KAUPTHING BANK HF. CREDITORS' REPORT

5 FEBRUARY 2009

UPDATE APRIL 2009

KAUPTHING BANK

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This report (including all subsequent amendments and additions) was prepared by the Resolution Committee for the creditors of Kaupthing Bank hf. ("the Bank") for information purposes only. It should give creditors an overview of the background, the current situation and the potential steps going forward. The additions and amendments to this report since the previously published versions of this report are intended to give the creditors information on recent developments but are not necessarily and should not be regarded as an exhaustive list of all developments which creditors may consider material. In preparing and updating this report, the Bank has not taken account of the interest of any particular creditor or group of creditors.

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- (a) Resolution of issues regarding the quantum of claims
- (b) Additional claims being made against the Bank
- (c) The realisation method(s) used over time
- (d) The impact of set off and netting including in connection with derivative contracts
- (e) Movements in currency exchange rates and interest rates
- (f) Prevailing market conditions when assets are sold

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## Major additions and amendments in the April update of the report

During the nine-month moratorium period, from 13 February to 13 November 2009, the Bank intends to compile a monthly report for creditors which will be available on the Bank's website, www.kaupthing.com, so that creditors and other interested parties can keep abreast of the main developments and achievements since the previous report was issued.

The additions and amendments to this report since the previously published versions of this report are intended to give the creditors information on recent developments but are not necessarily and should not be regarded as an exhaustive list of all developments which creditors may consider material.

In order to help readers who read the previous report, the major additions and amendments have been highlighted in blue text but all minor changes are left as black text. Deleted text, which is not applicable anymore and none of which was significant, has been deleted without any notification to the readers. The major additions and amendments can be found in the following chapters:

3.3 The Resolution Committee: Main tasks of the Resolution Committee today
3.4 The Resolution Committee: Current status of the Bank's subsidiaries
3.5 The Resolution Committee: Current status of the Bank's branches
4.2 Asset sales and restructuring: Assets sold to date
4.3 Asset sales and restructuring: Assets restructured to date
5.5 Financial Analysis: Update of financial matters
7.1 Potential restructuring Options: Valuation of assets transferred to New Kaupthing and the bond
7.3 Potential restructuring Options: The relationship between the Bank and New Kaupthing
7.5 Potential restructuring Options: The Bank's co-ordination group

# Abbreviations

The following abbreviations are used in this report:

| | |
|---|---|
| FME | The Icelandic Financial Supervisory Authority |
| ICC | Informal Creditors' Committee |
| The Bank | Kaupthing Bank hf. |
| New Kaupthing | Nyi Kaupthing Banki hf. |
| KSF | Kaupthing Singer and Friedlander Limited |
| FIH | FIH Erhvervsbank A/S |
| KT Lux | Kaupthing Bank Luxembourg S.A. |
| The Disbursement Act | Act No. 125/2008 on the Authority for Treasury Disbursements due to Unusual Financial Market Circumstances etc. |
| The Transfer Decision | Decision of the FME on the disposal of assets and liabilities of Kaupthing Bank hf. to New Kaupthing Bank hf. dated 21 October 2008 |
| The Bankruptcy Act | Icelandic Act on Bankruptcy, etc., No. 21/1991 |

# 1. Background

## *1.1 Broad context -The world wide credit crunch and the global financial crisis*

The world's banking system has taken centre stage in the current world financial crisis. From around mid 2007, but particularly in 2008, the market experienced acute adverse conditions characterized by the severe disruption to credit markets and turbulence in the banking and mortgage sectors. These conditions created an extremely difficult environment for banks in general and came to a head in the second half of 2008 and particularly in September and October. The severity of the situation was underlined by: i) the collapse of banking and financial sector shares in and around September 2008, ii) the collapse of Lehman Brothers, an international investment bank, on 15 September 2008 and iii) the huge and unprecedented "bail out" of American banks announced by the US Treasury Secretary on 20 September 2008, followed by similar rescue measures undertaken by most western countries.

In short, the global financial system was experiencing unprecedented difficulties and, consequently, credit markets (so essential to the smooth operation of the world financial system and to the wider economy) were seizing up, leading to what is popularly called the credit crunch. This, in turn, was having serious implications for the global economy and governments across the world as evidenced by dramatic falls in share prices and extreme volatility in the currency and commodity markets. Rating agencies were forced to reassess the credit ratings of financial sector institutions across the world.

## *1.2 The Icelandic banking crisis*

During the past decade, the Icelandic economy has undergone dramatic change. The development of an international financial sector, along with the growth of high tech industries, aluminium production and tourism, brought unprecedented wealth to a population of roughly 300,000 that had previously sustained itself mainly through a centuries-old fishing industry. In the course of that development, Iceland's three largest banks, Kaupthing Bank ("the Bank"), Glitnir banki hf. ("Glitnir"), and Landsbanki Islands hf. ("Landsbanki"), grew to levels almost ten times that of the country's gross domestic product.

On 29 September 2008, the Icelandic authorities announced their plans to acquire a 75% stake in Iceland's third largest bank, Glitnir, which had been encountering severe short-term funding problems. This government intervention seems to have triggered the opposite reaction to that of similar actions in other countries. Instead of restoring confidence, the reverse happened. The markets had no confidence in the approach taken by the Icelandic government and a crisis of confidence hit the Icelandic banking sector, resulting in outflows of deposits. It became clear that if it had not been for state intervention, Glitnir may have collapsed and there was speculation over the ability of the Central Bank of Iceland to provide the necessary support to the wider Icelandic banking system during the crisis. This precipitated a severe drop in the value of the Icelandic krona and caused rating agencies to downgrade their credit ratings for the Icelandic state and the Icelandic banks. Foreign investors tried to divest themselves of Icelandic assets and British depositors began to withdraw their deposits from Icesave, Landsbanki's internet banking product. In addition, there was an increase in the outflow of deposits from Kaupthing Edge UK, the internet banking product of the Bank's UK subsidiary Kaupthing Singer & Friedlander ("KSF").

On Monday 6 October 2008, trading in most Icelandic banking shares (including the Bank's) was suspended in Iceland and emergency legislation, Act No. 125/2008 on the Authority for Treasury Disbursements due to Unusual Financial Market Circumstances etc ("The Disbursement Act") was enacted allowing the Icelandic Financial Supervisory Authority ("FME") to take over the running of the Icelandic banks.

## 1.3 KSF placed into administration

After British depositors withdrew their deposits from Icesave, Landsbanki's internet banking product in the United Kingdom, the Icelandic authorities assumed control of Landsbanki. Immediately afterwards, there was a significant increase in the withdrawal of deposits from Kaupthing Edge in the United Kingdom, despite the fact that Kaupthing Edge deposits were guaranteed by the British compensation scheme and Icesave deposits by the Icelandic scheme. After the British Chancellor of the Exchequer stated that Iceland did not intend to honour its obligations to British depositors, the State Treasury, in the UK transferred Kaupthing Edge deposits from the Bank's subsidiary KSF to ING Direct, a wholly owned subsidiary of ING Group. KSF was subsequently placed into administration upon the application of the UK regulator, the Financial Services Authority ("FSA") in the UK. The Bank's creditors treated the situation as an event of default under various loan agreements and bond programs.

## 1.4 Overview of the Bank

The Bank was the largest Icelandic bank and is headquartered in Reykjavik. It is registered in Iceland and operated through branches and subsidiaries in all of the Nordic countries, the United Kingdom, the United States, Dubai, Qatar, Luxembourg, Belgium, Switzerland, Germany, Austria, Hong Kong, Japan and the Isle of Man. The Bank offered integrated financial services to companies, institutional investors and individuals. These services included corporate and retail banking, investment banking, capital markets services, treasury services, asset management and wealth management for private banking clients. The Bank's shares were listed on the stock exchanges in Iceland and Stockholm and the Bank was the 7$^{th}$ largest bank in the Nordic region in terms of market capitalization for a period of time. The majority of the Bank's operating income was generated in Iceland, Scandinavia and the United Kingdom. Since its inception in 1982, Kaupthing expanded operations through organic growth and a number of strategic acquisitions, including FIH Erhvervsbank ("FIH") in 2004 and Singer & Friedlander (now KSF) in 2005. At the end of H1 2008, the Bank's group employed over 3,300 people and its total assets were close to EUR 53bn.

## 2. Timeline of events

*29 September – 9 October 2008*

- The Icelandic authorities announce their plans to acquire a 75% stake in Glitnir
- The rating agencies downgrade Icelandic sovereign, Kaupthing, Glitnir and Landsbanki debt
- Trading in shares in the Bank suspended
- Icelandic parliament passes the Disbursement Act
- Central Bank of Iceland extends EUR 500m loan to the Bank
- FSA in the UK succeeds in having administrators appointed over KSF
- The Bank's board of directors requests that the FME take control of the Bank pursuant to the Disbursement Act

*9 October – 22 October 2008*

- FME appoints a Resolution Committee which immediately assumes control of the Bank
- Nyi Kaupthing Banki hf. ("New Kaupthing") is created
- Certain domestic assets and domestic deposits transferred to New Kaupthing in accordance with the transfer decision ("The Transfer Decision")

*22 October to date*

- The Resolution Committee works towards maximising the value of the Bank's assets
- The Resolution Committee holds meetings and conference calls with informal committee of the largest creditors of the Bank
- Moratorium granted and Olafur Gardarsson appointed as the Moratorium Supervisor
- Filing of Voluntary Petition under Chapter 15 of the US Bankruptcy Code
- Moratorium is recognized as a foreign main proceeding under Chapter 15 of the US Bankruptcy Code
- Morgan Stanley appointed as a financial advisor to advise and assist on restructuring the Bank
- Creditors' meeting convened by the Moratorium Supervisor
- Moratorium of the Bank extended by the District Court of Reykjavik to 13 November 2009
- According to the FME's decision dated 6 March 2009, the terms of the financial instrument which will be issued by the new banks to the old banks as a payment for the net asset value transferred to New Kaupthing, will be concluded no later than 18 May 2009

# 3. The Resolution Committee

## 3.1 The adoption of the Disbursement Act

As discussed in the previous chapter, Iceland is currently in the midst of a banking crisis of extraordinary proportions. The three main banks, which all collapsed in less than a week, accounted for about 85 percent of the domestic banking system. On 9 October 2008, in accordance with the provisions of Iceland's new Disbursement Act, which had been passed into law because of the unusual and dire circumstances in the financial market, the board of directors resigned and the FME appointed a five-member Resolution Committee, which immediately assumed the powers, and wields all the authority, of the Bank's board of directors. These actions were taken to guarantee the appropriate of level activity by the Bank in Iceland and to help stabilize the Icelandic financial system. The members of the Resolution Committee were selected by the FME from a broad cross-section of Icelandic business, legal and accounting fields. Today, the Bank's Resolution Committee consists of the following five members:

- Steinar Thor Gudgeirsson, Attorney to the Supreme Court of Iceland – Chairman
- Johannes Runar Johannsson, Attorney to the Supreme Court of Iceland
- Knutur Thorhallsson, Certified Public Accountant
- Gudni Adalsteinsson, Economist
- Theodor Sigurbergsson, Certified Public Accountant

Initially, the Resolution Committee operated in consultation and co-operation with the FME. However, after a moratorium status was granted to the Bank, on 24 November 2008, the Resolution Committee became virtually independent from any governmental body and currently directs the Bank in co-operation with Olafur Gardarsson, the Moratorium Supervisor. As an entity in Iceland with a banking licence, the Bank is still subject to supervision by the FME.

## 3.2 Initial objectives of the Resolution Committee

At its inception, the Resolution Committee had the objectives laid out below. Some of these objectives were set with reference to the Disbursement Act. However, it should be noted that the Resolution Committee played no part in determining the creation of New Kaupthing.

*Maintaining the Bank's commercial banking operations in Iceland* in line with the Disbursement Act. The Resolution Committee worked hard to ensure that the daily operations of the Bank's branches were not significantly affected.
This objective was reached when New Kaupthing was formally established on 18 October 2008 and took over the Bank's commercial banking operation in Iceland on 22 October 2008.

