the guarantees default, Kaupthing Bank hf. will pay compensation up to ISK 3,000 million to New Kaupthing Bank hf., agreement theron was signed in September 2009.

82. Depositors' and investors' guarantee fund

According to Act No. 98/1999 on Deposit Guarantees and Investor - Compensation Scheme the total assets of the Depositors’ and Investors’ Guarantee Fund shall amount to a minimum of 1% of the average amount of guaranteed deposits in the commercial bank concerned during the preceding year. In the event that total assets do not amount to the 1% minimum, all commercial banks shall contribute to the Fund an amount equivalent to 0.15% of the average of guaranteed deposits in the Bank during the preceding year. The Bank expensed 1% of the Bank's guaranteed deposits balance based on estimated future payments to the Fund, amounting to a net present value of ISK 2,969 million at period end 2008. The Bank has granted the Fund a guarantee for the total obligation amounting to ISK 4,077 million.

Amounts are in ISK millions

Operating lease commitments

83. Bank as a lessee

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

Future minimum lease payments	673

84. Bank as a lessor

The Bank has entered lease agreements on its investment properties. The lease agreements are for a period of up to 28 years, with majority being non-cancellable agreements. The future minimum lease payments under non-cancellable leases are as follows:

	31.12.2008
Less than one year	1,119
Over 1 year and up to 5 years	3,668
Over 5 years	1,733
Minimum lease payments under non-cancellable leases	6,520

Assets under management and under custody

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

	31.12.2008
Assets under management	604,566
Assets under custody	2,144,585

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

Contingent liabilities

86. Litigation is a common occurence in the banking industry due to the nature of the business undertaken. Due to the current economic and political climate in Iceland the prospects of possible litigation against the Bank has become more likely. The Bank has formal controls and policies for managing legal claims. Once professional advice has been obtained and the amount of loss reasonably estimated, the Bank makes adjustments to account for any adverse effects which the claims may have on its financial standing. At period end, the Bank had several unresolved legal claims.

There are two significant legal claims against the Bank. One is in respect of a few clients who have alleged that mistakes by employees of the Bank have resulted in the client suffering financial loss. A trial date has not yet been set and therefore it is not practical to state the timing of any payment. The Bank has made a provision in these financial statements for the claims amounting to ISK 80 million. The other significant legal claim is in respect of a number of clients who have alleged that assets under management were improperly managed resulting in the clients suffering financial loss. It is possible that some of these claims will be taken to court of law but due to uncertainity of amounts no provision for these claims has been made in these financial statements.

Amounts are in ISK millions

Notes to the Cash Flow Statement

87. Operational cash flows from interest and dividends:

	22.10. - 31.12.2008
Interest paid	13,169
Interest received	6,077
Dividend received	3

Interest paid includes interest credited to deposit accounts at 31 December 2008. In addition to the amount disclosed above, during the period the Bank has paid, or credited to deposit accounts, interest of approximately ISK 17,600 million that was accrued interest payable at 22 October 2008 on deposit accounts acquired from Kaupthing Bank hf.

88. Non-cash items included in net earnings before income tax and other adjustments:

	22.10. - 31.12.2008
Impairment on loans and other credit risk provisions	19,723
Depreciation and amortisation	109
Share of profit (loss) of associates	(498)
Indexation and exchange rate difference	(31,104)
Net loss on financial assets and liabilities at fair value through profit or loss	6,063
Net gain on disposal on property and equipment	(1)
	(5,708)

The cash flow from financing activities in the Consolidated Statement of Cash Flows excludes an equity contribution of ISK 71,225 million that was unpaid at 31 December 2008 and forms part of a total equity contribution from the Icelandic state of ISK 72,000 million, as outlined in note 79. The unpaid equity was subsequently contributed to the Bank as a government bond in 2009.

89. Changes in operating assets and liabilities:

	22.10. - 31.12.2008
Loans and receivables to credit institutions	(4,455)
Loans and receivables to customers	(2,935)
Bonds and debt instruments	(6,309)
Compensation instrument	(715)
Other assets	(11,437)
Due to credit institutions and central bank	70,554
Deposits	28,904
Financial liabilities at fair value	749
Other liabilities	9,163
	83,519

90. Cash and cash equivalents at period-end:

Cash in hand and demand deposits	87,555
Due from credit institutions	12,823
Cash and cash equivalents at period-end	100,378

Amounts are in ISK millions

Risk Management Disclosures

Introduction

New Kaupthing Bank hf. is an Icelandic bank offering comprehensive retail, corporate and investment banking services to individuals, companies and institutional investors. The Bank has five core business areas: Retail Banking, Corporate Banking, Corporate Finance, Asset Management, and Capital Markets and Treasury. These business areas are supported by six ancillary divisions: Finance, Back Office, Legal Services, Information Technology and Human Resources.

91. Risk Management's role and position in the Bank

The Bank's Risk Management department is independent and centralized and reports directly to the CEO. The CEO and the Board of Directors are responsible for defining and articulating a Risk Appetite for the Bank's operations. The Risk Appetite is translated into exposure limits and targets that are monitored by the Risk Management department, which reports its findings regularly to the CEO and the Board of Directors. Risk is measured and monitored according to internal policies, principles and processes that are reviewed and approved by the Board of Directors at least annually. New Kaupthing Bank hf.'s. CEO and all members of the New Kaupthing Bank hf. Board of Directors are subject to a fit and proper examination by the FME.

92. Organization of the Risk Management division

The Risk Management Department is divided into four units: Credit Control, which monitors credit exposures on a customer by customer basis; Portfolio Risk, which monitors risks in the Bank's Assets and Liabilities at the portfolio level; Economic Capital, which is responsible for the Bank's Internal Capital Adequacy Assessment Process (ICAAP) and Operational Risk which monitors risks associated with the daily operation of the Bank.

93. High level discussion of the consequences of the crash

The Bank faces numerous challenging risks related to the circumstances leading to the Bank's creation on 22 October 2008, following the failure of the North European bank, Kaupthing. The Bank acquired assets, liabilities and contingent liabilities in accordance with the decision of the FME which resulted in significant mismatching of FX, interest rate and liquidity in the Balance Sheet. An asset shortfall of ISK 38.300 million resulted in a priority claim on Kaupthing Bank.

94. Overview of the most material risks

The Balance Sheet of New Kaupthing Bank hf. presents significant asset-liability management challenges. A considerable portion of the transferred assets are denominated in low interest rate foreign currencies. The assets are predominantly funded with on-demand deposits denominated in Icelandic krona, a high interest rate currency. Liquidity risk, as well as risks related to imbalances in currency, duration and the interest rate base are discussed below.

The asset portfolio transferred from Kaupthing Bank hf. presents additional challenges. Assets were transferred at fair value, where the distressed nature of the Icelandic economy and the funding cost were taken into account. A conservative approach was taken to the asset valuation, which has reduced the Bank's downside risk. Nevertheless, much risk is related to the accuracy of the asset valuation and assumptions about the performance of the assets. These risks and credit concentration risks are discussed below.

