

KAUPTHING BANK HF. CREDITORS' REPORT

5 FEBRUARY 2009

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KAUPTHING BANK

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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 June 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:

- 2 [Timeline of events](#)
- 3.4 [Current Status of the Bank's subsidiaries](#)
- 3.5 [Current status of the Bank's branches](#)
- 3.6 [The current organizational structure of the Bank](#)
- 3.7 [Corporate communications and creditor relations](#)
- 4.2 [Asset sales and restructuring: Assets sold to date](#)
- 5.1 [The Bank/New Kaupthing split](#)
- 5.4 [Estimated valuation of the Bank's assets](#)
- 6.5 [The Winding-up Committee](#)
- 6.7. [Icelandic composition legislation overview](#)
- 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](#)

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 7th 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 on 5 February 2009
- Moratorium of the Bank extended by the District Court of Reykjavik to 13 November 2009
- Important amendments made to the Act on Financial Undertakings on 22 April 2009
- The Bank's Winding-up Committee appointed on 25 May 2009
- [According to the FME's revised decision on the disposal of assets and liabilities of the Bank to New Kaupthing, the deadline for agreeing the terms of the financial instrument between New Kaupthing and the Bank as a payment of the remuneration, is 17 July 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 level of 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, attorney to the Supreme Court, the Moratorium Supervisor. As an entity in Iceland with a banking licence, the Bank is still subject to supervision by the FME.

On 25 May 2009, in accordance with a request from the Resolution Committee, the District Court of Reykjavik appointed a Winding-up Committee for the Bank in accordance with the recent amendments to the Act on Financial Undertakings. The Winding-up Committee comprises Olafur Gardarsson, the aforementioned Moratorium Supervisor, David B. Gislason, attorney to the District Court, and Feldis L. Oskarsdottir, attorney to the District Court. The role of the Winding-up Committee will be further discussed in chapter 6.5 *The Winding-Up Committee*.

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 50 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 maximising the value of assets of the Bank 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 on a regular basis.

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 the terms of the financial instrument which New Kaupthing issues to the Bank as a payment of the remuneration for the transferred assets have been decided.

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 to review certain transactions, identified by the Resolution Committee, and to prepare and commence legal proceedings against parties that might be in debt to the Bank 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 the Bank 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. This sub-committee consists of two members of the Resolution Committee in addition to the former Internal Auditor of Kaupthing Bank.

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, excluding ISDA set-off cases, 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. 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, assets and 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.

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 *FIH* 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 also frees up cash for the Bank since Riksbanken returned to the Bank approximately SEK 2bn it had 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 have been 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 allowed 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 was very co-operative but a repayment was required at the earliest convenience.

If the entity had not 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 enabled 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.

[At a hearing in the Isle of Man High Court on Wednesday 27 May 2009, a Winding Up Order was made placing the Company into liquidation. Michael Simpson of PricewaterhouseCoopers and Peter Spratt of PricewaterhouseCoopers \(London\) were appointed as joint provisional liquidators of the entity and Joint Deemed Official Receiver at that time.](#)

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. 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 administrators are in the process of selling the entity allowing for repayments to all depositors of the Bank and its branch in Geneva.

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.

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 was seized by the German government, and its assets frozen by the German Financial Regulatory Authority, BaFin. [On 22 June 2009 the BaFin lifted its freeze on the assets of the Bank.](#)

[From the outset, 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. Since last year, the Bank has worked hard in co-operation with the German authorities to develop a solution which fully ensured the secure repayment of deposits to the Bank's customers.](#)

[In mid-April, the Bank announced that it had secured sufficient funds to reimburse all Edge deposits in Germany. In mid-May the Bank was ready to start the repayment process and sent letters to more than 34,000 depositors and confirmations have already been received from the vast majority.](#)

[On 22 June, the Bank announced that repayments had commenced as the Bank submitted instructions to a German financial institution to repay the deposits of around 20,000 customers. The repayment programme continues through June and it is hoped that refunds to more than 34,000 Edge customers will be completed in the next few weeks. For efficiency and technical reasons, the repayment process has to be administered in steps and therefore not all depositors will receive their payment at the same time.](#)

[The full principal of the deposits will be paid. Depositors who intend to file a claim for interests will be able to do so when the formal process of filing claims begins. Further information on the process of filing claims will be advertised and announced on the Bank's website, \[www.kaupthing.com\]\(http://www.kaupthing.com\) in due course.](#)

When these repayments have been concluded, Kaupthing Bank will have repaid all deposits defined by Icelandic law as priority claims, i.e. all foreign deposits made at branches belonging to the parent company.