*Protecting depositors both domestically & overseas* in accordance with the Disbursement Act. The Resolution Committee co-operated abroad with governments, financial authorities and central banks. This objective was achieved domestically, where New Kaupthing is now responsible for domestic deposits and, in terms of foreign depositors, has either been completed or final arrangements are being negotiated. According to the Disbursement Act, deposits received by the Bank or its branches are priority claims against the Bank. The Bank is thus under an obligation to repay deposits prior to regular claims. Icelandic law does not affect the repayment of deposits received by subsidiaries or their branches. Possible repayment of those deposits is the concern of the boards of directors or administrators of the relevant subsidiaries.

*Ensuring expertise and knowledge by hiring key employees*.

One of the main tasks of the Resolution Committee is to safeguard the value of Kaupthing assets until they have been transferred to creditors. In order to achieve this aim, there must be sufficient expertise in place to manage the assets and provide the necessary services.
This objective was achieved through the appointment of several qualified full-time and part-time employees. Around 30 specialists now work for the Resolution Committee.

*Ensuring cash flow in all currencies both domestically and to/from foreign jurisdictions.* The difficulties that were experienced with payments to and from Iceland were primarily due to the actions of foreign governments and foreign currency restrictions imposed by the Central Bank of Iceland. Efficient movement of capital was vital for the Icelandic economy. These difficulties were resolved in part with the Transfer Decision.

*Preserving the interests of creditors.* The Resolution Committee has focused on protecting the assets of the Bank and preserving value for creditors. Creditors have been informed of developments via the Bank's website, creditor contact address and press releases.
This objective is an ongoing task and will not be fully attained until a permanent solution for the assets, satisfactory to the creditors of the Bank has been identified and executed.

## *3.3 Main tasks of the Resolution Committee today*

The Resolution Committee is responsible for the Bank's daily operations and holds a number of organized meetings every week. When formal meetings are held, the presence of all members of the committee is required. Currently the work of the Resolution Committee is subject to the supervision of the Moratorium Supervisor. The most significant projects of the Resolution Committee are as follows:

*Protection of creditors' interests.* The main task of the Resolution Committee is to protect the interests of the Bank's creditors. From discussions with various creditors early in the process, the Resolution Committee learned that creditors were concerned about the immediate sale of assets. The Resolution Committee shares the creditors' desire to maximize the value of the Bank's estate and recognizes that this may take a significant period of time to achieve. In recent months, the Resolution Committee has therefore focused on maintaining and safeguarding the assets of the Bank in order to ensure the equal treatment of creditors and to maximise the value of assets with the aim of ensuring as high a recovery rate of claims as possible.

When the Resolution Committee evaluates any of the assets of the Bank, a preliminary valuation of the asset is performed and the scope of associated servicing and monitoring work is evaluated. Assets are valued in respect of two valuation scenarios: Firstly, current market value and secondly the cost and amount of support needed and potential recovery or redemption value if sold at a later stage.

To date, no assets have or will be sold in "fire sales". According to the strategy, assets are only sold if they require support beyond the means of the Bank or if a satisfactory bid price can be achieved for them after taking into account the future funding support needed to maintain these assets. Other assets should be preserved and protected until market conditions improve with temporary support from the Bank where and when deemed necessary. This should ensure that the maximum value for each asset can be passed on to creditors of the Bank at a later stage.

The Resolution Committee realizes that the outcome of this exercise may well have an impact on the overall recovery of Iceland and assist in regaining foreign investors' confidence and trust. Solutions which endeavour to find the best possible closure for all relevant parties in a realistic time frame and distribute the resulting value to creditors will be discussed further in chapter *7. Potential Restructuring Options.*

*Communication with creditors.* The Bank endeavours to maintain good and effective relations with its creditors. In October 2008, Deloitte UK was engaged by the Resolution Committee to facilitate and advise on creditor relations. Early in January 2009, Deloitte's appointment was terminated and the Resolution Committee assumed responsibility for all communication and consultation with creditors. To facilitate communication with creditors all over the world, the Bank's website, www.kaupthing.com has been developed into an information centre for creditors. The website is updated frequently and invites creditors to ask questions via a specific email address, creditorcontact@kaupthing.com. Every effort is made to respond to questions or comments in a timely manner or when relevant information becomes available.

Shortly after Deloitte's appointment, a committee, the Informal Creditors Committee ("ICC") was formed and is composed of representatives of the Bank's largest creditors. Although this committee does not have formal powers or duties under Icelandic law, it is consultative in nature. Indeed the Resolution Committee has engaged in discussions with the ICC with respect to, among other things, the protection, maximization and realization of the Bank's assets, and restructuring proposals aimed at making distributions to creditors of the Bank. The Resolution Committee meets with the ICC and holds conference calls with the committee when needed.

*Finalizing the Bank's balance sheet*. The aggregate balance sheet has been divided between the Bank and New Kaupthing as at 22 October 2008. Separate balance sheets for the Bank and New Kaupthing are currently being prepared. It is expected that this work will be concluded once Deloitte and Oliver Wyman have finalized their valuation of the assets which were transferred to New Kaupthing.

*Internal audit.* In October 2008, the Resolution Committee, at the request of the FME, engaged the international accounting firm Pricewaterhouse Coopers ("PWC") to perform a preliminary review on the operation of the Bank during the period 1 September – 21 October 2008. On 31 December, PWC delivered its report to the FME (the "PWC Report"). Part of the PWC Report relates to specific transactions occurring in the last months leading to FME's intervention into the affairs of the Bank.

The Resolution Committee has formed a sub-committee, consisting of two members of the Resolution Committee in addition to the formal Internal Auditor of Kaupthing Bank. The role of the sub-committee is to review certain transactions, identified by the Resolution Committee, and to prepare and commence legal proceedings against parties that might be in debt to Kaupthing due to those transactions, or are alternatively responsible for potential loss of the Bank resulting from the transactions. The aim of the Resolution Committee is, in other words, to realise all possible claims which Kaupthing might have against third parties in relation to the specific transactions mentioned above, including claims arising from possible or alleged wrongdoing by the former management of the Bank or third parties.

Furthermore, the Resolution Committee has decided that the aforementioned sub-committee shall be responsible for all correspondence and communication with the Special Investigation Commission ("SIC"), operating under the provision of Act No. 142/2008, the FME and the Special Prosecutor, operating under the provision of Act No. 135/2008.

This sub-committee is currently working on several projects with external experts, both domestic and foreign, e.g. a forensic team in London, external legal counsel, external auditors and other appointed consultants. The primary objective of these projects is to retrieve assets if and where appropriate.

*Closing derivative contracts and evaluating netting effects.* The Resolution Committee is working towards closing all derivative agreements and is evaluating any netting effects. Team of experts within the Bank is analysing the Bank's position on a counterparty by counterparty basis across all relevant financial instruments and a netting committee has been established to review and conclude each case.

The Bank has been reviewing and closing derivatives at their maturity dates or earlier upon client's requests, in accordance with the underlying agreements, terms and market conventions. Only derivatives which are in-the-money for the Bank have been settled. Other derivatives are netted in accordance with the agreement terms. Derivatives which are out-of-the-money represent unsecured senior claims against the Bank and have therefore not been settled. The Bank has reviewed several cases where set-off has been requested. The estimated size and impact of set-off and netting is still very uncertain. To date, the Bank has received set-off and netting claims from counterparties for the total of approximately ISK 200bn but this figure can by no means be taken as conclusive due to two primary reasons. Firstly, counterparties have the right to claim until the end of the formal claim period which has not started yet as the Bank is in moratorium and in that state it can only accept claims in accordance with Icelandic legislation on moratorium proceedings. Secondly, every case needs to be looked into and evaluated before each claim can be accepted or rejected.

Collection procedures are currently being prepared in many cases. The Bank has started collection process in several cases where the underlying collateral is liquid assets, in particular cash and or securities.

*Prevent the provisional attachment of assets and facilitate the retrieval of the Bank's assets.* The Resolution Committee is committed to protect the interests of creditors by preventing litigations, the provisional attachment or freezing orders on assets. In the European Economic Area the Bank seeks recognition of the moratorium on a case-by-case basis on grounds of the EU Winding-Up Directive No. 2001/24/EC. The Bank has also been granted an injunctive relief and the moratorium recognized as a foreign main proceeding under Chapter 15 of the United States Bankruptcy Code. This has provided the Bank with protection for its assets in the United States.

The Resolution Committee has also facilitated the release of assets through negotiations with local authorities or private parties in several countries.

*Stay on litigation against the Bank.*
The Resolution Committee has successfully opposed litigation threats and or freezing orders in the United States, Luxemburg, the Netherlands, Spain, and the United Kingdom and is currently opposing litigation in Austria. The Bank is currently in several litigation proceedings, including in the following matters:

- The Bank is currently suing Oscatello Investments Limited in the Reykjavik District Court because of about GBP 650m liability on an overdraft facility agreement. Two members from the Resolution Committee have now been appointed as board members in the board of Oscatello Investments Limited and also in a few subsidiaries. The Bank has enforced securities it held as collateral, e.g. in shares in Oscatello Investments Limited.

- The Bank is in litigation because of a swap agreement which was in place with BTMU when the FME appointed the Resolution Committee to take control of the Bank in accordance with the Disbursement Act.

- The High Court of England has consented to the Bank's request for permission to apply for judicial review of the legitimacy of the decision taken by the UK authorities to transfer to a third party, without compensation, deposits from Kaupthing Edge accounts at KSF, on 8 October 2008. The court will now fix a hearing at which evidence and arguments concerning the UK authorities' intervention into the operations of KSF will be considered. The Bank contends that the actions of the UK authorities were unjust and illegal. The Resolution Committee welcomes the court's decision and hopes that promised financial support will be forthcoming from the Icelandic Government to ensure that legal proceedings can be continued. The Resolution

Committee also wishes to underline that the court's decision in no way indicates what the final outcome of this case will be.

*Collecting claims and enforcing securities.*
The Bank continues to enforce rights against its debtors in case of non-performance of obligations. That includes enforcing pledges and other securities, taking control of relevant entities etc.

*Review unusual transactions.*
The Resolution Committee continues to review any unusual or irregular transactions which are brought to its attention and concern the Bank. Any transactions which merit further reviewing will be given appropriate attention and handled accordingly.

*Finding solutions for the Bank's main branches and subsidiaries*. The Resolution Committee has conducted a substantial amount of work abroad to: i) secure the future business of entities, ii) restructure and sell off entities, iii) close down entities. Furthermore, members of the Resolution Committee or representatives have been nominated by the committee to replace former representatives of the Bank in subsidiaries which can still be effectively controlled by the Bank.

*Policy formulation regarding the Bank.* The Resolution Committee is focused on finding the best possible closure for all relevant parties in a realistic time frame and distributing the resulting value to creditors. From discussions with the creditor community the Resolution Committee learned that creditors wanted to be able, along with the Resolution Committee, to engage with governmental authorities and agencies. The Resolution Committee is working on this matter in co-operation with the government, the Central Bank of Iceland and the FME.

The next two subchapters below discuss the current status of each of the Bank's subsidiaries and branches.

## *3.4 Current status of the Bank's subsidiaries*

Foreign subsidiaries of the Bank and their branches are directly responsible for the deposits made with them. These entities are not governed by Icelandic law. The rights of depositors regarding deposits made with a subsidiary of the Bank or branch of a subsidiary will be determined by the law and regulations applicable to that entity.

*FIH* is a subsidiary wholly owned by the Bank. It is a Danish full service corporate & investment bank specializing in lending to Danish companies. The entity was acquired by the Bank in 2004. The entity is operational and is no longer in the process of being sold. The Bank remains the sole shareholder of FIH and two representatives of the Resolution Committee are board members. The Icelandic Central Bank holds the entity's shares of the Bank as pledge against a EUR 500m loan. The board of directors of FIH has adopted a plan to adjust and focus FIH's future activities to meet the current market situation of the financial sector. As part of this adjustment, FIH has closed down the equities trading, research and wealth management department. These business areas were not expected to contribute positively to FIH's earnings on a short-term or a medium-term basis. In the future, FIH will focus on the core business areas: loans to corporate customers supplemented by two advisory units: Corporate Finance (FIH Partners) and Financial Solutions (advisory related to strategic risk management and liability management). The Resolution Committee has always been of the opinion that the entity should not be sold in the current market environment because its value is presumably much higher and the Bank should be worth more in the future, when markets have recovered.