The Bank faces very significant country risk as its exposures are concentrated to Iceland, a country which at period end 2008 experienced a nearly total economic collapse and subsequent political turmoil.

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

As part of its preparation for granting the Bank an operating license, the FME has conducted a rigorous assessment of the Bank's risk management and governance infrastructure. The assessment identified areas for improvement and the Bank is working closely with the FME to address these.

Risk Management Strategy

95. Definition of Material Risks

a) Credit risk

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

b) Market risk

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

c) Liquidity risk

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

d) Operational risk

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

96. Credit Risk Strategy

The Bank has a two-pronged strategy for credit risk. In the near term, emphasis will be placed on recovering value from the portfolio of impaired assets which was acquired from Kaupthing Bank hf. To this end, the Bank has expanded its recovery department and defined a complete set of procedures which outline how value will be maximized without compromising transparency. The FME carefully monitors the recovery process.

Longer term, the Bank recognizes that carefully monitored credit risk is a base for stable profits. Undertaking credit risk is a cornerstone in the Bank's strategy for maintaining the future profitability of the Bank. The main asset of the Bank is its loan portfolio, and therefore managing and analyzing the loan portfolio is of utmost importance. The emphasis is on keeping a high quality credit portfolio, by seeking business with strong parties, maintaining a strict credit process, critically inspecting loan applications, identifying and reacting to possible problem loans at an early stage and other measures.

a) Credit Granting Process

A fundamental requirement is to have a comprehensive structure for credits which is coherent across the Bank. This structure applies both for the granting of new credits and for the restructuring of impaired credits. The highest authority in credits is the Board Credit Committee. The next-highest credit granting authority is the Bank Credit Committee which operates within limits specified as a fraction of the Bank's capital. Corporate Banking and Retail Banking operate their individual credit committees with tighter credit granting limits. The principle of central management of risk is maintained by having the Bank's CEO or his deputy as a member of the Board Credit Committee and the Bank Credit Committee, and by the having the Managing Director of Risk Management attend the meetings of the Bank Credit Committee. The CEO is responsible for maintaining the Bank's exposures within legal and policy limits.

The pricing of each new credit granted and the credits arising from the impaired-loan restructuring process should reflect the risk taken. The client's interests must be protected at all times and there must be a high likelihood that the client will be able to repay a given loan. In particular, the quality of collateral can never be the sole reason for a positive credit decision.

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

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

The Bank seeks to limit its total credit risk through diversification of the loan portfolio across sectors and by limiting large exposures.

96. cont.

b) Quantification and Rating model description

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

The policy of the Bank is to apply sophisticated credit models to monitor credit risk. These credit models do not come into play in the application of the Basel II standardized approach to capital requirements calculations but they are the basis for a future application of an internal rating based approach. Therefore, the development, implementation and application of these models must be in accordance with Basel II requirements. The credit models are an integral component in the Bank's Internal Capital Adequacy Assessment Process (ICAAP) strategy.

c) Sources of Credit Risk

Loan portfolio

The main assets of the Bank are its loans. To maintain and further improve the quality of the loan portfolio it is imperative to constantly monitor loans, both individually and at the portfolio level. However, it is not the policy of the Bank to solely issue credit of very low risk but it is important that the price of issued credit reflects both risk and costs incurred. This means that a detailed assessment of individual customers, their financial position and the collateral is a prerequisite for granted credits.

Commitments and guarantees

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

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

Derivatives trading

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

Master netting agreements

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

d) Loan provisioning

The Bank's loan book consists of loans which were acquired from Kaupthing Bank hf. at fair value. However, the maximization of the value of the loan book requires that the Bank continue to service it on a face value basis.

In a face value treatment of the loan book an allowance for credit losses is established if there is objective evidence that the Bank will be unable to collect all amounts due on a claim, i.e. a loan, commitment, guarantee etc., according to the original contractual terms or the equivalent value. An allowance for credit losses is reported as a reduction of the carrying value of a claim on the Balance Sheet, whereas for an off-balance sheet item such as a commitment a provision for credit loss is reported in other liabilities. Additions to the allowances and provisions for credit losses are made through impairment on loans.

When considering loans at face value, allowances and provisions for credit losses are evaluated at a counterparty-specific level and a collective basis, based on the principles described below.

Meanwhile, the fair value pricing of the loan takes into account impairment for credit loss and counterparty-specific provision is not considered unless the impairment of the loan is believed to exceed the difference between the face value and the fair value.

96. cont.

Counterparty-specific provisions

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

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

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

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

An allowance for impairment is reversed only when the credit quality has improved such that there is reasonable assurance of timely collection of principal and interest in accordance with the original contractual terms of the claim agreement. No impairment has been reversed in 2008 and no reversal of deep discount has occured.

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

Collective Provisions

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

Special provisioning for currency exchange-rate impairment

The loan book transferred from Kaupthing Bank hf. contains a category of loans which requires special consideration. These are loans in foreign currency to Icelandic companies and individuals whose income is in ISK. When the ISK depreciates against the foreign currency, the ISK value of the loan increases, whereas the borrower's ability to pay remains fixed. When such a loan has been transferred at a fair value below face value, provisions must be made for the unrecoverable increase due to ISK depreciation.

97. Market Risk Strategy

The Bank's strategy is to invest its own capital on a limited and carefully selected basis in transactions, underwritings and other activities that involve market risk.

The main types of market risk are interest rate risk, equity price risk and foreign exchange risk.

The Bank is exposed to market risk from its proprietary trading activities and its asset and liability management.

In the case of proprietary trading the Bank accepts the market risk. The Board of Directors decides how much market risk exposure the proprietary trading units within the Bank are allowed to assume, expressed as a maximum overnight exposure in equities, fixed income and derivatives. The Board entrusts the CEO with the enforcement of this policy and the Risk Management with the evaluation and monitoring of positions and limits.

In the case of asset and liability management the Bank aims to reduce or eliminate this risk going forward.

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

97. cont.

a) Currency risk

Currency risk is the risk of loss due to adverse movements in foreign exchange rates. The Bank is primarily exposed to currency risk through a currency mismatch between assets and liabilities.

The Bank's strategy for reducing its currency imbalance is twofold: The systematic ISK-redenomination of defaulting foreign currency loans to customers which have ISK income, and hedging of currency imbalances through agreements with the Icelandic Central Bank and through currency swaps with Icelandic customers.

Net exposures per currency are monitored centrally in the Bank.

b) Interest rate risk

The Bank faces interest rate risk in the banking and trading books. The interest rate risk faced in trading book is primarily due to listed Icelandic Treasury notes, Housing Fund bonds and OTC interest rate swaps. The interest rate risk in the banking book is mainly related to floating rate indices and, to a very limited extent, fixed interest rate.