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 Kaupthing Edge Germany deposits.

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 approx. 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.

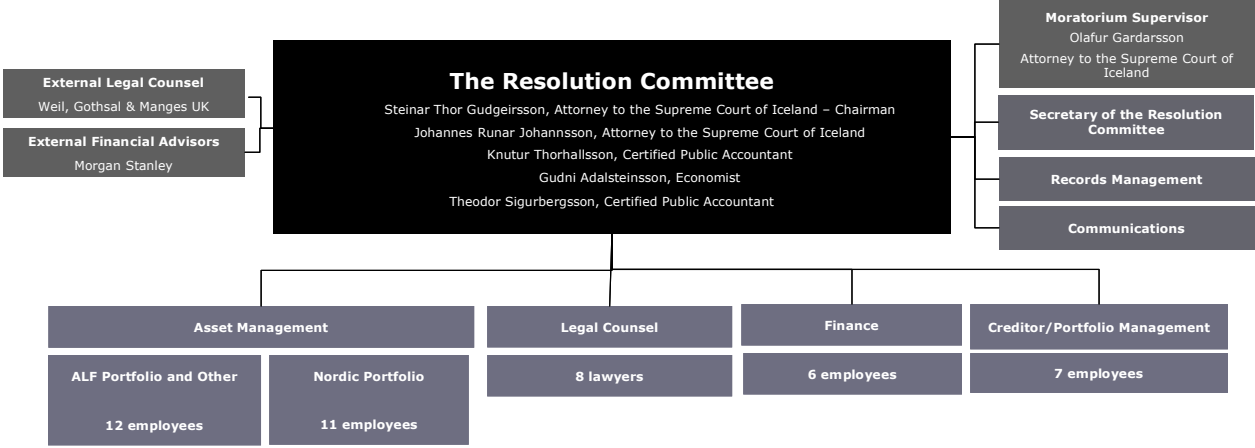
3.6 The current organizational structure of the Bank

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 asset management division is the largest division in the Bank. There are 23 employees in this division, most of whom are very experienced in the investment & corporate banking field with up to 17 years experience in the industry from international reputable financial institutions. In this team, the Bank has hired specialists with a diversified background and experience both domestically and internationally, across corporate finance, corporate banking, private equity, leverage finance, operational and capital restructuring and workouts supported with a team of legal specialists with extensive experience across all legal aspects of banking transactions. 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.

The specialists in the asset management division lead the projects internally and the process is supported by an external advisory service as needed. 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.

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 in the current environment fees generated from the loan portfolio will cover the costs of running the asset management division.

The team has been managing the assets of the Bank in important steps. The initial step, commencing at the collapse of the Bank, was to stabilize the assets which were hit by the sudden change of the Bank's status and to retain their value. Closing down branches and transferring assets to the Bank in Iceland was the second step. This required significant resources and manual work as loans of over 50 borrower groups were transferred to Iceland involving quite complicated legal issues.

As a third step, an overview of the assets was compiled. For this purpose, each asset was analyzed and employees were assigned as responsible persons. Assets were prioritised by size and urgency. The team is now in phase four of developing a strategy and setting objectives for assets to maximize the recovery on behalf of the Bank's creditors.

Legal counsel

The legal counsel division provides support and legal advice to the Resolution Committee and all the divisions within the Bank as needed. 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. 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.

Finance

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

According to the FME's revised decision on the disposal of assets and liabilities of the Bank to New Kaupthing, the deadline for agreeing the terms of the financial instrument between New Kaupthing and the Bank as a payment of the remuneration is 17 July 2009. This implies that the finalized initial balance sheet and the financial statements as at YE 2008 will not be ready until thereafter, when the terms of the financial instrument have been finalized.