Further information on this entity can be found at www.fih.dk.

*Kaupthing Bank Sweden* is a subsidiary wholly owned by the Bank. Following the opening of a Stockholm branch in September 2000, the Bank acquired both the Swedish securities firm Aragon and JP Nordiska Bank in 2002. Kaupthing Bank Sweden offered integrated financial services to institutional investors, companies and individuals. These services included corporate banking, investment banking, capital markets services, asset management and comprehensive wealth management for private banking clients.

After 9 October 2008, the entity was still operational with support from the Swedish government. Without the Resolution Committee's co-operation with Riksbanken, the Swedish Central Bank, and the Swedish Financial Authorities, the entity would have been closed down. Last autumn, Kaupthing Pension Consulting and Kaupthing Finans AB were sold as these business lines did not constitute a core business for Kaupthing Sweden and the latter would have required continued financial support. At the end of March, the Resolution Committee closed a transaction with Ålandsbanken Abp where the latter acquired the private banking, capital markets and asset management assets of Kaupthing Bank Sweden.

The Resolution Committee believes that the transaction with Ålandsbanken Abp constitutes a fair deal for the Bank as the sale price is acceptable and enables Kaupthing Bank Sweden to pay 100% of subordinated loans to the Bank and over 50% of its equity. This transaction will also free up cash for the Bank since Riksbanken will return to the Bank approximately SEK 2bn it has frozen in its accounts, plus Icelandic government bonds of ISK 9.5bn which are currently with the Icelandic Central Bank. The Bank will not need to refinance and fund future activities of Kaupthing Bank Sweden. The private banking, asset management and capital markets businesses had substantial funding needs in 2009 which do not align well with the current status of the Bank. The corporate loan portfolio and some other loans will be moved to the Bank. These assets fit well with the other asset pools the Bank is currently managing. This portfolio accounted for the majority of the Swedish assets of the Bank.

Deposits held by Kaupthing Sweden have been repaid to depositors. The repayment was funded with a loan from Riksbanken, the Swedish Central Bank but the above mentioned sale to Ålandsbanken will allow for immediate repayment of the facility. This facility was put in place in early October last year by Riksbanken in order for Kaupthing Bank Sweden to be able to pay back all deposits. Riksbanken has been very co-operative but a repayment was required at the earliest convenience.

If the entity had not to been sold, there is a substantial risk that only the deposits which had already been paid and perhaps the Riksbanken's facility could be repaid. However, this solution enables the Bank to settle the Riksbanken facility as well as retrieving a sizable loan portfolio. In case of a bankruptcy of the entity, the recovery of the subordinated loan had presumably been very low, there would have been uncertainty over how much the Bank had retrieved from the Swedish Central Bank and the equity would have been worthless. The result of the transaction is that assets of appr. EUR 800m at nominal value were retrieved.

Further information on this entity can be found at www.kaupthing.se.

*KSF* is a wholly owned subsidiary of the Bank, acquired in 2005. It was an established bank in the UK offering integrated financial services to companies, institutional investors and individuals. These services included corporate banking, investment banking, treasury services, and comprehensive wealth management services for private banking clients.

On 8 October 2008, KSF was taken into administration and Maggie Mills, Tom Burton, Alan Bloom and Patrick Brazzill of Ernst & Young, UK, were appointed as administrators. Kaupthing EDGE UK was transferred by the UK Treasury to ING Group and later the same day, the entity was put into administration on the application of the FSA.

Further information on this entity can be found on the administrators' website www.kaupthingsingers.co.uk.

*Kaupthing Singer & Friedlander (Isle of Man) Limited* is a wholly owned subsidiary of the Bank. The entity carried out traditional banking activities as well as asset management activities for a broad spectrum of corporate and private customers along.

The entity is in provisional liquidation and Michael Simpson of PricewaterhouseCoopers and Peter Spratt of PricewaterhouseCoopers (London) were appointed as joint provisional liquidators of the entity.

Further information on this entity can be found on the administrators' website www.kaupthingsingers.co.im.

*Kaupthing Bank Luxembourg* ("KT Lux") is a wholly owned subsidiary of the Bank and *Kaupthing Bank Belgium* is a branch of KT Lux. The main services offered at KT Lux were private banking and wealth management. The services included asset management, securities brokerage, the issuing of credit cards and the establishment and management of holding companies in addition to providing general deposit accounts and loans.

On 9 October 2008, KT Lux's board of directors applied for a suspension of payments status with the Luxembourg District Court sitting in commercial matters. KT Lux was granted this status and its management was monitored by administrators. The Court appointed PriceWaterhouseCoopers Luxembourg, represented by Mrs Emmanuelle Caruel-Henniaux and Mr Franz Fayot, to act as KT Lux's administrators. This decision also applies to the Belgian branch of KT Lux.

The government of Luxembourg and a consortium of investors led by a Libyan sovereign wealth fund have entered into a memorandum of understanding aiming to continue the activities of KT Lux. The latter has agreed to acquire KT Lux subject to the other reconstruction conditions being met. To facilitate the restoration, the governments of Luxembourg and Belgium, along with the Depositors' Guarantee Fund in Luxembourg have agreed to lend KT Lux EUR 600m if the sale of the entity goes through to enable it to repay its retail depositors. KT Lux is also working on a scheme of arrangement with its 31 bank creditors. If the entity manages to conclude the arrangements with its creditors and the Libyan sovereign wealth fund, it is expected that approximately 22,000 depositors in Luxembourg and Belgium will fully recover their deposits at KT Lux.

Further information on this entity can be found on the administrators' website www.kaupthing.lu.

*Kaupthing Bank Luxembourg, Geneva Branch* is a branch of Kaupthing Bank Luxembourg.
The main services offered at KT Lux, Geneva Branch were private banking and asset management for private and institutional clients, as well as advisory services in alternative investments for qualified investors. The entity is in an insolvency process and all assets have been frozen. Depositors have now been paid back to a certain extent in accordance with the Deposit Protection of Swiss Banks and Securities Dealers.

Further information on this entity can be found on the liquidators' website www.kaupthing-geneva.ch.

*Kaupthing Bank US* is a wholly owned subsidiary of the Bank established in 2000. The entity focused on securities brokerage and investment banking. The entity is in its final stages of being closed and wound down.

The *Bank's subsidiary in Japan* has been closed down without the need for any insolvency proceeding. The *Bank's subsidiary in Hong Kong* is in insolvent liquidation.

### 3.5 *Current status of the Bank's branches*

According to the Disbursement Act, deposits made by private individuals and companies are priority claims. Whether the legislation applies to depositors depends on which entity in the Kaupthing Group they were deposited with. The legislation only applies to Icelandic financial undertakings. The Resolution Committee of the Bank anticipates that the Bank will be able to pay back its deposits which have been defined as priority claims, made at the parent company and in branches belonging to the parent company. This process can take some time, due to various complications within each entity, and the continued patience of customers is very much appreciated.

*Kaupthing EDGE Austria* is a branch of the Bank. It was established in 2008 and offered competitive solutions for depositors. Depositors have now been paid back. The entity is in the process of being closed and wound down.

*Kaupthing Bank Finland* was a branch of the Bank. The branch offered a wide range of investment banking services to companies, institutions and wealthy private individuals. Following the appointment of the Resolution Committee the Finnish FSA took charge of the branch on 9 October 2008.

A few days after 9 October 2008, the Resolution Committee managed to prevent the entity from going into administration along with the associated potential fire sale of assets to protect the asset base of the Bank. In co-operation with the Finnish authorities, the Resolution Committee negotiated loans to the entity with three commercial banks in Finland which were guaranteed in part by the Finnish authorities. This enabled the entity to repay deposits in the branch. The credit portfolio and certain other assets of Kaupthing Bank Finland were pledged against these loans. The asset management operation has been sold as well as a part of the loan portfolio. The remaining part of the loan portfolio has been transferred to the parent company and is now managed by specialists in the asset management team. The branch was closed down at the end of January. Had the entity ended up in administration, the assets of the entity would have been sold in order to pay back depositors and it is unlikely that any assets would have been transferred to the Bank in Iceland. Therefore, the Resolution Committee believes that this was the best solution for the Bank as it prevented potential fire sale of assets and instead, assets of appr. EUR 107m at nominal value were retrieved.

*Kaupthing EDGE Germany* is a branch of the Bank. It was established in 2008 and offered competitive solutions for depositors. The operation has been seized by the German government, and its assets have been frozen by the German Financial Regulatory Authority, BaFin.

The Bank has secured sufficient funds to repay all deposits back to depositors of the entity. The Bank has been committed to paying back all priority claims as quickly as possible and has placed great importance on settling the claims of the depositors of the entity. When this repayment has been made, the Bank will have repaid all deposits defined by Icelandic law as priority claims, i.e. deposits made at the parent company and at branches belonging to the parent company.

Despite great efforts, due to various complications, this process has been more time consuming than originally anticipated. Most of these difficulties have now been resolved. However, the Bank is still working on some technical issues with regard to the payment procedure.

Furthermore, DZ Bank AG, which was appointed as the payment agent for the entity's customers, seized EUR 55m, which in the opinion of the Bank should have been used to reimburse the entity's depositors. There is every indication that this matter will have to be resolved in court but it will not affect the Bank's decision to pay out all deposits.

Kaupthing Bank and the German authorities have had comprehensive discussions on this matter in the last few months to develop a solution which fully ensures the secure repayment of deposits to the Bank's customers.

The entity's depositors will receive a letter from the Bank outlining the payment procedure. Customers will have the opportunity to change their contact and account details. Thereafter, the balance of deposits as it was when the entity was placed into moratorium will be repaid.

The Bank would again like to thank the entity's depositors for their continued patience. As before, depositors are encouraged to visit the Bank's online information centres www.kaupthing.com and www.kaupthingedge.de. Further information and instructions will be posted on these websites later in April.

*Kaupthing Bank Norway* is a branch of the Bank. Kaupthing entered the market in Norway in 2003, when the Bank acquired Tyren Holding AS, an asset management company. The branch provided comprehensive financial services including asset management, in a separate entity, and private banking to wealthy private individuals, investment banking and capital markets services to companies, institutional investors and private clients. In addition, it had started to provide their clients with banking services, adding retail banking and corporate banking to its range of services.

On 11 October 2008, the Norwegian government placed a freezing order on the assets of the entity and related companies and placed the operation of the branch under administration. In co-operation with the Norwegian government, the Resolution Committee managed to prevent the immediate sale of assets from the entity, something which otherwise would have been done to enable it to pay back depositors. Instead, the deposits held by the branch were repaid to depositors by the Norwegian Banks' Guarantee Fund. In February, the Resolution Committee and the administrators in Norway reached an amicable agreement which included release of the assets which were under administration in Norway. As a result, the majority of the corporate loan portfolio has been transferred to the Bank in Iceland and other assets saved from imminent fire sale. This agreement also prevented lengthy and very costly process of dealing with the administrators and netting the entity. If the Resolution Committee had not managed to prevent the immediate sale of assets from the entity, the entity had presumably only been able to pay back part of the deposits and no assets would have been left to be transferred to the parent company. The result is that imminent fire sale of assets was prevented which resulted in retrieval of assets of appr. EUR 300m at nominal value.

*Kaupthing Bank Dubai and Qatar* were two branches of the Bank, one in the Dubai International Financial Centre and one in the Qatar Financial Centre, both established in 2007. The branches focussed on providing investment banking services in the region. The ongoing operations of the branches have been sold to the Bank's previous management in Dubai and Qatar. The proceeds from the sale are held by the Bank.