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

The Bank's strategy for managing its interest rate risk and its inflation risk is to strive for an interest rate balance between assets and liabilities and a balance between inflation-linked assets and liabilities by offering deposit incentives and by targeted lending practices.

c) Derivatives

The Bank's use of derivatives is through derivative sales and trading portfolios. The types of derivative currently used by the Bank are asset swaps, forwards and interest rate and cross currency swaps.

d) Market price risk

Market price risk is the risk of loss due to changes in market prices. The Bank's main exposures are through listed Icelandic Treasury notes and Housing Fund bonds and to a very limited extend listed equities. Management of currency risk is handled separately.

Market price risk is measured by notional amount for equities and basis-point value approach for fixed income products.

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

Methods for establishing fair value

i. Fair value established from quoted market prices

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

In some cases, the carrying value of the financial instrument in note 62 is used as an approximation for the fair value of the instrument. This is straight-forward for cash and cash equivalents but is also used for short-term investments and borrowings to highly rated counterparties, such as credit institutions, on contracts that carry interests close to or equal to market rates and expose the Bank to little or no credit risk.

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

97. cont.

ii. Fair value established using valuation techniques with observable market information

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

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

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

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

iii. Fair value established using valuation techniques with significant unobservable market information

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

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

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

98. Liquidity Risk Strategy

Liquidity risk is an unavoidable source of risk in the Bank’s operations. Liquidity risk is the current or prospective risk that the Bank either does not have sufficient financial resources available to meet its liabilities when they fall due, or can secure them only at excessive cost. Liquidity risk arises from the inability to manage unplanned decreases or changes in funding sources. The funding liquidity risk limit is quantified by secured liquidity ratio as well as applying stress test to identify scenarios of possible liquidity strain.

The Bank calculates its secured-liquidity ratio from cash on hand and cash balance with the Central Bank of Iceland, Treasury notes and Housing Fund bonds which are held specifically as liquidity reserves and other eligible assets for repo transactions with the Central Bank and compare it with the total interest bearing liabilities.

FME has set a guideline for minimum secured liquidity ratio of 20%. The high liquidity reserve required by the FME reflects the uncertainty of the deposit’s stickiness of the Icelandic banks and the fact that a large part of the Bank’s liabilities are primarily short-term or on demand deposits while the contractual maturity of the assets is much higher. A pressing task for the Bank will be to monitor its liquidity reserves and understand and model the behavior of the deposit base.

The Bank’s stress tests are primarily focused on the effect of lifting the capital controls in Iceland on the deposit base.

The Bank‘s strategy is to lengthen the maturity profile on the liability side, making it comparable to other Nordic banks and strengthening the Bank’s liquidity reserve.

99. Operational Risk Strategy

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

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

The Bank aims to maintain an open, no blame, operational risk culture and to seek to get to the point of no surprises by utilizing the Bank’s operational tools and processes to the fullest extent possible. The Bank operates no tolerance policy for internal fraud.

a) ICAAP considerations

The Bank has elected to use the Basel II basic indicator approach to the calculation of Risk Capital requirements for Operational Risk.

Risk Capital for Operational Risk is measured 15% of the average over three years of the sum of net interest income and net non interest income, outlined in the Capital Requirements Directive (CRD). As New Kaupthing Bank hf. does not have three years of operation, the 15% is of the sum of net interest income and net non interest income.

100. Capital Adequacy and ICAAP Strategy

The Bank's capital policy is to maintain a strong capital base to support business development and to meet regulatory capital requirements, even in times of stress. Long term capital planning at New Kaupthing Bank hf. currently is based on a benchmark minimum Core Tier 1 capital ratio of 12%, using Pillar 2 calculations. Additional capital can be injected by the Ministry of Finance as Tier 2 capital in the form of a subordinated loan, at the discretion of the FME. The capital reserve is equivalent to a 4% capital ratio.

All Tier 1 capital and the reserve Tier 2 capital is in the form of Treasury notes. The book value of intangible assets is deducted in arriving at the Tier 1 capital ratio.

It is the policy of the Bank to refrain from paying dividends, divesting shares and conducting share buy-backs for 3 years after its initial capitalisation. This policy will only be altered in cooperation with the FME and only if the Bank and the FME jointly determine that a sustainable turnaround of the Icelandic Economy has been achieved.

a) Capital adequacy and the Basel I and II capital adequacy standards

The FME supervises the Bank, receives information on the capital adequacy of, and sets capital requirements for, the Bank as a whole.

Bank supervision is currently transitioning from the Basel I capital adequacy standard to the Basel II capital requirements directive (CRD). As such the Bank calculates the capital adequacy both in terms of Basel I and Basel II but with focus on Basel II and compliance to the CRD. The Basel II CRD consists of three Pillars:

- Pillar 1, that contains the set of rules for calculation of the capital requirement based on risk weights for credit risk, market risk and operational risk.
- Pillar 2, that describes the supervisory review and evaluation process (SREP). Pillar 2 also contains a framework for internal capital adequacy assessment process (ICAAP). The ICAAP is an ongoing process that aims at describing the Bank’s risk appetite, current risk profile and how the Bank intends to mitigate those risks, as well as how much current and future capital is needed having considered the risk profile and risk mitigates in place.
- Pillar 3, that describes market discipline and disclosure requirements for risk profile, methods and processes and capital management.

Capital Requirements according to Pillar 1 are based on the sum of risk weighted assets for credit risk, market risk and operational risk, computed using formulas from the EU’s Capital Requirements Directive (CRD). The CRD offers different approaches for calculating RWA for these risk types:

Credit Risk

Standard approach, Foundation IRB approach, and Advanced IRB approach.

Market Risk

Standardised approach and Internal value at risk model.

Operational Risk

Basic indicator approach, Standardised approach, and AM approach.

100. cont.

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

b) Approaches used for capital requirement calculations:

New Kaupthing Bank hf. will use the Basel II standardized method to calculate the capital requirements for credit risk under Pillar 1.

The Bank uses credit rating models for its corporate and retail portfolio but will be focusing on recalibrating those models for the post-crisis business environment and deploying them in its internal risk capital management and ICAAP. When the consistent fidelity of the credit rating models can be demonstrated they will be submitted to the FME as part of an application to use the Foundation Internal Ratings Based (FIRB) approach to calculating the capital requirements for credit risk.

The Bank will use the standardized method for market risk.

The Bank will use the basic indicator approach for operational risk.

The Bank has implemented methods and tools for operational risk management based on the minimal requirements for the standardised approach. The Bank will continue refining these tools and methods as part of its internal management of operational risk and will be using them within its ICAAP.

c) Internal Capital Assessment Process:

The internal capital adequacy assessment process (ICAAP) is an ongoing process that ensures that the Bank has in place sufficient risk management processes and systems to identify, manage and measure the Bank's total risk exposure. The ICAAP is aimed to identify and measure the Bank's risk across all risk types and ensure that the Bank has sufficient capital in accordance to its risk profile.