In January, finance finalized the budget for the year 2009 for each division which was approved by the Resolution Committee.

The division is responsible for executing all aspects of the Bank's finances according to the strategy formulated by the Finance Committee. This implies accounting procedures, financial disclosure and budgetary planning. The division is 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.

Internal committees

To further strengthen the infrastructure and the operations of the Bank, four working committees were established early this year. These committees have at least weekly meetings and work within formal guidelines to resolve the tasks at hand.

The *Asset Committee* has the role of both credit committee and investment committee in a traditional financial institution. It comprises two members of the Resolution Committee and three MDs of the Asset Management team. Cases related to the assets of the Bank are presented with memos by the employees responsible and can range from a simple waiver request to a request for disposal of assets. If the Asset Committee wishes to approve a drawdown request or a request for disposal of assets, the case is referred to the Resolution Committee which makes the final decision to approve or decline the request.

The *Finance Committee* is responsible for the Bank's finances. Its main role is to formulate the finance division's strategy in terms of book-keeping and accounting procedures. The committee is responsible for all financial disclosure both externally and internally to the Resolution Committee and its sub-committees. The Finance Committee defines which guidelines the Bank adheres to, both with respect to accounting rules and international standards and internal work procedures. The committee develops and oversees the execution of budgetary plans. The committee is responsible for liquidity management of cash and cash equivalents.

The *Inspection Committee* has the role of reviewing transactions, identified by the Resolution Committee, and to prepare and commence legal proceedings against parties that might be in debt to the Bank 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 the Bank 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. This sub-committee consists of two members of the Resolution Committee in addition to the former Internal Auditor of Kaupthing Bank.

This committee is also 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.

The *Set-off and Netting Committee* is responsible for preparation of netting and set-off cases, collection of claims deriving from derivative contracts and related matters. The Set-off and Netting Committee consists of one member from the Resolution Committee, one member from the Winding-Up Committee and one employee from Kaupthing. The committee was originally established in February but was re-established in the beginning of June following the appointment of the Winding-up Committee. The participation of the Winding-up Committee is needed for the set off process, as its current role is to evaluate all claims brought against the Bank, including claims that might be used for set-off. The collection process of derivatives claims is ongoing but no actual set-off has been executed. It is difficult to evaluate the number of set-off cases since such cases might come up in the process of creditors filing their claims.

3.7 Corporate communications and creditor relations

In order to improve communications and relations with stakeholders and the general public the Resolution Committee has appointed Helga Bjork Eiriksdottir as Communications Manager. The role of the Communications Manager is to formulate a corporate communications policy, deal with the media and promote the function and activities of the Resolution Committee and the Bank in Iceland and abroad. The Resolution Committee intends to further improve its corporate communications function in order to foster greater expertise and transparency in its activities.

As this report clearly shows, dealings with creditors are extensive and regulated. Since 9 October 2008, several meetings have been held with creditors to discuss how things are progressing and to invite them to express their views. In addition weekly conference calls are held with the ICC.

The website, www.kaupthing.com, is a place where creditors, the media, authorities and other parties can access regular updated information about the Bank. Interested parties can send questions, read the latest announcements and updates and can keep abreast of the main developments since 9 October 2008. The next step is to improve user access and to enable users to subscribe to news stories and updated material. Since the site was launched in October 2008 there have been close to 900,000 visits from 306,000 users.

This report for creditors is currently updated once a month and to facilitate overview by frequent readers the Bank provides a summary of the main updates in each report. Numerous questions are sent to creditorcontact@kaupthing.com and germanhelpdesk@kaupthing.com every day which the Bank aims to respond to as quickly as possible. Since November last year the Bank has responded to more than 5,300 queries.

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. This summary is intended to give the reader an update of the asset sales but should not be taken as conclusive and the Resolution Committee accepts no responsibility if some asset sales are not included in this summary.

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.