## *3.6 The current organizational structure of the Bank*

The Resolution Committee shares the creditors' desire to maximize the value of the Bank's estate and recognizes that this may take a significant period of time to achieve. As previously discussed, one of the Resolution Committee's main aims is to safeguard the value of the Bank's assets until they are transferred to the creditors in whatever form. In order to achieve this goal, the Resolution Committee must possess the requisite expertise to manage the assets and to provide the necessary services. Therefore the Resolution Committee has hired experts in various fields to manage the Bank's assets, which include the loan portfolio, bonds, shares, and foreign subsidiaries and branches.

The analysis of the tasks of the Resolution Committee, outlined in subchapter 3.3, was the first step towards making the work of the Resolution Committee and the Bank more efficient. The Resolution Committee's next step in this process was to hire experts with the requisite knowledge of the tasks of the Resolution Committee and asset management.

The bank operates, today, as an asset management company where long-term goals are the key factor. It is clear from the discussions the Resolution Committee has had with several creditors that the main focus for creditors is for them to recover as much of their claims as possible, but the time frame for getting reimbursed is more flexible.

As stated above, the Resolution Committee has hired skilled employees specialized in the fields in which the Bank most needs them. Four divisions have been created which report to the Resolution Committee and each division has a managing director responsible for the operation of that division.


*Asset management*

The purpose of the unit is to develop the Bank's assets with the ultimate goal of securing maximum recovery from these assets. This is amongst other done by pro-active management of every asset, maintaining a cash flow plan for the Bank's loan portfolio which is updated regularly; by assessing the capital requirements of the asset portfolio and the Bank's capacity to meet this. The Bank's loan portfolio consists of more than 100 borrower groups and the total outstanding notional is around ISK 962bn as at 15 November 2008.

The objective of the division is to maintain and support the Bank's asset portfolio, increase the value of the asset portfolio and prevent a "fire sale" of assets. It is expected that the asset portfolio will be self-financing and instalments and interest payments on the loans will be sufficient to support other assets if needed. Furthermore, it is expected that fees generated from the loan portfolio will cover the costs of running the asset management division.

The asset management division is the largest division in the Bank. In this team, the Bank has hired specialists with a diversified background and experience across corporate finance, corporate banking private equity, leverage finance, restructuring and workouts supported with a team of legal specialists with extensive experience across all legal aspects of banking transactions.

There are 17 employees in this division, most of whom are very experienced in the investment & corporate banking field with 8-17 years experience in the industry from international reputable financial institutions. The specialists in the asset management division lead the projects internally and the process is supported by an external advisory service as needed.

The employees' comprehensive experience in investment and corporate banking includes multiple restructuring projects, both domestically and internationally. Prior projects include, capital restructurings, debt to equity conversions, complex modelling, negotiations and shareholder agreement revisions. Some members of staff have worked on both sides of the fence, that is whilst employees or managers of respective businesses and also from the banking side.

Tasks where the asset management has engaged with external advisers include corporate finance advisory, due diligence reports, business verification, tax planning and appraisal and valuation.

*Legal counsel*
The legal counsel division provides legal advice wherever needed on asset management and Resolution Committee projects. The division also supervises the hiring of outside legal experts, both in Iceland and abroad, and the work they provide and is expected to have the requisite expertise on legal aspects of all agreements and related documents. The division also has an overview of all legal agreements and the services provided and costs incurred by external legal advice.

The legal counsel division provides support to the Resolution Committee and all the divisions within the Bank. There are several legal experts in this division with extensive knowledge in financial legislations, the Icelandic bankruptcy legislation and the legal aspects of netting and set-off. They also seek legal advice externally as needed.

*Finance*
The role of the finance division is to supervise the Bank's finances.

The FME's decision dated 6 March 2009 stated that terms of the financial instrument which will be issued by the new banks to the old banks as a payment for the net asset value transferred to the new banks, will be concluded no later than 18 May 2009. This implies that the finalized initial balance sheet and the financial statements as at YE 2008 will be ready shortly after 18 May 2009. In addition, finance has finalized a budget for 2009 for each division.

The division is currently working on merging Icelandic subsidiaries into one subsidiary which is called Kirna. All cash held in Icelandic subsidiaries have been transferred to parent. In addition, assets from foreign branches are being transferred to the parent company and several foreign branches are in winding and closing down process.

The division is also currently working on internal processes and procedures which are being fine-tuned. Back office and book-keeping tasks have all been outsourced to New Kaupthing.

*Creditor & Portfolio management*
Creditor management is responsible for relations with creditors. The team manages the relationship with Morgan Stanley, the Bank's financial advisor and provides them with the necessary support. The team also organizes and prepares meetings, conference calls and memos to the ICC and other creditors when needed. In addition, the team maintains the online information centre for creditors, www.kaupthing.com.

The portfolio management function provides support to the asset management team. It analyses the Bank's loan portfolio both on an aggregate level and on individual exposure basis. This entails tasks like collateral analysis, covenant monitoring, cash flow projections, credit risk analysis, etc.

# 4. Asset sales and restructuring

## 4.1 General approach and rationale

As discussed in the previous chapter, the Resolution Committee is committed to protecting the asset base of the Bank. The committee fully realizes that current market conditions are unlikely to produce acceptable values for many of its assets. Therefore, the Resolution Committee is determined to support the assets of the Bank where practicable to reach maximum value and does not entertain any "fire sale" bids.

To minor extent, however, the Resolution Committee has disposed of overseas assets. These disposals have been driven by a mix of two things: i) local regulatory authority “freeze of assets” or agreements to prevent the freezing of certain assets; and ii) acceptable bid prices taking into account the future funding support needed for maintaining these assets.

The Resolution Committee has taken measures to ensure that certain foreign assets would not be sold at "fire sale" prices by reaching agreements with three countries in which the Bank had entities in insolvency proceedings – i.e. the Swedish government, the Finnish government and the Norwegian government. The relevant agreements provide that the governments will not sell assets at the current distressed levels but will instead aim to sell assets in such a way that the maximum value possible is obtained for each asset. This arrangement is likely to ensure that the best possible prices will be obtained for the assets and makes it more likely that proceeds will flow back to the Bank and as a result increase proceeds paid to creditors.

## 4.2 Assets sold to date

The following assets have been sold from the parent company on behalf of the Resolution Committee.

*Kaupthing Bank Dubai and Qatar* was primarily an investment banking services operation based on human capital and fees from mandates. It became evident that it would be expensive to close down the operations and it was therefore more economic to sell the assets and liabilities of the branches to its employees. The proceeds from the sale are held by the Bank.

*A loan to a UK real estate holding company* was sold a few weeks after 9 October 2008 of the Bank. This asset was easily marketable and was sold at a fair price. The Bank needed cash to support other assets and since the bid price was considered fair, it was accepted.

*A 20% stake in the asset management firm Drake Management* was also sold a few weeks after the fall of the Bank. This asset was easily marketable and was sold at a fair price. The Bank needed cash to support other assets and since the bid price was considered fair, it was accepted.

The following assets have been sold from the branches of the Bank.

*A loan to a Norwegian equipment manufacturer* was sold to repay the Norwegian Banks' Guarantee Fund which paid Kaupthing Norway depositors.

*Kaupthing Bank Asset Management* operations in Finland and certain loans from the loan book in Finland that received satisfactory bids were sold to pay back part of a loan from the Finnish government.

The following assets have been sold from the subsidiaries of the Bank as far as the Resolution Committee is aware.

*Kaupthing Pension Consulting* and *Kaupthing Finans* AB have been sold as these business lines did not constitute a core business for Kaupthing Bank Sweden and the latter would have required continued financial support. The proceeds were used to pay back part of a loan from the Swedish Central Bank which was granted to Kaupthing Sweden on 8 October.

At the end of March, the Resolution Committee closed a transaction with Ålandsbanken Abp where the latter acquired the private banking, capital markets and asset management assets of Kaupthing Bank Sweden. More details on the transaction can be found in chapter *3.4 Current status of the Bank's subsidiaries*.

The aggregate book value of the assets sold by the Resolution Committee from the parent company and its branches in voluntary sales is less than EUR 65m but in addition, some forced assets sales have taken place to pay back deposits, which have been defined as priority claims.

## *4.3 Assets restructured to date*

The Resolution Committee shares the creditors' desire to maximize the value of the Bank's estate and recognizes that this may take a significant period of time to achieve. Assets are only sold if they require support beyond the means of the Bank or if a satisfactory bid price can be achieved for them after taking into account the future funding support needed to maintain these assets. Other assets should be preserved and protected until market conditions improve with temporary support from the Bank when and where deemed necessary. This should ensure that the maximum value for each asset can be passed on to creditors of the Bank at a later stage.

The Bank implements pro-active management to ensure maximum recovery for the Bank's assets. The Bank's loan portfolio consists of more than 100 borrower groups and the total outstanding notional was around ISK 962bn as at 15 November 2008. The Bank monitors several borrowers in its loan book very closely and has been or is currently working on restructuring several groups. When appropriate, the Resolution Committee appoints external advisors and consultants to ensure expertise in every case. Depending on the nature of the project, these external parties can be financial advisors, legal counsels, real estate consultants, accountants, auditors, etc. The cost of these is in most cases paid by each respective borrower. The Bank has acquired a controlling interest in companies and nominated board members were it deems necessary. If a debt facility in the Bank's books needs capital restructuring or a debt equity conversion, the Bank will analyse the case and then execute if it makes sense from a commercial point of view. To date, the Bank has had few cases where capital restructuring or a debt equity conversion is necessary action to protect asset values.

*Mosaic Fashions.*
The Bank and the former senior management of Mosaic Fashions have established Aurora Fashions to take over the retail chains Karen Millen, Coast, Warehouse and Oasis, which all previously belonged to Mosaic Fashions. The administrators which were appointed to Mosaic Fashions sold in an asset deal parts of Shoe Studio to Dune and parts of the Principles assets to Debenhams. This operation was completed with considerable efforts from foreign reputable consultants, including Deloitte, DLA Piper and BDO Stoy Hayward.

Since last autumn Mosaic Fashions had been experiencing significantly deteriorating earnings due to the UK recession and financial difficulties because of its balance sheet. As a result Mosaic Fashions was forecasting an additional cash requirement and potentially required new money to fund working capital. The Resolution Committee refused to provide necessary working capital for the group as it was as it would only be a temporary solution for the company and its unsustainable business model.

After attempts to restructure the business in consultation with key stakeholders, the company's board of directors decided at a meeting on 1 March 2009 to request that the company be put into administration. This step was necessary as it seemed clear that the company would not be able to meet its obligations to its creditors. Attempts to restructure the business with a view to securing its continued operations have failed.

Aurora Fashions is now financially sound, moderately leveraged, with reduced capital requirements and should be fit to meet the challenges of the current market. The new structure will strengthen these brands by reducing debt, bringing a greater focus to operations, increasing liquidity and providing opportunities to create a more flexible cost structure by reducing fixed expenses. The transaction has been successful. Going forward the aim is to further stabilize the operation, continue focusing on de-leveraging the business but also preserve the upside if and when the retail market recovers. Once the benefits of Aurora's strategy become evident, the Resolution Committee is confident that there will be a significant recovery for the Bank.

The Bank managed to secure the future of Mosaic's most valuable brands in order to protect the Bank's position. The recovery of the Bank's claims would have been low in case of the entity's bankruptcy.

*All Saints.*
The Bank has reached an amicable agreement with the main shareholders of the British retail chain All Saints, which will consolidate the company's position as the leading design led brand on the British market. The agreement signals a successful solution to the injection granted to Kaupthing in the British courts recently and parties are looking forward to continue to work together.
All Saints was founded in 1994 and in 2003 was acquired by Kevin Stanford when its sales were less than GBP 5m. Since then the company has been transformed into a brand that occupies a strong position on the British High Street. The company has demonstrated robust growth in both revenues and strong LFL performance in very challenging market conditions. All Saints current management team, led by Kevin Stanford as chairman and Stephen Craig as CEO, will continue to lead the business going forward. The Bank rates the company's prospects positive going forward despite the difficult conditions in the UK retail market. This agreement removes the uncertainty over the company's shareholding, and will allow it to continue its growth.