To measure the Pillar 2 capital requirement the Bank uses an internal capital model (economic capital model). This model is based on Pillar 1 calculations, using internal models for credit risk calculations, and takes into consideration risks that are not covered under Pillar 1, e.g. concentration risk, residual risk, country risk, settlement risk, fx risk, liquidity risk, interest rate risk in the banking book, reputation risk, legal and compliance risk, business risk, strategic risk, et al.

The Bank has implemented methods to calculate concentration risk for single name concentration and sector concentration. Methods for evaluating other Pillar 2 risks will be developed in line with further development of the Bank's economic capital model.

Stress tests are an important part of the ICAAP and show how the Bank's capital could be affected by sharp macro-economic changes, downswings in the Bank's core business or other major events. The Bank is currently running, under the ICAAP, stress testing scenarios on its business plan and planned capital needs. The Bank is currently reviewing and enhancing its stress testing framework which will be deployed in the Bank's ICAAP, once it is ready.

d) Capital allocation

The allocation of capital between specific operations and activities is, to a large extent, driven by the optimisation of the return achieved on the capital allocated. The amount of capital allocated to each operation or activity is based primarily upon expected regulatory capital usage, calculated within the business plan, but in some cases the regulatory requirements do not reflect fully the varying degree of risk associated with different activities. In such cases the internal capital requirements may be inflated to reflect different risk profiles.

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

Economic capital usage of each operation will then be continuously compared with allocated capital to ensure that the Bank's risk profile remains within its risk appetite. Performance calculations are linked to this process in terms of calculation of return on allocated capital.

Risk Disclosures

101. Credit Risk Disclosures

The valuation that occurred as the Bank's assets were transferred from Kaupthing Bank hf. attempted to account for all realized and foreseen losses, which greatly reduces traditional counterparty credit risk in the Bank's loan portfolio. Nevertheless, the Bank is exposed to credit-type risks through the loan portfolio that are related to the accuracy of the asset valuation, the performance of the loan book and the success of the restructuring of non-performing loans. There is also risk associated with the credit concentration to a few customer names and to business sectors.

a) Asset valuation

Asset valuation risk is the risk that assets transferred to the Balance Sheet of the Bank were overvalued. Different valuation methods were used depending on the nature of the underlying assets and collateral. In the table below, the loan portfolio has been categorized in accordance with the valuation methods. The last two columns indicate how much weight each valuation method has in terms of book value and fair value results. Additionally, retail assets were valued on a homogeneous pool basis. The result from the asset valuation was rigorously scrutinized by the agents of the interested parties.

Category: Description (D) / Valuation method (V):	Book Value	Fair Value
Higher discount factor: D: Loans where New Kaupthing Bank hf. a expects full recovery and the contractual cash flow is used. V: Present value of discounted contractual cash flows at market interest rates.	12%	38%
Collateral value: D: Loans where the underlying collateral value is greater than the value of future expected cash flow. V: Assessment of underlying collateral.	58%	24%
Real estate companies: D: Real estate companies. V: The Iceland Property Registry rate with a discount of approximately 8%.	8%	15%
EV/EBITDA multiples: D: Operating companies that generate positive cash flow, but are currently unable or are estimated to be unable to service their debt, and estimated value is greater than underlying collateral value. V: EV/EBITDA multiples.	15%	15%
Currently in recovery: D: Borrowers that are currently in a recovery and restructuring process. V: Individual assessment using discounted cash flows, collateral value, multiples and other methods available.	7%	8%
	100%	100%

The loans which were valued using the methods in the table were approximately 80% of the total loan portfolio, on a fair value basis. Approximately 20% of the fair value loan book was valued on a homogeneous pool basis. The latter category includes individuals and SMEs.

A discussion of the main sources of valuation risk follows:

Loans valued based on EV/EBIDTA multiples comprise approximately 12% of the total fair-value loan-book (15% of 80%). These loans are not a major cause for concern. Firstly the category's contribution to the loan book is small. Secondly, the experience of the loans in the category since 22 October 2008 has been that the valuation has been conservative.

Among the risk parameters in the Collateral Value category are loans whose value has been linked to the price of fishing quotas. New Kaupthing Bank hf. conservatively discounted the price of fishing quotas by 25% compared to market prices, in order to perform the valuation of these loans. It is estimated that approximately 7% of the fair value loan book is directly sensitive to the price of fishing quotas. Consequently, an additional 20% reduction in the price of fishing quotas would translate into a 1.5% drop in the value of the fair value loan book.

Another risk parameter of concern is the price of real estate. The fair value valuation of the real estate related loans was based on a forecast of the real estate market by the Central Bank of Iceland. real estate prices affect value in the Collateral Value and the real estate Company categories. Approximately 12% of the fair value loan book is estimated to be directly sensitive to the real estate-price parameter. Thus, a 20% additional reduction in real estate price would lead, approximately, to a 2.4% reduction in the value of the fair value loan book.

New Kaupthing Bank hf. Consolidated Financial Statements for the period 22 October to 31 December 2008 48 Amounts are in ISK millions

101. cont.

The largest contribution to the value of the loan book is the category referred to as Higher Discount Factor. This category was applied to loans to companies with an ability to service debt. The discounted fair value of these loans was based on New Kaupthing Bank hf.'s. higher cost of funding. The valuation risk is that the cost of funding penalty is even greater than was assumed during the valuation. Each 1% increase in the funding cost of New Kaupthing Bank hf., compared to the valuation assumptions would lead to a 1.3% reduction in this portion of the portfolio, for a 0.4% reduction on a loan book basis.

To put the aforementioned sensitivity study into perspective, please consider that each 1% loss in value of the loan book would correspond to approximately 0.5% percentage point reduction in New Kaupthing Bank hf.'s Tier 1 capital ratio.

b) Non-performing loans

The sharp depreciation of the ISK in the autumn of 2008 and the following inflation left many borrowers with foreign currency and Icelandic indexed linked loans unable to service their loans. Payment holidays were offered to all customers, regardless of their ability to pay, as a temporary solution. Permanent solution to those customers in real need will be offered in the coming months of 2009.

The Bank is highly focused on the performance of the loan book and uses the following classification to monitor the development of the performance.

This classification is a bit ambiguous at period-end, since it does not distinguish between the customers in need of a payment holiday and those who were able to service their debts.

Non-performing are loans that are:
- more than 90 days in default.
- the borrower is currently in restructuring.
- have received specific provisions.
- the borrower has taken advantage of payment holidays of both principal and interest payments.

Stress loans are those that are:
- between 30 and 90 days in default.
- the borrower has taken advantage of payment holidays, paying only interests.

All other loans are classified as performing.