Several of the Bank's Swedish assets that were transferred to Kaupthing Bank hf. when Ålandsbanken Abp acquired Kaupthing's Swedish subsidiary, have to date been realized at a 100% recovery rate, implying that values of SEK 350m (EUR 33m) from the Swedish portfolio have already been secured. In addition, two loans in the Nordic region of a total of EUR 5.5m have been fully repaid; one after several bids below par had been rejected.

A loan to a US hosiery wholesaler was sold in the spring for a price significantly higher than its perceived market value. The company has been under strain and is performing significantly under budget. The company was in breach of covenants and was certain to default on its payments this fall. Transaction was preceded by a financial and operational due diligence performed by independent financial consultants engaged by the Bank

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 100m but in addition, some forced assets sales have taken place to pay back deposits.

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 where 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 injunction 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 compensate for the net asset transfer between the banks.

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 appointed Deloitte to prepare an independent net asset valuation for New Kaupthing and Oliver Wyman was appointed to co-ordinate the valuation process and review the valuation. The valuation of the net assets by Deloitte and the review of the valuation by Oliver Wyman took longer than initially envisaged but was completed towards the end of 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.

Total of appr. ISK 190bn in assets at book value were transferred back, thereof appr. ISK 90bn which were unpledged. These assets present additional value to the creditors, but instead the compensation instrument is likely to be lower. The liabilities related to the pledged assets had remained within the Bank based on the preliminary balance sheets.

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

	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
Assets					
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	15.11.2008	30.06.2008
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		<u>2.962.380</u>	<u>3.778.046</u>
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		<u>3.769.548</u>	<u>3.353.840</u>
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		<u>(807.168)</u>	<u>424.206</u>
Total Liabilities and Equity		<u>2.962.380</u>	<u>3.778.046</u>
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 geographical region:			
UK			661.067
Scandinavia			122.681
Luxembourg			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
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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
<i>Bonds and debt instruments:</i>			
Listed	234.113	11.267	245.380
Unlisted	21.042	33.140	54.182
Bonds and debt instruments	255.155	44.407	299.562
<i>10 largest positions:</i>			
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
<i>Shares and instruments with variable income:</i>			
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
<i>10 largest positions:</i>			
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
<i>Associated companies:</i>			
Listed	62.299		62.299
Unlisted		7.312	7.312
Associated companies:	62.299	7.312	69.611
<i>Positions:</i>			
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
<i>Subsidiaries:</i>			
Listed		10.665	10.665
Unlisted	260.110	262.653	522.763
Subsidiaries:	260.110	273.318	533.428
<i>Positions:</i>			
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.

The below 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, excluding ISDA set-off cases, 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. 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.

The participation of the Winding-up Committee is needed for the set off process, as its current role is to evaluate all claims brought against the Bank, including claims that might be used for set-off. The collection process of derivatives claims is ongoing but no actual set-off has been executed.

As is evident from discussions in this report, some significant changes have occurred on the balance sheet since 15 November 2008. Below is an update of some of the most significant changes. This update can however not be considered conclusive and is only intended to provide the reader with a better understanding of the Bank's balance sheet. All numbers presented below are before any impairment.

- Due to the correction of the FME's transfer decision, the loans to customers portfolio increased by appr. ISK 190bn at nominal value and thereof, appr. ISK 90bn which were unpledged. As a result, the compensation instrument is likely to be lower.
- Due to the closing and sale of the subsidiary in Sweden, the loans to customers portfolio increased by appr. ISK 110bn while the subordinated loan booked as loans to credit institutions and investments in subsidiaries decreased by a similar amount.
- Due to selective voluntary sale of assets, loans to customers have decreased by appr. ISK 18bn at nominal value and the cash reserves have increased respectively although it needs to be taken into account that not all assets have been sold at nominal value.

- Due to full and partial repayments of some loans, loans to customers have decreased and the cash reserves have increased by the same amount.