*Former Middlesex Hospital Site.*
Kaupthing is currently engaged in exclusive discussions with Stanhope PLC, one of Britain's leading property developers, regarding the development of the former Middlesex Hospital site. If an agreement is reached, Stanhope will oversee the development, design and reorganisation of the site with the aim of maximising its value. Should it go ahead, Stanhope will also inject new capital into the project. No agreement has yet been signed but the Resolution Committee of Kaupthing Bank wishes to clearly state that the site has not been sold and that if a partnership agreement is reached with Stanhope, the bank will retain majority control of the site. This is in line with the Resolution Committee's policy of maximising the value of the bank's assets.

# 5. Financial analysis

## *5.1 The Bank/New Kaupthing split*

On 6 October 2008 the Disbursement Act was passed by the Icelandic parliament, providing the FME with the authority and power to intervene in the operations of financial undertakings in order to respond to the unusual circumstances in the Icelandic financial sector. On 9 October 2008, in accordance with the same act, the FME appointed the Resolution Committee to take control of the Bank. On 21 October 2008, the FME issued the Transfer Decision, by which it determined to transfer certain specific assets of the Bank and certain specific obligations of the Bank, to New Kaupthing, which is owned by the Icelandic government. According to the FME, these actions were taken to secure the continuation of vitally important domestic banking and payment services.

Under the Transfer Decision, New Kaupthing takes over all of the Bank's deposit liabilities in Iceland, and also the bulk of the Bank's assets that relate to its Icelandic operations, such as loans and other claims. Other assets and liabilities will remain in the Bank, which will in turn remain under the control of the Resolution Committee. In turn the FME initially decided that New Kaupthing shall issue a bond to the Bank, equivalent to the surplus of assets over liabilities at fair value. In a more recent statement, the FME recognizes that a different solution may be found for each bank and that not necessarily a bond but financial instruments will be defined to transfer payment from New Kaupthing to the Bank to compensate fair value for the net transfer of assets.

PwC has established a preliminary statement of net assets for New Kaupthing at the date of its establishment and conducted a valuation of the assets that remained in the Bank. Any currently released information on balance sheet numbers for the Bank and New Kaupthing should be regarded as preliminary only and may well change based on this process.

The FME has also appointed Deloitte to prepare an independent net asset valuation for New Kaupthing and Oliver Wyman has been appointed to co-ordinate the valuation process and review the valuation. The valuation of the net assets will take longer than initially envisaged. According to the FME, the preparation of the valuation of net assets by Deloitte is to be completed by the end of March 2009 and the review of the valuation of the net assets by Oliver Wyman is to be completed no later than 15 April 2009.

PwC has audited the asset transfer from the Bank to New Kaupthing to ensure that it was completed in full accordance with the FME transfer decision. PwC has completed their revision and have concluded that some assets that were initially moved to New Kaupthing should have stayed with the Bank. Hence, this has now been corrected and these assets will increase the size of the corporate loan portfolio of the Bank. It should be added that all cash flow to and from the assets since the FME transfer decision was made will be compiled and corrected for between the two banks.

The Resolution Committee supports these amendments as they are in full accordance with the FME transfer decision and the committee consider these assets to be above average quality of the Bank's assets. It should also be noted that these amendments will consequently decrease the size of the compensation instrument.

The current estimated balance sheet of New Kaupthing and its development, based on the above except PwC auditing of the asset transfer, are presented in the table below.

| *All amounts in ISKbn* **Assets** | **Book value of assets transferred to New Kaupthing 22.10.2008** | **Preliminary Fair Value Adjustments** | **New Kaupthing before capital injection and bond issue** | **Bond Issue and Capital injection (outstanding)** | **New Kaupthing Opening balance sheet (estimate) 22.10.2008** |
|---|---|---|---|---|---|
| Cash and balances with central banks .......................... | 2 | | 2 | 75 | 77 |
| Loans to credit institutions ............................................ | 47 | (20) | 27 | | 27 |
| Loans to customers ...................................................... | 1.410 | | 1.410 | | 1.410 |
| Impairment on loans to customers ................................ | (19) | (935) | (954) | | (954) |
| Bonds and debt instruments .......................................... | 44 | | 44 | | 44 |
| Shares and instruments with variable income ............... | 22 | | 22 | | 22 |
| Investments in associates ............................................. | 9 | | 9 | | 9 |
| Investments in subsidiaries ........................................... | 12 | | 12 | | 12 |
| Property and equipment ................................................ | 9 | | 9 | | 9 |
| Other assets .................................................................. | 44 | | 44 | | 44 |
| **Total Assets** | 1.580 | (955) | 625 | 75 | 700 |
| **Liabilities** | | | | | |
| Due to credit institutions and central banks ................... | 78 | | 78 | | 78 |
| Deposits ......................................................................... | 339 | | 339 | | 339 |
| Borrowings ..................................................................... | | | | | |
| Other liabilities ............................................................... | 34 | | 34 | | 34 |
| Bond issued to old Bank ................................................ | | | | 174 | 174 |
| **Total Liabilities** | 451 | | 451 | 174 | 625 |
| **Equity** | | | | | |
| Shareholders' equity ...................................................... | | | | 75 | 75 |
| Other equity ................................................................... | 1.129 | (955) | 174 | (174) | |
| **Total Equity** | 1.129 | (955) | 174 | (99) | 75 |
| **Total Liabilities and Equity** | 1.580 | (955) | 625 | 75 | 700 |
| Exchange rate (EUR/ISK) | 150,245 | 150,245 | 150,245 | 150,245 | 150,245 |

## *5.2 The Bank's balance sheet*

The financial information in the next three subchapters is based on 15 November 2008 which was the cut-off date the Moratorium Supervisor was obligated to use according to the Icelandic Act on Bankruptcy, etc., No. 21/1991 ("Bankruptcy Act") in his presentation of the Bank's financial information presented at the Creditors' Meeting held on the 5 February 2009.

Readers' attention is drawn to the terms of the disclaimer at the beginning and the end of this report.

Below is the balance sheet of the Bank at book value as at 15 November 2008. The Bank's balance sheet as at 30 June 2008 is included to facilitate comparison with the latest reviewed accounts. Further discussions on the notes can be found in the next subchapter, *5.2 Further breakdown of the Bank's balance sheet*.

| *All amounts in ISKm* | | 15.11.2008 | 30.06.2008 |
|---|---|---|---|
| **Assets** | **Notes** | | |
| Cash and balances with central banks | | 4.012 | 11.591 |
| Loans to credit institutions | 1 | 235.300 | 901.441 |
| Loans to customers | 2 | 962.788 | 1.665.889 |
| Bond from New Kaupthing | 3 | 173.761 | |
| Bonds and debt instruments | 4 | 299.562 | 241.872 |
| Shares and instruments with variable income | 5 | 184.998 | 199.841 |
| Derivatives | 6 | 347.162 | 135.766 |
| Derivatives used for hedging | | | 20.432 |
| Investments in associates | 7 | 69.611 | 106.580 |
| Investments in subsidiaries | 8 | 533.428 | 385.529 |
| Intangible assets | | | 50.001 |
| Property and equipment | | 628 | 9.120 |
| Tax assets | 9 | 2.519 | 1.453 |
| Other assets | 10 | 148.611 | 48.531 |
| **Total Assets** | | 2.962.380 | 3.778.046 |
| **Liabilities** | | | |
| Due to credit institutions and central banks | | 9.001 | 143.787 |
| Deposits | 11 | 96.104 | 496.086 |
| Financial liabilities measured at fair value | 12 | 148.384 | 111.701 |
| Borrowings | 13 | 2.867.206 | 2.284.341 |
| Subordinated loans | 14 | 456.707 | 292.925 |
| Tax liabilities | | 150 | 55 |
| Other liabilities | 15 | 191.996 | 24.945 |
| **Total Liabilities** | | 3.769.548 | 3.353.840 |
| **Equity** | | | |
| Share capital | | 7.270 | 7.187 |
| Share premium | | 136.591 | 148.362 |
| Other reserves | | 132.241 | 61.196 |
| Retained earnings | | (1.083.270) | 207.461 |
| **Total Equity** | | (807.168) | 424.206 |
| **Total Liabilities and Equity** | | 2.962.380 | 3.778.046 |
| Exchange rate (EUR/ISK) | | 171,077 | 124,390 |

## *5.3 Further breakdown of the Bank's balance sheet*

*All amounts in ISKm*

**Note 1: Loans to credit institutions**

| Loans to credit institutions specified by types of loans: | Pledged | Unpledged | Total |
|---|---|---|---|
| Money market loans | | 14.239 | 14.239 |
| Bank accounts | | 167.998 | 167.998 |
| Bank accounts subsidiaries | 27.184 | | 27.184 |
| Net position against subsidiaries | | 25.879 | 25.879 |
| **Loans to credit institutions** | 27.184 | 208.116 | 235.300 |

**Note 2: Loans to customers**

a. Loans to customers specified by types of loans:

| | Pledged | Unpledged | Total |
|---|---|---|---|
| Subordinated loans | | 4.333 | 4.333 |
| Other loans | | 958.455 | 958.455 |
| **Loans to customers** | | 962.788 | 962.788 |

b. Loans to customers specified by sectors:

| | |
|---|---|
| Individuals | 52.000 |
| Holding companies | 318.210 |
| Industry | 186.758 |
| Real estate | 157.809 |
| Service | 136.185 |
| Trade | 111.825 |
| **Loans to customers** | 962.788 |

c. Loans to customers specified by geograpical region:

| | |
|---|---|
| UK | 661.067 |
| Scandinavia | 122.681 |
| Luxemourg | 83.415 |
| Other counties | 95.624 |
| **Loans to customers** | 962.788 |

d. Loans to customers - breakdown by currency

| | |
|---|---|
| GBP | 524.719 |
| USD | 224.330 |
| EUR | 144.418 |
| Other | 69.321 |
| **Loans to customers** | 962.788 |

e. 10 largest loans to customers - sector and country

| | |
|---|---|
| UK / Service | 85.251 |
| UK / Trade | 72.834 |
| UK / Industry | 60.351 |
| UK / Trade | 59.486 |
| UK / Individual | 50.488 |
| Luxembourg / Holding | 43.200 |
| UK / Real estate | 42.065 |
| UK / Holding | 41.200 |
| UK / Holding | 31.422 |
| UK / Holding | 26.663 |
| **10 largest loans to customers** | 512.962 |

## Note 3: Bond from New Kaupthing

| | |
|---|---|
| Bond from New Kaupthing | 173.761 |

Under the Transfer Decision, New Kaupthing takes over all of the Bank's deposit liabilities in Iceland, and also the bulk of the Bank's assets that relate to its Icelandic operations, such as loans and other claims. In turn New Kaupthing shall issue a bond/security to the Bank, equivalent to the surplus of assets over liabilities at fair value. PwC has established a preliminary statement of net assets for New Kaupthing at the date of its establishment, 22 October 2008. This preliminary statement is used as a basis for the current valuation of the bond. The value in terms of the bond/security have not been finalised and the ultimate value of this instrument is presently uncertain and its value is likely to be materially different from the value recorded here. Further information can be found in chapter *5.1 The Bank/New Kaupthing split.*

## Note 4: Bond and debt instruments

Bond and debt instruments are specified as follows:

| | Pledged | Unpledged | Total |
|---|---|---|---|
| *Bonds and debt instruments:* | | | |
| Listed | 234.113 | 11.267 | 245.380 |
| Unlisted | 21.042 | 33.140 | 54.182 |
| **Bonds and debt instruments** | 255.155 | 44.407 | 299.562 |
| *10 largest positions:* | | | |
| 1 Central Bank of Iceland | 17.717 | | 17.717 |
| 2 Housing Financing Fund | 16.182 | | 16.182 |
| 3 Housing Financing Fund | 15.391 | | 15.391 |
| 4 Housing Financing Fund | 11.632 | | 11.632 |
| 5 Credit Suisse International | | 8.039 | 8.039 |
| 6 Glitnir Banki | 4.959 | | 4.959 |
| 7 Housing Financing Fund | 4.926 | | 4.926 |
| 8 Hypo Public Finance Bank | 4.732 | | 4.732 |
| 9 Ssif Nevada Lp | 4.394 | | 4.394 |
| 10 Capitalia Societa Per Azioni | 4.316 | | 4.316 |
| **Bonds and debt instruments** | 84.249 | 8.039 | 92.288 |