The following table shows a breakdown of the fair value loan book based on these categories :

	% of fair value of loans
Performing	77%
Stressed	9%
Non-performing	14%
Total	100%

c) Credit Concentration Disclosures

New Kaupthing Bank hf. seeks proper diversification in the granting of all new credits. Nevertheless, the loan portfolio which was transferred to New Kaupthing Bank hf. from Kaupthing Bank hf. suffers from material credit concentrations because only Icelandic assets were transferred to New Kaupthing Bank hf. and assets were transferred at fair value resulting in a very different loan portfolio make-up.

Amounts are in ISK millions

101. cont.

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

31.12.2008	Individuals	Holding companies	Industry	Real estate	Service[1]	Other	Total
Cash and balances with central banks	-	-	-	-	87,555	-	87,555
Loans and receivables to credit institutions	-	-	-	-	47,697	-	47,697
Loans and receivables to customers	37,179	66,362	110,874	45,701	59,253	17,645	337,014
Overdrafts	*6,537*	*198*	*3,168*	*473*	*6,037*	*1,274*	*17,687*
Subordinated loans	-	*7,896*	-	-	*159*	-	*8,055*
Other loans	*30,642*	*58,268*	*107,706*	*45,228*	*53,057*	*16,371*	*311,272*
Bonds and debt instruments	-	-	471	256	9,670	364	10,761
Listed	-	-	*471*	*250*	*8,364*	*12*	*9,097*
Unlisted	-	-	-	*6*	*1,306*	*352*	*1,664*
Compensation instrument	-	-	-	-	41,156	-	41,156
Other financial assets	18	39	320	9	9,385	15	9,786
Total on-balance sheet maximum exposure to credit risk	37,197	66,401	111,665	45,966	213,560	18,024	492,813

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

	Individuals	Holding companies	Industry	Real estate	Service[1]	Other	Total
Financial guarantees	471	1,115	8,008	424	6,938	1,687	18,643
Credit default swaps, investment grade	-	-	-	-	-	-	-
Unused overdrafts	18,625	5,356	7,825	228	4,711	3,527	40,272
Loan Commitments	-	4,210	-	-	-	-	4,210
Total on-balance sheet maximum exposure to credit risk	19,096	10,681	15,833	652	11,649	5,214	63,125

1. Included is financial service.

The majority of the revenues from external customers was attributable to Iceland.

New Kaupthing Bank hf. has used methods based on the Herfindahl-Hirshman index to analyze credit concentration to individual borrowers and industry sectors and found that concentrations warrant granularity increases to capital requirements for credit risk in order to compensate. Refer to note 105 b) for results.

New Kaupthing Bank hf. Consolidated Financial Statements for the period 22 October to 31 December 2008 50 Amounts are in ISK millions

101. cont.

d) Large Exposure Disclosures

A large exposure is defined as an exposure to a group of financially related borrowers which exceeds 10% of the Bank's risk capital. The exposure is presented net of the credit risk mitigating effects of collateral which is eligible under Basel II rules.

The legal maximum for individual large exposures under the rules of the FME rule is 25% of risk capital and the sum of all large exposures cannot exceed 800% of risk capital.

The loan book which was transferred from Kaupthing to New Kaupthing Bank hf. contained loans which, while appropriately sized in Kaupthing Bank hf.'s large Balance Sheet, have a much larger impact on New Kaupthing Bank hf.'s more modest Balance Sheet. New Kaupthing Bank hf. has 10 large exposures if eligible collateral is not accounted for. If exposures are taken net of eligible collateral the number drops to 6.

no.	% of Tier 1	% of Tier 1 net
1	53%	51%
2	37%	37%
3	23%	0%
4	21%	21%
5	18%	11%
6	18%	7%
7	17%	13%
8	16%	16%
9	15%	8%
10	11%	8%

Two exposures exceed the legal limit and Nýi Kaupthing has sought and obtained dispensation from the FME while it looks for an opportunity to divest, syndicate or share the risk from these loans with a willing party.

The sum of all large exposures is 229% but only 172% if accounting for eligible collateral, which is well below the 800% legal maximum and the Bank's internal 300% limit.

	Total exposure	Total net exposure
Exposure > 10%	229%	172%

Amounts are in ISK millions

102. Market Risk Disclosures

a) Currency Risk Disclosures

The Bank has a high exposure to currency risk, due to the large currency imbalance between assets and liabilities, brought about by the method in which the Balance Sheet of the Bank was created following the collapse of Kaupthing Bank hf. The liabilities of the Bank are predominantly ISK-denominated deposits whereas the Bank's assets consist largely of foreign currency denominated loans to customers.

Breakdown of assets and liabilities by currency:

Assets	ISK	EUR	USD	CHF	GBP	JPY	Other	Total
Cash with central bank	7,667	37,409	18,990	1,133	16,542	1,340	4,475	87,555
Loans to credit institutions	9,005	8,332	3,219	3,278	471	1,792	21,599	47,697
Loans and receivables to customers	85,934	81,458	46,159	50,293	13,794	35,253	24,123	337,014
Unpaid share capital	71,225	-	-	-	-	-	-	71,225
Bonds and debt instruments	10,249	512	-	-	-	-	-	10,761
Shares and equity instruments	3,052	1,056	1,342	-	1	-	1,158	6,609
Compensation instruments	19,371	21,785	-	-	-	-	-	41,156
Investment property	12,079	-	-	-	-	-	-	12,079
Investments in associates	2,843	-	-	-	-	-	-	2,843
Property and equipment	7,656	-	-	-	-	-	-	7,656
Intangible assets	2,432	-	-	-	-	-	-	2,432
Tax assets	551	-	-	-	-	-	-	551
Other assets	10,464	1,257	1,074	(0)	654	3	174	13,625
Total assets 31.12.2008	242,527	151,809	70,784	54,704	31,462	38,388	51,529	641,203

Liabilities	ISK	EUR	USD	CHF	GBP	JPY	Other	Total
Due to credit inst. and central bank	114,654	751	3,898	369	75	7	2,979	122,733
Deposits	270,028	71,485	26,477	792	48,086	1,401	3,072	421,341
Financial liabilities at fair value	2	-	-	-	-	-	-	2
Tax liabilities	941	-	-	-	-	-	90	1,031
Other liabilities	11,042	3,523	2,144	3	1,715	1	722	19,150
Equity	76,946	-	-	-	-	-	-	76,946
Total liabilities 31.12.2008	473,613	75,759	32,519	1,164	49,876	1,410	6,862	641,203
Net on-balance sheet position	(231,086)	76,050	38,265	53,540	(18,414)	36,979	44,667	
Net off-balance sheet position	(256)	254	-	-	-	-	-	
Net position at period-end	(231,342)	76,304	38,265	53,540	(18,414)	36,979	44,667	
Loans to custom. with ISK income	140,494	(32,031)	(17,574)	(36,784)	(5,485)	(27,046)	(21,575)	
Net effective position at period-end	(90,848)	44,273	20,691	16,756	(23,899)	9,933	23,092	

A natural hedge for currency risk

The currency risk is mitigated by the specific nature of foreign currency loans to customers with ISK income. We refer to this as a natural hedge. These loans were transferred from Kaupthing Bank hf. at fair value which is based on the customer's ability to repay the loan, which is largely unaffected by changes in the exchange rate. IFRS accounting rules stipulate that the depreciation of the ISK against the loan currency be classified as an impairment event rather than a gain in the loan value if the borrowers ability to repay the loan remains unchanged. Conversely, an appreciation of the ISK is an impairment reversal and that this reversal may be made in certain situations up to the gross value of the loan, which may be significantly higher than the fair value at which the loan was transferred to New Kaupthing Bank hf. The Bank has modeled the effect of this mitigating effect and has presented the relevant authorities with its measure of the effective currency risk which is attributed to this portfolio of loans. The period end 2008 values of the foreign currency imbalance are shown in the following table. The nominal value refers to the value of the imbalance without accounting for the natural hedge.