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

<i>All amounts in mISK</i>	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	<u>2.962.380</u>	<u>(745.432)</u>	<u>(135.898)</u>	<u>2.081.051</u>	<u>618.114</u>
Exchange rate (EUR/ISK)	171,077	171,077	171,077	171,077	171,077
Liabilities					
<i>Senior Liabilities</i>					
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	<u>3.312.841</u>	<u>(745.432)</u>	<u>(135.898)</u>	<u>2.431.512</u>	
Subordinated loans	<u>456.707</u>			<u>456.707</u>	
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	<u>(807.168)</u>			<u>(807.168)</u>	
Total Liabilities and Equity	<u>2.962.380</u>	<u>(745.432)</u>	<u>(135.898)</u>	<u>2.081.051</u>	
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 first granted a moratorium on payments until 13 February 2009.

The Moratorium Supervisor convened the Bank's creditors to a meeting on 5 February 2009 and sought the opinion of the attendees regarding the Bank's position but matters were not voted on nor were any formal decisions made as such actions are not provided for under the Bankruptcy Act. The meeting was thus held for informational purposes for creditors in light of the court hearing of 13 February 2009 where a petition was filed by the Resolution Committee's petition for a nine-month extension to the moratorium on payments. On 19 February 2009 the District Court of Reykjavik agreed to the request for the extension of the moratorium on payments until 13 November 2009. On that date a new hearing will be held to consider the matter and decide on whether a further extension of the moratorium will be granted. The hearing will be an open one.

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.

The maximum time period for the moratorium is 24 months. According to a new Act no. 44/2009 amending Act no. 161/2002 on Financial Undertakings the moratorium can effectively end in three ways; i) a winding up process, ii) an insolvent liquidation or iii) a scheme of arrangement between the Bank and its creditors.

While under the moratorium, the ICC continues to work as an informal forum for creditors. The ICC has no formal powers under Icelandic law.

6.2 The Moratorium Supervisor

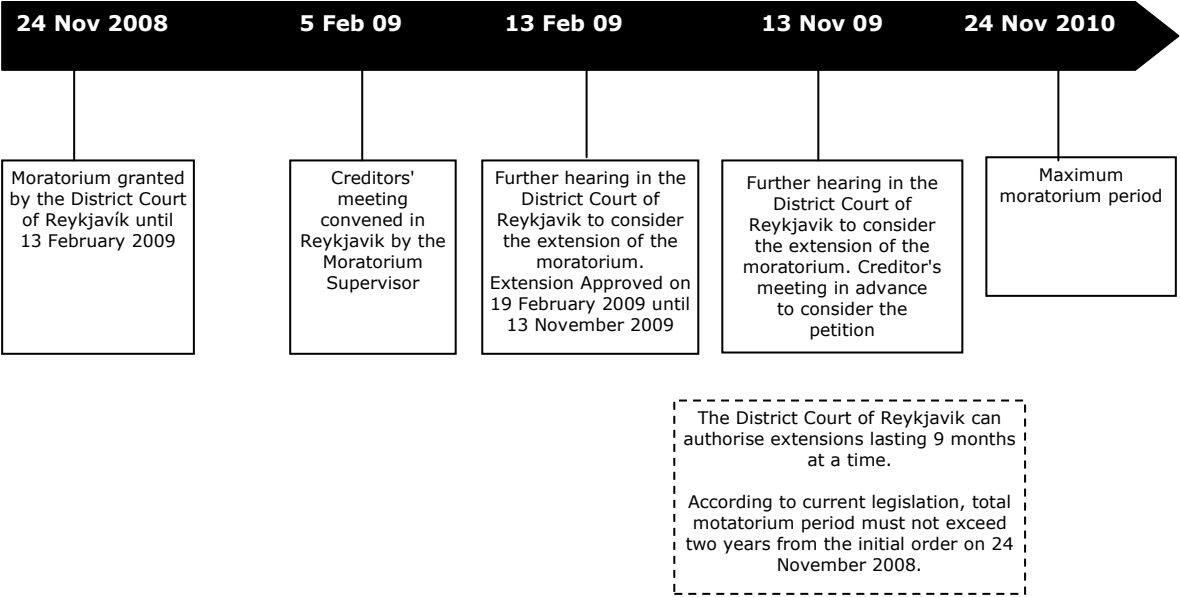
As discussed above, Olafur Gardarsson, Attorney to the Supreme Court of Iceland and a partner of the Reykjavik Law Firm, was appointed as the Moratorium Supervisor. He has been a Supreme Court Attorney since 1992 and his areas of expertise include mergers and acquisitions, corporate and telecommunications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