## Note 5: Shares and instruments with variable income

Shares and instruments with variable income are specified as follows:

| | Pledged | Unpledged | Total |
|---|---|---|---|
| *Shares and instruments with variable income:* | | | |
| Listed | 138.235 | 2.410 | 140.644 |
| Unlisted | 2.449 | 41.905 | 44.354 |
| **Shares and instruments with variable income:** | 140.683 | 44.315 | 184.998 |
| *10 largest positions:* | | | |
| 1 Trade / UK | 45.451 | | 45.451 |
| 2 Financial / Scandinavia | 30.233 | 28 | 30.260 |
| 3 Industry / UK | 27.208 | | 27.208 |
| 4 Industry / UK | 21.247 | | 21.247 |
| 5 Service / Scandinavia | 8.416 | | 8.416 |
| 6 Trade / UK | | 7.509 | 7.509 |
| 7 Trade / UK | | 6.854 | 6.854 |
| 8 Real estate / Other | | 5.632 | 5.632 |
| 9 Industry / Iceland | 5.439 | | 5.439 |
| 10 Holding / Other | | 4.943 | 4.943 |
| **Shares and instruments with variable income:** | 137.994 | 24.966 | 162.960 |

## Note 6: Derivatives

Derivatives are specified as follows:

| | |
|---|---|
| Asset swaps | 48.236 |
| FX contracts | 88.701 |
| Interest rate swap | 204.813 |
| Options | 5.242 |
| Other derivatives | 170 |
| **Derivatives:** | 347.162 |

Derivatives specified by financial and nonfinancial counterparties:

| | |
|---|---|
| Financial | 295.846 |
| Non financial | 51.316 |
| **Derivatives:** | 347.162 |

### Note 7: Investment in associated companies

Instruments in associated companies are specified as follows:

| | Pledged | Unpledged | Total |
|---|---|---|---|
| *Associated companies:* | | | |
| Listed | 62.299 | | 62.299 |
| Unlisted | | 7.312 | 7.312 |
| **Associated companies:** | 62.299 | 7.312 | 69.611 |
| *Positions:* | | | |
| Storebrand | 62.299 | | 62.299 |
| Finoble | | 645 | 645 |
| KP II BV | | 6.667 | 6.667 |
| **Associated companies:** | 62.299 | 7.312 | 69.611 |

### Note 8: Investment in subsidiaries

Instruments in subsidiaries are specified as follows:

| | Pledged | Unpledged | Total |
|---|---|---|---|
| *Subsidiaries:* | | | |
| Listed | | 10.665 | 10.665 |
| Unlisted | 260.110 | 262.653 | 522.763 |
| **Subsidiaries:** | 260.110 | 273.318 | 533.428 |
| *Positions:* | | | |
| FIH | 238.605 | | 238.605 |
| Kaupthing Bank Luxembourg | | 70.641 | 70.641 |
| Kaupthing Singer & Friedlander | | 91.345 | 91.345 |
| Norvestia | | 10.665 | 10.665 |
| Kaupthing Sverige | 21.505 | | 21.505 |
| Singer & Friedlander Isle of Man Holdings Ltd. | | 14.425 | 14.425 |
| Kirna and subsidiaries | | 70.101 | 70.101 |
| New Bond Street Diversified Fund | | 8.320 | 8.320 |
| Kaupthing ASA | | 3.276 | 3.276 |
| Fron Insurance | | 1.736 | 1.736 |
| Other | | 2.809 | 2.809 |
| **Subsidiaries:** | 260.110 | 273.318 | 533.428 |

### Note 9: Tax assets

Tax assets are specified as follows:

| | |
|---|---|
| Prepaid income tax for 2007 | 2.519 |
| **Tax assets** | 2.519 |

### Note 10: Other assets

Other assets are specified as follows:

| | |
|---|---|
| Unsettled derivatives | 118.194 |
| Accounts receivables | 24.935 |
| Accrued income | 2.518 |
| Prepaid expenses | 1.267 |
| Non-current assets and disposal groups classified as held for sale | 78 |
| Sundry assets | 1.618 |
| **Other assets** | 148.611 |

Unsettled securities trading are specified as follows:

| | |
|---|---|
| Against financial counterparty | 93.233 |
| Against non financial counterparty | 24.961 |
| **Unsettled securities trading** | 118.194 |

### Note 11: Deposits

Deposits are specified as follows:

| | |
|---|---|
| Deposits in Germany branch | 48.415 |
| Deposits linked to loans | 47.689 |
| **Deposits** | 96.104 |

## Note 12: Financial liabilities at fair value

Financial liabilities are specified as follows:

| | |
|---|---|
| Asset swaps | 12.348 |
| FX contracts | 13.812 |
| Interest rate swap | 59.875 |
| Options | 4.434 |
| CDO | 51.397 |
| Other derivatives | 6.518 |
| **Financial liabilities** | 148.384 |

Financial liabilities specified by financial and nonfinancial counterparties:

| | |
|---|---|
| Financial | 114.844 |
| Non financial | 33.540 |
| **Financial liabilities** | 148.384 |

## Note 13: Borrowings

Borrowings are specified as follows:

| | |
|---|---|
| Bonds issued | 1.882.779 |
| Bills issued | 67.849 |
| Money market loans | 348.549 |
| Other loans | 568.029 |
| **Borrowings** | 2.867.206 |

Bonds issued are specified as follows:

| | |
|---|---|
| 144A | 503.971 |
| EMTN | 1.252.103 |
| Samurai | 103.285 |
| Domestic | 17.945 |
| Covered Bonds | 5.475 |
| **Bonds issued** | 1.882.779 |

Money Market loans are specified as follows:

| | |
|---|---|
| Central Bank of Iceland - Repo loans | 222.352 |
| Other banks | 126.197 |
| **Money Market loans** | 348.549 |

Other loans:

| | |
|---|---|
| Other banks | 568.029 |
| **Other loans:** | 568.029 |

## Note 14: Subordinated loans

Subordinated loans are specified as follows:

| | |
|---|---|
| EMTN Tier 1 | 101.290 |
| Stand alone Tier 1 | 95.552 |
| Domestic Tier 1 | 4.618 |
| 144A Lower Tier 2 | 173.163 |
| EMTN Lower Tier 2 | 82.084 |
| **Subordinated loans** | 456.707 |

## Note 15: Other liabilities

Other liabilities are specified as follows:

| | |
|---|---|
| Unsettled derivatives | 102.194 |
| Liabilities to Norway and Finland regarding deposits | 85.025 |
| Accounts payable other | 4.387 |
| Accrued income / prepaid income | 390 |
| **Other liabilities** | 191.996 |

Unsettled derivatives are specified as follows:

| | |
|---|---|
| Against financial counterparty | 77.233 |
| Against non financial counterparty | 24.961 |
| **Unsettled securities trading** | 102.194 |

## 5.4 Estimated valuation of the Bank's assets

According to article 13 of Act no. 21/1991 on Bankruptcy etc. the Moratorium Supervisor is obliged to invite the creditors of the Bank to a meeting. This was done on 5 February 2009. According to article 14 of the same act, the Moratorium Supervisor is obliged to present his estimate of the Bank's assets and liabilities as at the reference date, 15 November 2008, at the creditors' meeting. The act does not specify which criteria or methodology companies in a moratorium are obliged to use.

The summary below, which has not been audited, has been prepared by employees of the Resolution Committee who are familiar with the assets in question. It should be emphasized that this valuation has been prepared using the current criteria on 15 November 2008. The valuation of the Bank's assets is based on the estimated sale price of the assets in November 2008, i.e. as if all the Bank's assets had been sold in the market at that time. The valuation has been prepared on the basis of a transaction between a willing seller and a willing buyer of the relevant asset. The valuation therefore does not take into account the current strategy of the Resolution Committee which assumes that the Bank's assets are supported and protected and prevents the assets from being sold in the current market conditions. In addition, the valuation does not take into account any potential increase in the value of assets resulting from the possible restructuring of the Bank. Due to the great uncertainty in the market and market conditions in the years to come, there was no attempt at this stage to assess the possible future value of assets. The below calculation of liabilities may not be complete or accurate as some of the existing or potential liabilities are subject to legal uncertainty.

This valuation does not take into account the possible impact of set-off and netting which will affect both the asset and the liability side of the balance sheet. The preliminary estimated impact of set-off and netting ranges from ISK 200-400bn, and this is very likely to make a material difference to overall creditor recoveries. To date, the Bank has received set-off and netting claims from counterparties for the total of approximately ISK 200bn but this figure can by no means be taken as conclusive due to two primary reasons. Firstly, counterparties have the right to claim until the end of the formal claim period which has not started yet as the Bank is in a moratorium and in that state it can only accept claims in accordance with Icelandic legislation on moratorium proceedings. Secondly, every case needs to be looked into and evaluated before each claim can be accepted or rejected. Therefore, the estimated size and impact of set-off and netting is still very uncertain.

Readers' attention is drawn to the terms of the disclaimer at the beginning and the end of this report.

| *All amounts in mISK* | Balance sheet 15.11.2008 book value | Pledged positions | Priority claims | Balance sheet 15.11.2008 after subtracting | Estimated valuation 15.11.2008 |
|---|---|---|---|---|---|
| **Assets** | (1) | (2) | (3) | (2) and (3) | |
| Cash and balances with central banks | 4.012 | | | 4.012 | 4.012 |
| Loans to credit institutions | 235.300 | (27.184) | | 208.116 | 100.000 |
| Loans to customers | 962.788 | | | 962.788 | 250.000 |
| Bond from New Kaupthing | 173.761 | | | 173.761 | 170.000 |
| Bonds and debt instruments | 299.562 | (255.155) | | 44.407 | 10.000 |
| Shares and instruments with variable income | 184.998 | (140.683) | | 44.315 | 10.000 |
| Derivatives | 347.162 | | | 347.162 | 90.000 |
| Investments in associates | 69.611 | (62.299) | | 7.312 | 0 |
| Investments in subsidiaries | 533.428 | (260.110) | | 273.318 | 20.000 |
| Property and equipment | 628 | | | 628 | 0 |
| Tax assets | 2.519 | | | 2.519 | 0 |
| Other assets | 148.611 | | | 148.611 | 100.000 |
| Priority Claims | | | (135.898) | (135.898) | (135.898) |
| **Total Assets** | 2.962.380 | (745.432) | (135.898) | 2.081.051 | 618.114 |
| Exchange rate (EUR/ISK) | 171,077 | 171,077 | 171,077 | 171,077 | 171,077 |
| **Liabilities** | | | | | |
| *Senior Liabilities* | | | | | |
| Due to credit institutions and central banks | 9.001 | | | 9.001 | |
| Deposits | 96.104 | | (48.415) | 47.689 | |
| Financial liabilities measured at fair value | 148.384 | | | 148.384 | |
| Borrowings | 2.867.206 | (745.432) | | 2.121.775 | |
| Tax liabilities | 150 | | | 150 | |
| Other liabilities | 191.996 | | (87.483) | 104.513 | |
| **Total Senior Liabilities** | 3.312.841 | (745.432) | (135.898) | 2.431.512 | |
| **Subordinated loans** | 456.707 | | | 456.707 | |
| **Equity** | | | | | |
| Share capital | 7.270 | | | 7.270 | |
| Share premium | 136.591 | | | 136.591 | |
| Other reserves | 132.241 | | | 132.241 | |
| Retained earnings | (1.083.270) | | | (1.083.270) | |
| **Total Equity** | (807.168) | | | (807.168) | |
| **Total Liabilities and Equity** | 2.962.380 | (745.432) | (135.898) | 2.081.051 | |
| Exchange rate (EUR/ISK) | 171,077 | 171,077 | 171,077 | 171,077 | |

# 6. The moratorium

## *6.1 Introduction*

On 21 November 2008 the Resolution Committee filed an application with the District Court of Reykjavik, pursuant to Bankruptcy Act to stay creditor actions in order to facilitate the financial reorganization of the Bank. On 24 November 2008 the Bank was granted a moratorium on payments until 13 February 2009. At an open hearing in court on 13 February 2009, the Resolution Committee and Olafur Gardarsson, the Moratorium Supervisor, filed the Resolution Committee's petition for a nine-month extension to the moratorium on payments. On 19 February 2009 the District Court of Reykjavík agreed to the request for the extension of the moratorium on payments until 13 November 2009.