Amounts are in ISK millions

102. cont.

	Book value	Effective value
FX imbalance due to customers with FX income	90,848	90,848
FX imbalance due to customers with ISK income	140,494	53,388
Total	231,342	144,236

Sensitivity to currency exchange rates

The ISK depreciated by 6.8% against a trade-weighted currency-basket from 22 October 2008 until year-end 2008 with an accumulation of provisions for impairments in FX loans to customers with ISK income. If the ISK exchange rate index appreciated by 15% from its period-end 2008 level then our sensitivity analysis show that this would have the effect that the Tier 1 CAD-ratio of the Bank would decrease by 1.4 percentage points, from 10.8% to 9.4% (or from 9.5% to 8.1%, if the natural FX hedge is disregarded).

The relevant authorities have granted temporary dispensation until end 2009 from rules regarding a large currency imbalance.

b) Interest Rate Risk Disclosures

The Bank's Balance Sheet is subject to various interest rate risk associated with mismatches between interest-bearing assets and interest-bearing liabilities. These mismatches are characterized by a large maturity gap between its assets and liabilities (see asset and liability maturity table in Liquidity Risk Disclosure section) where a large amount of liabilities is on demand but the duration of interest bearing assets are much higher, resulting in a yield curve risk for the Bank. The Bank also faces interest basis risk between interest bearing assets and interest bearing liabilities due to different types of floating rate indices in different currencies.

The following table shows the sensitivity of the fair value to changes in interest rate by currency and maturity in millions of ISK in the Bank. Risk is quantified by assuming a 100bp simultaneous upward shift in all yields curves in the relevant duration band.

		0-1Y	1-5Y	5-10Y	10-20Y	>20
CPI Indexed linked	ISK	(3,000)	84,000	47,000	35,000	50,000
Non Indexed linked	ISK	(9,000)	(190,000)	(53,000)	(129,000)	(33,000)
	EUR	3,000	(15,000)	-	-	-
	Other	(7,000)	-	-	-	-

The Bank is exposed to inflation risk when there is a mismatch between inflation-linked assets and liabilities. The total amount of indexed assets of the Bank amounted to ISK 42.1 billion and the total amount of indexed liabilities amounted to ISK 63.7 billion, respectively, at period-end.

c) Market Price Risk Disclosures

The Bank is not materially exposed to market price risk for financial assets at period end 2008.

At year-end 2008 the Bank had in place market risk limits for its proprietary trading desk in listed Icelandic Treasury notes, Housing Fund bonds and, to a limited extent, equities.

The New Kaupthing Bank hf. loan book was acquired on 22 October at a fair value which was calculated during the weeks subsequent to the acquisition. Any changes in the economic environment which occurred until 31 December were therefore unavoidably factored into the calculation of the 22 October fair value. Consequently, there are no material changes between a 22 October fair value and a 31 December fair value.

d) Derivatives Risk Disclosures

The Bank is not materially exposed to derivative risk at period end 2008.

103. Liquidity Risk Disclosures

The Bank's primary source of funding is deposits from individuals, corporations and financial institutions. The Bank's liquidity risk stems from the fact that the maturity of loans exceeds the maturity of deposits, the majority of which is on-demand.

a) Maturity on book value

The table below presents cash flows by maturity on book value at period-end.

The breakdown by maturity on book value of assets and iabilities:

Assets	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	With no maturity	Total
Cash with central bank	87,555	-	-	-	-	-	87,555
Loans to credit institutions	12,823	22,267	989	10,988	630	-	47,697
Loans and receivables to customers	-	5,988	44,588	170,774	115,664	-	337,014
Unpaid share capital	-	-	71,225	-	-	-	71,225
Bonds and debt instruments	10,145	-	183	145	288	-	10,761
Shares and equity instruments	-	-	-	-	-	6,609	6,609
Compensation instrument	-	-	-	41,156	-	-	41,156
Investment property	-	-	-	-	-	12,079	12,079
Investments in associates	-	-	-	-	-	2,843	2,843
Property and equipment	-	-	-	-	-	7,656	7,656
Intangible assets	-	-	-	-	-	2,432	2,432
Tax assets	-	-	-	-	-	551	551
Other assets	117	2,116	9,775	544	-	1,073	13,625
Total assets 31.12.2008	110,640	30,371	126,760	223,607	116,582	33,243	641,203
Liabilities							
Due to credit inst. and central bank	81,407	41,326	-	-	-	-	122,733
Deposits	199,770	139,929	37,121	27,286	17,235	-	421,341
Financial liabilities at fair value	-	-	2	-	-	-	2
Tax liabilities	-	-	-	-	-	1,031	1,031
Other liabilities	2,401	6,883	5,796	1,575	782	1,713	19,150
Total liabilities 31.12.2008	283,578	188,138	42,919	28,861	18,017	2,744	564,257
Assets - liabilities 31.12.2008	(172,938)	(157,767)	83,841	194,746	98,565	30,499	76,946

b) Secured liquidity

The Bank calculates its secured-liquidity ratio from cash on hand and cash balance with the Icelandic Central Bank, Treasury notes and Housing Fund bonds and other eligible assets for repo transactions with the Central Bank and compares it with the total interest bearing liabilities.

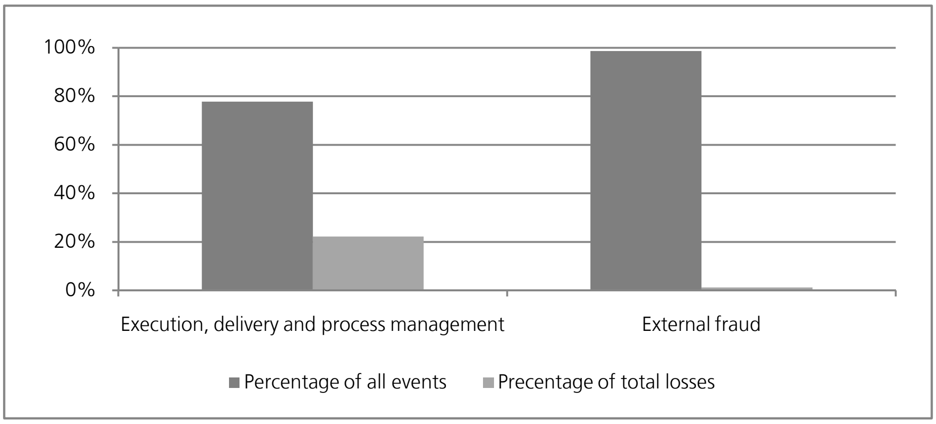
At the period end 2008 the ratio between secured liquid assets and interest bearing liabilities was 27.4% which would enable the Bank to withstand an instantaneous deposit outflow in excess of 25%.