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 will be requested by the Resolution Committee as the Resolution Committee believes that it will be in the best interests of creditors to extend the moratorium. 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

The provisions governing the moratorium have been amended by Act no. 44/2009 which came into force on 22 April 2009. The Bank remains under the direction of the Resolution Committee which is responsible for the daily operations of the Bank in accordance with Act no. 44/2009 but remains also under the supervision of the Moratorium Supervisor. The Resolution Committee holds the powers of the board of directors as well the powers of the Bank's shareholders' meeting according to new provisions. Formerly the Resolution Committee held only the powers of the board of directors on the grounds of the decision of the FME of 8 October 2008. 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 provisions of Act no. 44/2009 stipulate that the Resolution Committee shall manage the interests of the Bank according to the same rules as a trustee would be subject to according to the Bankruptcy Act, although with some exceptions. The exceptions mainly concern the objective for the Resolution Committee to maximise the value of the Bank's assets which includes waiting for the Bank's outstanding claims to mature, instead of realising them immediately. To this end, the Resolution Committee is allowed to disregard a decision of a creditors' meeting if the Resolution Committee deems such a decision contrary to its objective. This means that the Resolution Committee has ample time to safeguard the interests of the Bank and its creditors.

The reference to provisions governing the actions of a trustee under the Bankruptcy Act entail that the Resolution Committee has the capacity to manage the Bank's assets and it alone can dispose of its assets and answer for its obligations. The Resolution Committee acts for the Bank in court and executes agreements on behalf of the Bank as before. The Resolution Committee shall make sure that all assets are disposed of in the most efficient manner possible and shall enforce all claims owned by the Bank. The Resolution Committee furthermore takes such actions as necessary to prevent damage to the Bank.

The Resolution Committee can convene creditors' meetings as appropriate to introduce measures taken in regard to the Bank's interests. In such meetings suggestions or decisions may be sought from creditors in regard to measures which have yet to be taken and suggestions may be sought on matters regarding the management of the Bank's interests. The creditors' meeting cannot influence measures which have already been taken by the Resolution Committee, only such measures which have yet to be realised. The Resolution Committee is allowed consult with individual creditors in matters concerning the relevant creditor's interests.

A petition for the Bank to enter insolvent liquidation cannot be filed nor can its assets become 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 The Winding-up Committee

According to the new Act no. 44/2009 amending the Act no. 161/2002 on Financial Undertakings, a Winding-up Committee shall be appointed to handle various matters of the Bank while the moratorium is in effect. In accordance with the provisions of Act no. 44/2009, the District Court of Reykjavik appointed a Winding-up Committee for the Bank. The Winding-up Committee comprises Olafur Gardarsson, attorney to the Supreme Court and the Moratorium Supervisor, Feldis L. Oskarsdottir, attorney to the District Court and David B. Gislason, attorney to the District Court. The Winding-up Committee does not hold any power over the Resolution Committee nor vice-versa. Both are however committed to work together in the best interests of the Bank and its creditors.

The role of the Winding-up Committee is to, among other things, call upon any creditors who have a claim against the Bank and take a position regarding their recognition. The Winding-up Committee shall call for claims and set the deadline for filing claims, which can be no longer than six months, counting from the day when a call for claims is announced. The Winding-up Committee makes a register of filed claims and decides how they are ranked in the order of priority of payment of claims. It also deals with the envisaged payment of claims following the first creditors' meeting, which will be held upon expiry of the time limit for the filing of claims.

The Winding-up Committee can also challenge and claim rescission of actions of the Bank in accordance with the rules on rescission in the Bankruptcy Act. This entails, with some simplification, that the Winding-up Committee can rescind certain unusual actions of the Bank which took place prior to 15 November 2008 and can claim damages or repayment from parties benefiting from such actions.