The moratorium is a procedure under Icelandic law which has provided the Bank with appropriate protection from legal actions, such as the freezing of assets, and ensures that it is able to maintain a banking license sufficient to support its assets.

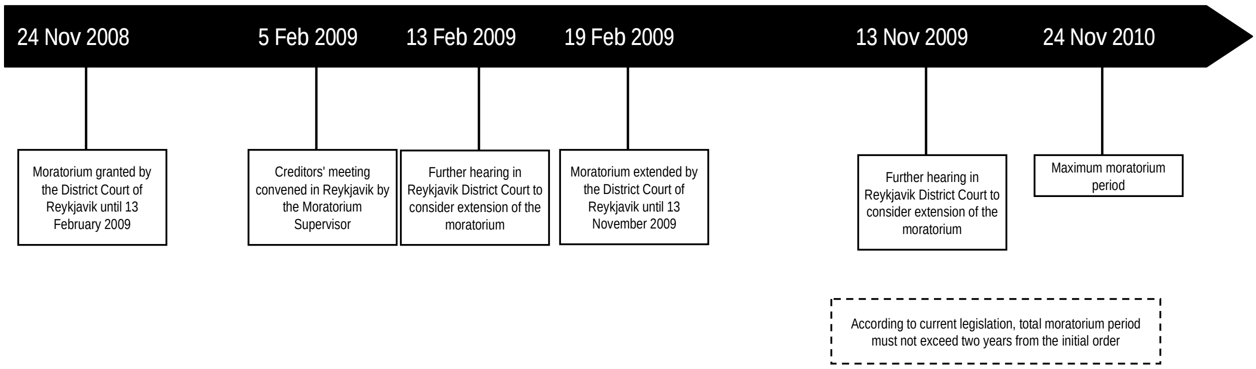
## *6.2 The Moratorium Supervisor*

As discussed above, Olafur Gardarsson, Attorney to the Supreme Court of Iceland and a partner of the Reykjavik Law Firm, was appointed as the Moratorium Supervisor. He has been a Supreme Court Attorney since 1992 and his areas of expertise include mergers and acquisitions, corporate and telecommunications law.

The Moratorium Supervisor has the power to oversee the distribution of assets of the Bank and the payment of claims during the moratorium. He will work with the Resolution Committee, which will continue to wield the powers of the Board of Directors of Kaupthing and will as such continue to have decision-making powers in accordance with Icelandic law. He must approve all major transactions undertaken by the Bank and ensure that no such transactions are in violation of the Bankruptcy Act. His aims are consistent with those of the Resolution Committee, namely to preserve assets and to optimize recoveries for the creditor body. He assists the Bank in its efforts to restructure its finances and to decide how best to achieve any reorganization. He has a duty to inform the District Court of Reykjavík if the Bank does not abide by the Moratorium Supervisor's directions or the provisions of the Bankruptcy Act.

## *6.3 Timeline for the moratorium*

According to Act No. 161/2002 on Financial Undertakings, the District Court can currently not authorize a moratorium lasting longer than a total of 24 months from the court hearing of 24 November 2008 and can only be extended for a maximum of 9 months each time an extension is granted. The Bank has been granted extension until 13 November 2009 when a court session shall be held again to consider the matter. At that time, further extension may be requested by the Resolution Committee if it believes that it will be in the best interests of creditors to extend the moratorium. If further extension will be requested, the Moratorium Supervisor is obligated to summon the Bank's creditors to another meeting which is to be held no later than three days prior to 13 November 2009. The development of the moratorium process so far, can be seen below.




## 6.4 Analysis of the moratorium legislation

While in moratorium, the Bank remains under the direction of the Resolution Committee which is responsible for the daily operations of the Bank in accordance with the Transfer Decision of 9 October 2008 but is also under the supervision of the Moratorium Supervisor. The Bank remains subject to Act No. 161/2002 on Financial Undertakings and the general supervision of the FME. The District Court of Reykjavik however has exclusive jurisdiction over the enforcement of the moratorium, its extension and termination.

The moratorium process restricts the payment of claims by the Bank, except to the extent it may be certain that the claim would be paid, considering its rank in the order of preference of claims, if the Bank were to enter insolvent liquidation following the moratorium. However, the payment of a debt or the performance of an obligation is allowed in order to prevent significant damage to the Bank. The Bank cannot, while in moratorium, dispose of the Bank's assets except in order to secure the day-to-day operations of the Bank, to effect the reorganization of the Bank's finances or if the disposal of an asset is necessary to protect the value of that asset. While in moratorium the Bank cannot assume new financial obligations unless that is done in order to continue the Bank's business operation or to forestall significant damage.

Most contractual or legal provisions providing for consequences of non-performance will not apply during the period of the moratorium. The Bank may not enter insolvent liquidation nor have its assets subject to an attachment, an execution or a forced sale while the moratorium remains in effect. No law suit can be commenced against the Bank while the moratorium is in effect unless such action is specifically provided for by law or relates to criminal proceedings.

## 6.5 Icelandic composition legislation overview

Under Icelandic law, a scheme of arrangement refers to an agreement on settlement or relinquishment of debts concluded between a debtor and a certain majority of his creditors, which is subsequently confirmed in court. When the scheme of arrangement settlement has been approved by the court it is binding on creditors and is to be implemented according to its terms.

A scheme of arrangement has the same objective as a moratorium: to address a debtor's financial difficulties. A scheme of arrangement seeks to solve a debtor's financial difficulties by proportionally reducing creditors' claims, whereas a moratorium gives the debtor a certain grace period to consolidate and reorganize its business with the hope that the debtor can increase, or at least preserve, the value of its financial interests. A scheme of arrangement process does not give rise to a stay on creditor action. However, a scheme of arrangement can be used as an exit route from a moratorium.

The original debts are extinguished on performance of the scheme of arrangement.

The minimum creditor support required is 60% by value and number of creditors voting. If the write-down is greater than 60% of the debt, then the minimum creditor support required to approve the scheme of arrangement is increased accordingly. If an alternative to the write-down of a debt is proposed – e.g. a debt for equity swap – the requisite creditor approval is also 60%.

The Resolution Committee would continue to wield the power of the board of directors during a scheme of arrangement proceeding and as such would continue to have the decision-making power. The court appointed supervisor would continue to work with the Resolution Committee during a scheme of arrangement proceeding.

## *6.6 Rationale for the moratorium*

One of the main tasks of the Resolution Committee and its employees has been to protect assets and safeguard the interests of creditors. The Bank's Resolution Committee believes that the interests of the creditors are best served by restructuring the Bank's operations and delaying the sale of assets until the market conditions improve. This is in accordance with the wishes of the creditors which have expressed their views to the Moratorium Supervisor and Resolution Committee. The committee is of the opinion that a sale of assets is a poor option under the current circumstances, since there are few potential buyers as a result of the economic downturn and difficulties affecting most western economies. The value of the Bank's assets is at a historical all-time low, access to credit for potential buyers is heavily restricted, to name but a few reasons. The Resolution Committee believes that the interests of the creditors are best served if the Bank's assets are held to maturity or sold over a longer period. The creditors and the experts consulted by the Resolution Committee are in agreement over this approach. This should mean that creditors recover a higher proportion of the claims than they would if assets were sold under the present circumstances.

Applying for the moratorium was, in the opinion of the Resolution Committee, a necessary step to ensure that all creditors of the Bank are treated fairly and appropriately in accordance with Icelandic law through the protection of the Bank’s assets.

The Resolution Committee is committed to protecting the interests of creditors by preventing the provisional attachment or freezing of assets. The moratorium has provided the Bank with appropriate protection from legal actions, such as the freezing of assets, and ensured that it maintains a banking licence sufficient to support its assets. In the European Economic Area the Bank seeks recognition of the moratorium on a case-by-case basis on grounds of the EU Winding-Up Directive No. 2001/24/EC. The Bank has also been granted recognition and injunctive relief under Chapter 15 of the United States Bankruptcy Code. This has provided the Bank with protection for its assets in the United States. The Resolution Committee has successfully opposed freezing orders in the United States and Luxemburg. Further freezing orders are being opposed in the Netherlands and Luxemburg. Without the moratorium, preventing proposed freezing orders would be considerably more difficult for the Bank, if not impossible.

The moratorium has and will continue to provide the “breathing space” needed for the Resolution Committee to concentrate on the tasks at hand within the Bank so that it can achieve its objectives to protect creditors' interests, maximise the recovery rate of claims and ensure equal treatment of creditors.

While protecting the Bank from certain actions by creditors, restrictions are also placed on the Bank in regards to its authorization to dispose of assets, to discharge liabilities and to assume new liabilities.

## 6.7 *Potential closing of the moratorium process*

As previously outlined, the Bank was granted a moratorium on debt payments and a license for financial reorganization in a court hearing on 24 November 2008. The District Court can currently not authorize a moratorium lasting longer than a total of 24 months from the court hearing, i.e. until 24 November 2010.

The moratorium process of the Bank would most likely conclude by means of either of the following:

i) Insolvent liquidation

If the moratorium period is not extended and the Bank is forced into insolvent liquidation, the Moratorium Supervisor and the Resolution Committee firmly believe that further value will be lost.

In a state of insolvency liquidation, the management of the assets of the Bank would vest in a liquidator. Claims against a bankruptcy estate denominated in foreign currency shall be converted into the Icelandic currency at the selling rate posted on the day when the bankruptcy order was issued and it is very likely that a trustee in bankruptcy will convert all liquid assets into the Icelandic currency in the event of insolvency in order to transfer the currency risk from the estate to the Bank's creditors. Such a measure would be understandable from the point of view of the trustee of the estate, but it may not be in the interests of the Bank's creditors.

According to the Bankruptcy Act, the trustee in bankruptcy shall ensure that the winding-up is concluded without undue delay. As stated above the Resolution Committee and the Moratorium Supervisor believe that the interests of the creditors are best served by restructuring the Bank's operations and delaying the sale of assets until the market conditions improve. It is therefore clear that the obligations of the trustee in bankruptcy according to the article may prevent this from happening. In addition, a Bank in insolvent liquidation would forfeit its banking license, face forced asset sales, and have less flexibility to support its assets. It is likely that performing loans to customers as well as listed and unlisted assets would be sold at a substantial discount.

It is the opinion of the Moratorium Supervisor and the Resolution Committee that this option would minimize debt recovery for the creditors of the Bank and it would not be in their best interests.

ii) Scheme of Arrangement

A scheme of arrangement seeks to solve a debtor's financial difficulties by proportionally reducing creditors' claims but at the same time allows the debtor to stay solvent. This arrangement endeavours to maximize debt recovery and preserves creditors' interest by granting the debtor the opportunity to be restructured and support assets instead of being forced into an immediate sale of assets. If the moratorium process of the Bank were to be concluded by scheme of arrangement, potential restructuring options of the Bank can be considered and evaluated. Further discussions on potential restructuring options can be found in chapter *7. Potential restructuring options.*

As discussed in subchapter *6.5 Icelandic composition legislation overview*, the minimum creditor support required for a scheme of arrangement is 60% in terms of value and the number of creditors voting. Claims are converted into Icelandic krona when the original composition application is made but distributions can be in any currency specified under the scheme.