Amounts are in ISK millions

104. Operational Risk Disclosures

The Bank's losses due to operational risk are registered in the Bank's loss database. Loss events are analyzed to understand the cause of the event, control failure and amendments made where applicable to reduce the risk of the event happening again.

Losses of ISK 29 million were registered into the loss database from the start of the Bank to period-end. The majority of the loss events are due to mistakes in processing. The largest single loss accounted for 42% of the total loss amount.



The Bank has several loss events due to the collapse of the Bank that have not been realized or are realized during 2009.

105. Capital Adequacy Disclosures

Equity at 31 December 2008 amounts to ISK 76,946 million. The core Tier 1 capital ratio, calculated in accordance with Article 84 of the Act on Financial Undertakings was 9.5%, exceeding the minimum legal requirement of 8%.

On 12 August 2009, the FME defined conditions for granting New Kaupthing Bank hf. an operating license as a financial undertaking. According to these conditions, New Kaupthing Bank hf. must be capitalized with a minimum Core Tier 1 ratio of 10% from that date and this which must be maintained for at least 3 years after the initial capitalization unless revised by the FME." The Bank complies with the 10% ratio from 13 August 2009.

a) Pillar 1

Risk weighted assets are calculated based on Basel II capital requirements directive (CRD). The standardized approach is used for calculating credit and market risk and the basic indicator approach for operational risk.

A remark about capital requirements for currency imbalance is in order. As indicated in our discussion about currency risk, there exists a risk mitigation in the form of a natural hedge when the imbalance is due to an FX loan to a borrower with ISK income. The effect of this natural hedge is reflected in the RWA for market risk where the 38% effective contribution of the corresponding portion of the FX imbalance has been accounted for.

The table shows the Bank's RWA calculations for 22 October and 31 December of 2008. Also shown, for comparison, are the 22 October and 31 December values if the mitigating effects of the natural hedge are not taken into account. In this case the 10.6% period-end Tier 1 CAD ratio drops to 9.5%, but the 8% regulatory capital requirements are comfortably exceeded.

	No FX hedge		With FX hedge	
RWA	22.10.08	31.12.08	22.10.08	31.12.08
Credit risk	415,997	490,403	415,997	490,403
Market risk	209,555	242,021	117,020	154,915
Operational risk	58,831	58,831	58,831	58,831
Risk weighted assets	684,383	791,255	591,848	704,149
Capital Requirement (Pillar 1)	54,751	63,300	45,630	56,332
Tier 1 Capital	69,925	74,871	69,925	74,871
Total own funds	69,925	74,871	69,925	74,871
CAD ratio	10.2%	9.5%	11.8%	10.6%

Amounts are in ISK millions

105. cont.

b) Pillar 2

New Kaupthing Bank hf. is developing methods to calculate concentration risk for single name concentration and sector concentration. Methods for evaluating other Pillar II risks will be developed in line with further development of the Bank's economic capital model.

The Bank is exposed to relatively high concentration in the loan portfolio. According to the Bank's ICAAP, single name concentration and sector concentration lead to an add-on of 2.3% and 2.9% respectively, on top of the capital requirement for credit risk.

No Pillar 2 adjustments are made for FX risk, because we feel that the effects of the natural hedge on the FX risk are adequately and appropriately addressed in Pillar 1.

Other information

Mortgage loans

106. The Bank has a service level agreement providing back office services.

	22.10. - 31.12.2008
Fee income	45

Related parties

107. New Kaupthing Bank hf. is 100%-owned by the Icelandic state. The New Kaupthing Bank hf. Group's products and services are offered to the state, state authorities and state companies (including other State Owned Banks) in competition with other vendors under generally accepted commercial terms. In a similar manner, New Kaupthing Bank hf. and its Group companies purchase products and services from state authorities and companies at market prices and otherwise under generally accepted commercial terms. No significant share of the New Kaupthing Bank hf. Group's net interest, expenditure or earnings is attributable to the Icelandic state or any of its authorities or companies. Those transactions are related party transactions as defined in IAS 24 Related Party Disclosures but are not disclosed owing to the volume of transactions conducted.

The Bank has a related party relationship with its associates, the Board of Directors of the Parent Company, the key management personnel of the Bank and close family members of individuals referred to above. Loans to related parties are insubstantial and are reported in the Balance Sheet.

No unusual transactions took place with related parties in the year of 2008.
Transactions with related parties have been conducted on arm's length basis.

Netting between New Kaupthing Bank hf. and Kaupthing Bank hf.

108. According to the FME decision of 22 October 2008, the customers of Kaupthing Bank hf. are allowed to net their debt against assets transferred to New Kaupthing Bank hf. As the claim registration period for customers of Kaupthing Bank hf. will end on 30 December 2009 the amount of possible netting is unknown but the effect on the Balance Sheet will principally be a reclassification of assets from Loans and receivables to Accounts receivables within Other assets In accordance with an agreement signed on 3 September 2009 relating to certain aspects of the financial settlement between the banks which sets out the way guarantees, shared collateral and claims subject to set off are treated. There is uncertainty regarding compensation for interest recognised on the transferred asset from Kaupthing Bank hf. from the time the transaction took place until the netting process is finalized. The amount for interest recognised in 2008 is considered immaterial in the accounts for 2008.

Amounts are in ISK millions

Events after the Balance Sheet date

109. Acquisition of certain business activities of SPRON and Sparisjódabanki Íslands hf.

In accordance with a decision of the Icelandic Financial Services Authority ("FME") on 21 March 2009 (By the authority of Art. 100a of Act No. 161/2002 on Financial Undertakings, cf. Art. 5 of Act No. 125/2008 on the Authority for Treasury Disbursements due to Unusual Financial Market Circumstances etc.), New Kaupthing Bank hf. took over SPRON and Sparisjódabanki Íslands hf. obligations due to deposits, overdrafts on current accounts (along with accompanying collateral rights), import and export guarantees and guarantees due to discharge of contract by companies and individuals linked to regular activities, but excluding:

- Deposits due to savings banks.
- Deposit Obligations which were created in a manner whereby a creditor had, by bond and/or other equivalent promissory note, received payment for his claim before the date of maturity, but at the same time created a Deposit with SPRON or Sparisjódabanki Íslands hf.
- Money market deposits from financial undertakings which may own deposits at SPRON or Sparisjódabanki Íslands hf.
- Obligations due to: a) obligations of subsidiaries abroad, b) companies under moratorium, composition or in bankruptcy, c) obligations of those owning a qualifying holding in SPRON or Sparisjódabanki Íslands hf. and connected parties, d) obligations to Icelandic financial undertakings; e) other specifically identified liabilities.