It should be pointed out that the Resolution Committee and the Moratorium Supervisor are working towards a solution whereby the restructuring of Kaupthing will be completed by a scheme of arrangement with creditors in order to prevent the bank from entering insolvency proceedings, which would reduce the value of assets.

# 7. Potential restructuring options

In accordance with the FME's Transfer Decision, Kaupthing was divided into the Bank and New Kaupthing on 22 October 2008. As previously discussed in subchapter *5.1 The Bank/New Kaupthing Split*, New Kaupthing primarily consists of the domestic operations funded by local deposits. With the assistance of PwC, Iceland, a preliminary balance sheet statement of New Kaupthing was prepared and the government is currently committed to injecting equity into the New Kaupthing.

## *7.1 Valuation of assets transferred to New Kaupthing and the bond*

According to the Transfer Decision, New Kaupthing will issue a financial instrument to the Bank. The value of the financial instrument should represent the surplus of assets over liabilities at fair value. The terms of the financial instrument will be of great significance for the Bank and the recovery rate of the creditors' claims depends partly on the price obtained for the assets transferred to New Kaupthing.

The FME has also appointed Deloitte, UK, to prepare an independent net asset valuation for New Kaupthing and Oliver Wyman has been appointed to co-ordinate the valuation process which is ongoing and review the valuation. The methods used aim at "fair value measurement based on orderly transactions between market participants on the measurement date and not the price that would be achieved in a forced liquidation or distressed sale". The valuation criteria seek to consider the long-term economic environment in Iceland and not the immediate market value of Icelandic loans. The valuation of the net assets will take longer than initially envisaged. According to the FME, the preparation of the valuation of net assets by Deloitte is to be completed by the end of March 2009 and the review of the valuation of the net assets by Oliver Wyman is to be completed no later than 15 April 2009. Any currently released information on balance sheet numbers for the Bank and New Kaupthing should be regarded as preliminary only and may well change based on this process. The Bank and Morgan Stanley are envisaged to be granted access to a summary report from Oliver Wyman and Deloitte on the net assets transferred to New Kaupthing after 15 April 2009.

## *7.2 Other restructuring methods*

The creditors have stressed the importance of the Resolution Committee's protecting their interests during the current appraisal process. The Resolution Committee, as requested by representatives of the creditors, has appointed Morgan Stanley to advise on this process and to come up with ideas and proposals to resolve issues concerning New Kaupthing and the restructuring of Kaupthing. The Resolution Committee and Morgan Stanley have learned via discussions with creditors that they have several principal issues with the initial proposal presented by the FME in the initial Transfer Decision, where creditors were to be compensated for the forced net asset transfer to New Kaupthing with a bond issue and have suggested that consideration should be given to alternative options for structuring ownership of New Kaupthing.

Creditors would e.g. like to see the following objectives carefully looked into:

i) Avoid relying solely on the methodology suggested in the initial Transfer Decision in valuing the assets transferred to New Kaupthing as it is subject to various debatable assumptions

ii) Most of the potential future upside of the assets in New Kaupthing should flow back to creditors of the Bank

iii) If the government injects capital into New Kaupthing, some upside sharing with the government should be considered

iv) Most of creditors' exposure to New Kaupthing should be in the form of senior debt

## *7.3 The relationship between the Bank and New Kaupthing*

Rather than New Kaupthing paying the Bank for the transferred assets with just a bond issue and the Icelandic government as the sole owner of New Kaupthing as suggested in the initial transfer decision, a series of alternative ideas has been explored. Morgan Stanley's work on the reorganisation of the Bank including its relationship to New Kaupthing, carried out on behalf of the Resolution Committee is at a preliminary stage. Some preliminary alternative structure options have been developed by Morgan Stanley which take the above guiding principles for the mutual benefits of the Icelandic government and creditors into account. The objective is to devise solutions acceptable to all parties involved, including Icelandic and foreign creditors, the Icelandic government as owner of New Kaupthing and the Icelandic supervisory authorities. In the opinion of the Resolution Committee and the Moratorium Supervisor, it is not only in the interest of Kaupthing and its creditors to find a solution, but it is also in the interest of New Kaupthing, the Icelandic government and the general public. An agreement between the parties involved over the future of New Kaupthing will undoubtedly facilitate the support of the stakeholders for New Kaupthing including its funding, and thereby also facilitate and potentially accelerate the re-emergence of the Icelandic financial and business sectors. Reaching a positive agreement with creditors of Kaupthing may therefore be a critical step towards re-establishing normal banking relationships between Iceland and the international community.

Concerns of creditors, objectives in the restructuring as well as preliminary structuring options have been outlined to various representatives in the government over the last weeks.

On 12 March 2009, the Ministry of Finance issued a press release with its objectives in the negotiations regarding compensation instruments to creditors:

- "To ensure appropriate treatment of creditors in all three old banks including transparency and timely flow of information in the negotiation process.
- The application of international best practices.
- To secure a stable post-settlement Icelandic banking system that will be able to fulfil its obligations under the compensation instruments to be issued by the new banks.
- To engage in regular consultation and cooperation with the old banks' Resolution Committees and their advisors to take account of their views.
- To seek an agreement that secures approval of the creditors and will facilitate regaining access to the international capital markets for the Government of Iceland and the new banks."

As part of this process Hawkpoint, the appointed financial advisor to the government, is working with New Kaupthing to prepare a customary information package for review by Kaupthing and Morgan Stanley. Furthermore, Hawkpoint has engaged in a process with the Resolution Committee and Morgan Stanley which discuss with the ICC regarding the structuring of compensation instruments.

## *7.4 Consideration of wider restructuring options*

It is the ultimate role of the Moratorium Supervisor and the Resolution Committee to maximize the value of the Bank's assets and pass on the value to its creditors. Creditors have expressed their views that the maximum value of the assets would not be reached via asset sales under current market conditions. Therefore, according to creditors' requests, the Moratorium Supervisor and the Resolution Committee have been working on other solutions to preserve the value of these assets until the markets recover. In many cases, the assets need to be held for some time for them to be redeemed at full value. According to the Bank's strategy, assets are only sold if they require support beyond the means of the Bank or if a satisfactory bid price can be achieved for them after taking into account the future funding support needed to maintain these assets. Therefore, the Resolution Committee will also ask Morgan Stanley, as its financial advisor, to come up with structuring ideas on how the assets can be passed over to creditors at a later stage. All these ideas should aim at providing ongoing support to the assets and building a structure where creditors can exit their holdings over time by selling bonds and/or shares.

## *7.5 The Bank's co-ordination group and other government appointed parties*

As some of the structuring ideas might require an input and acceptance from other parties than the Bank's creditors, the Resolution Committee asked for a special co-ordination group to be set up for the Bank, between the Resolution Committee, ministries and the Central Bank of Iceland. This group does not have formal powers and is consultative in nature.

The members of the co-ordination group are Thorsteinn Thorsteinsson - a senior advisor employed temporarily by the ministry of finance, Steinar Thor Gudgeirsson - Chairman of the Resolution Committee of the Bank, Thorhallur Arason - representative of the Ministry of Finance, Helga Oskarsdottir - representative of the Ministry of Commerce and Jon Sigurgeirsson - representative of the Central Bank of Iceland.

The ministry of finance has also appointed Hawkpoint, the UK corporate finance advisory firm, as their financial advisor. They will work under the supervision of Icelandic authorities. The main parties involved in the restructuring process of New Kaupthing are the Resolution Committee, Morgan Stanley, Mr. Thorsteinsson and Hawkpoint.

Mr. Thorsteinsson is in charge of the negotiation process between the new banks and the old banks regarding the net assets acquired by the new banks. The main parties involved in the restructuring process of New Kaupthing are the Resolution Committee, Morgan Stanley, Mr. Thorsteinsson and Hawkpoint.

The Prime Minister’s Office has enlisted the services of Swedish banking expert Mats Josefsson, on a temporary basis as advisor on rebuilding Iceland’s banking system. He is also the chairman of the co-ordination committee which has the overall responsibility of developing, implementing and communicating a comprehensive strategy for bank restructuring. Other members of this committee are representatives of entities within the administration. For the avoidance of doubt, the co-ordination group is not the same as the co-ordination committee.

In addition, Kaarlo Jännäri, former Director General of the Finnish FSA, who has extensive experience in a collapsed financial sector environment, has been engaged by the government to assess the regulatory framework and supervisory practices and to propose necessary changes to strengthen safeguards against potential new crises.

## *Appendix A – Meeting minutes from the creditors' meeting held 5 February 2009*

Minutes recorded by Kaupthing Bank's Moratorium Supervisor at a creditors' meeting, cf. Art. 14 of the Icelandic Act no. 21/1991 on Bankruptcy etc.

A meeting was held on Thursday 5 February 2009 at 10:00 a.m. at Hilton Reykjavík Nordica, Sudurlandsbraut 2 in Reykjavík, with the creditors of Kaupthing Bank hf., Borgartún 19, 105 Reykjavík, ID-No. 560882-0419, concerning the bank's authorisation for a moratorium.

Olafur Gardarsson, Attorney to the Supreme Court of Iceland, Moratorium Supervisor, chaired the meeting and recorded the minutes, cf. Art. 14 paragraph 2 of Icelandic Act no. 21/1991. The meeting was called in accordance with the provisions of Article 98, paragraph 3 of the Act no.161/2002 on Financial Undertakings, cf. Act no 129/2008.

The meeting was attended by representatives of the bank's creditors, a total of 250 people. Given that the majority of those present did not speak Icelandic it was decided that the main section of the meeting would be held in English. Tomas Jonsson, Attorney to the Supreme Court of Iceland, helped the Moratorium Supervisor chair the meeting. The bank's resolution committee was also present to answer questions.

The Moratorium Supervisor gave a report on the assets and liabilities as of the reference date, explained how he believed the debtor's finances could be reorganised and described what measures had already been taken in this respect. Those attending the meeting received a copy of a presentation, and a detailed summary in English and Icelandic by the Moratorium Supervisor was also distributed. The presentation and the summary are enclosed with these minutes.

The Moratorium Supervisor announced his proposal that an application be made to extend the moratorium by nine months at the next hearing of the Reykjavik District Court which is to be held on 13 February at 2:00 p.m.

The Moratorium Supervisor then sought the views of the creditors on his actions and proposals for action. When the Moratorium Supervisor had finished, creditors were given the opportunity to ask questions and put across their points of view. Twenty-one people raised questions.

Questions were raised concerning various topics which had been discussed in the Moratorium Supervisor's presentation and the Moratorium Supervisor and members of the resolution committee answered these questions as far as they were able. A summary of the questions raised and the committee members' replies is enclosed with these minutes. A German investor speaking on behalf of more than 800 German deposit holders declared the group's support for the extension of the bank's moratorium. A letter was also presented from two creditors in which they agreed to the extension but only for a further three months. This letter is enclosed with these minutes.

No objections were raised to the extension of the moratorium. The Moratorium Supervisor asked the meeting twice whether anybody objected to applying for an extension to the moratorium. No objections were raised.

At the end of the meeting the Moratorium Supervisor presented the main points from the minutes to the meeting and invited those present to add any remarks they may have. The minutes were approved in their current form.

The meeting was adjourned at 12.15 p.m.
Ólafur Gardarsson

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This report (including all subsequent amendments and additions) was prepared by the Resolution Committee for the creditors of Kaupthing Bank hf. ("the Bank") for information purposes only. It should give creditors an overview of the background, the current situation and the potential steps going forward. The additions and amendments to this report since the previously published versions of this report are intended to give the creditors information on recent developments but are not necessarily and should not be regarded as an exhaustive list of all developments which creditors may consider material. In preparing and updating this report, the Bank has not taken account of the interest of any particular creditor or group of creditors.

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- (a) Resolution of issues regarding the quantum of claims
- (b) Additional claims being made against the Bank
- (c) The realisation method(s) used over time
- (d) The impact of set off and netting including in connection with derivative contracts
- (e) Movements in currency exchange rates and interest rates
- (f) Prevailing market conditions when assets are sold

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