As consideration, SPRON issued a bond claim on Drómi ehf. in the sum of ISK 96,676 million to New Kaupthing Bank hf. but value of overdrafts are still to be agreed upon.

The estimated financial impact of this acquisition is:	22.03.2009
Fair value:	
Loans and receivables to customers	5,188
Bonds	91,489
Deposits from customers	(96,676)
Total	-

As consideration, Sparisjódabanki Íslands hf. Issued a bond claim on Sparisjódabanki Íslands hf. in the sum of ISK 371 million to New Kaupthing Bank hf.

The financial impact of this acquisition is:	22.03.2009
Fair value:	
Loans and receivables to customers	1,073
Bonds	371
Deposits from customers	(1,444)
Total	-

Amounts are in ISK millions

110. Acquisition of Sparisjódur Mýrasýslu

New Kaupthing Bank hf. bought all assets of Sparisjódur Mýrasýslu (SPM), in accordance with a purchase agreement dated 3 April 2009 including the branch in Borgarnes, real estate, fixed assets, cash, loan portfolio, all security interests of Sparisjódur Mýrasýslu, including all pledges, guarantees and other similar rights linked to the claims, securities holdings, trademarks and other intangible asset and rights, listed as well as unlisted, holdings in associate companies and subsidiaries and all other claims, funds and other assets and rights as current at the end of the date of delivery. New Kaupthing Bank hf. took over non-due obligations according to import and export guarantees, guarantees due to discharge of contract by companies and individuals connected to regular activities, but excluding:

- Rights conferred by derivatives contracts.
- Money market deposits owned by financial undertakings deposits owned by financial undertakings in administration.
- Guarantees for

a) the obligations of subsidiaries,

b) companies in administration, subject to composition or undergoing bankruptcy proceedings,

c) obligations to Icelandic financial undertakings,

d) other specific gurarantees as decided by the buyer.

At the date of the Consolidated Financial Statements the composition with the creditors of Sparisjódur Mýrasýslu had not been finalized and therefore there is uncertainty on amounts related to this agreement.

The estimated financial impact of the acquisition of SPM is shown in the table below:	03.04.2009
Fair value:	
Cash and cash balances with central bank	96
Loans and receivables to credit institutions and customers	27,031
Bonds and shares	1,120
Investment in associates	274
Property and equipment	723
Other assets	344
Deposits from customers	(19,835)
Borrowings	(9,382)
Other liabilities	(371)
Total	-

Agreements

111. On 17 July 2009, the Resolution Committee of Kaupthing Bank hf. signed a "Heads of Terms" agreement with the Icelandic Ministry of Finance regarding the capitalisation and future ownership of New Kaupthing Bank hf. The "Heads of Terms" provides two options for capitalising New Kaupthing Bank hf: a capitalisation where Kaupthing Bank hf. acquires a majority shareholding of 87% in New Kaupthing Bank hf.; and a Government capitalisation where the Icelandic Ministry of Finance becomes the sole owner of New Kaupthing Bank hf. The Heads of Terms were formally reflected in agreements executed in September 2009.

Government Capitalization:

1. Government capitalization agreement, where the Icelandic state capitalized New Kaupthing Bank hf. with ISK 72,000 million which has been reflected in the Financial Statements.

2. Call option instrument issued by the Icelandic state to Kaupthing Bank hf. providing Kaupthing Bank hf. an option to purchase ordinary shares in New Kaupthing Bank hf. for one month time period yearly until the end of the year 2014.

3. Escrow and contingent value rights agreement where Kaupthing Bank hf. receives 80% of the appreciation of defined New Kaupthing Bank hf. loans if Kaupthing Bank hf. does not capitalize the Bank. The increase in value of the defined loans will decrease the value of the compensation instrument as disclosed in note 64. There was no appreciation of the defined loans in 2008.

Resolution committee of Kaupthing Bank hf. holding 87% and the Icelandic state 13%:

1. New Kaupthing Bank hf. capitalization agreement, which sets out the methods for the resolution committee of Kaupthing Bank hf. to purchase New Kaupthing Bank hf. The capitalization will be paid by Icelandic assets; cash, loans and receivables.

2. Tier 2 capital instrument where New Kaupthing Bank hf. has agreed to issue ISK 25,000 million of unsecured subordinated notes under certain conditions to the Icelandic state.

A further agreement was signed relating to certain aspects of the financial settlement between Kaupthing Bank hf. and New Kaupthing Bank hf. which sets out the way guarantees, shared collateral and claims subject to set off are treated as per note 108.

Amounts are in ISK millions

Subsidiaries

112. Shares in subsidiaries are specified as follows:

Company:	Country	Currency	Business Group[1]	Share Capital in millions	Equity interest accum. %
Arion Custody Service hf., Ármúli 13, 108 Rvk	Iceland	ISK	OD	115	100.0
Eignasel ehf., Borgartún 19, 105 Rvk	Iceland	ISK	OD	0	100.0
ENK 1 ehf., Borgartún 19, 105 Rvk	Iceland	ISK	OD	0	100.0
Exista Properties ehf., Sudurlandsbraut 22, 108 Rvk	Iceland	ISK	OD	3	100.0
Fasteignafélagið Jörfi ehf., Sudurlandsbraut 22, 108 Rvk	Iceland	ISK	OD	500	100.0
Gen hf., Borgartún 19, 105 Rvk	Iceland	ISK	AM & PB	4	100.0
GIR Fund Management, Walker House Mary Street, George Town	Cayman Isl.	EUR	AM & PB	0	100.0
Kaupthing Advisory Company S.A., 35a, avenue J.F. Kennedy	Luxembourg	EUR	AM & PB	0	100.0
Kaupthing Management Comp S.A., 35a, avenue J.F. Kennedy	Luxembourg	EUR	AM & PB	0	100.0
Landfestar ehf., Sudurlandsbraut 22, 108 Rvk	Iceland	ISK	OD	1,501	100.0
Okkar líftryggingar hf., Sóltún 26, 105 Rvk	Iceland	ISK	RB	17	100.0
Rekstrarfélag Kaupthings banka hf., Borgartún 19, 105 Rvk	Iceland	ISK	AM & PB	44	100.0
Sparisjódur Kaupthings hf., Borgartún 19, 105 Rvk	Iceland	ISK	RB	100	100.0

1. RB: Retail Banking, AM & PB: Asset Management and Private Banking, OD: Other Divisions.