The Winding-up Committee deals with the evaluation and recognition of claims. Generally speaking, the procedure for calls for claims may be as follows:

- A calling-in notice is issued. The calling-in notice will set the deadline for filing claims, counting from the day when the call for claims is announced in the "Legal Gazette".
- The deadline for filing claims is likely to be six months.

- A claim must be filed before the expiry of the set time limit for the filing of claims. If a claim against the Bank is filed after this date, it will be cancelled, unless the conditions for a special exception are fulfilled.
- At the end of the deadline for the filing of claims, the Winding-up Committee shall prepare a register of claims, i.e. a register of the claims received in which it shall state its opinion on whether and, if so, how each claim should be recognised.
- A creditors' meeting is convened to discuss the recognition of claims. Under current legislation, the meeting is expected to be held within one month after the deadline for filing claims has passed. More than one creditors' meeting may be called.
- One week before the abovementioned creditors' meeting, the Winding-up Committee shall make a copy of the claims register available at its office for inspection by those who come there and who have filed a claim against the Bank.
- It is difficult to gauge how long it will take to complete the process of taking a position on the filed claims, both because of the vast amount of creditors involved and because the process of taking a position on many of the claims may be complex and time-consuming.
- The method for the filing of claims has not been worked out in full detail yet. The provisions of Act no. 21/1991 on Insolvency etc. regarding filed claims against a bankruptcy estate apply to the claims filed against the Bank.
- One of the principles in insolvency legislation is the principle of equality of creditors. The Winding-up Committee shall, however, also have to consider certain exceptions to that principle, such as the order of priority of payment of claims.
- The Winding-up Committee has made no decision regarding what kind of proof will be required for the existence of filed claims. General rules of the Icelandic law regarding proof of claims shall apply.
- Claims must, however, be precise and, among other things, specify the amount being claimed, along with an itemised list of the principal of the claim, interest and costs. Creditors shall supply information on what forms the basis of their rights, along with documents to support their case.

Creditors' meetings convened by the Resolution Committee, on one hand, and the Winding-up Committee, on the other, deal with different aspects of the Bank's operations. In practice, however, it is likely that these meetings will be held jointly, although varying provisions of insolvency legislation may apply, depending on which issues are being discussed at the meeting.

After the deadline for filing of claims has expired, the Winding-up Committee shall convene a creditors' meeting. Under current legislation, the meeting is expected to be held within one month after the deadline for filing claims has passed. The claims register shall be made accessible to creditors one week before the meeting. A claimant, who is unwilling to accept the Winding-up Committee's position as regards the recognition of his/her claim against the Bank, shall state his objections at a creditors' meeting or notify the Winding-up Committee in a letter received by it no later than at that meeting. In the same manner, a creditor may object to the Winding-up Committee's position on the recognition of a claim filed by another creditor if the conclusion regarding the claim affects the interests of the objecting party. Insofar as no objection is raised against the Winding-up Committee's position on the recognition of a claim, its position shall be regarded as approved.

The claims register shall be presented at the creditors' meeting, as well as any objections that may have been made. At the creditors' meeting, the Winding-up Committee shall provide those in attendance with the explanations they require regarding the subject matter of individual claims, as well as the reasons for its position towards the recognition of those claims. If an objection is raised at the meeting against the Winding-up Committee's position on the recognition of a claim, the Winding-up Committee shall endeavour to settle the dispute. If this is not successful, the parties concerned shall be called to a separate meeting for this purpose. If the dispute cannot be settled in this manner, the Winding-up Committee shall refer the matter to the District Court of Reykjavik.

At the end of the first creditors' meeting, the Winding-up Committee is authorised to pay the recognised claims in one lump sum or several payments and in part or in whole. If this is done, care shall be taken to ensure that the Bank's assets are sufficient to at least equally cover all the other claims, which are included in the same rank and which have not been rejected in the winding-up process. The Winding-up Committee shall also ensure that all creditors with recognised claims in the same rank are paid at the same time, although it is possible to deviate from this with the approval of those who do not get paid or by a decision made by the Winding-up Committee if a creditor offers to relinquish a claim in exchange for a partial payment, which is deemed to be a proportionally lower amount than that which other claimants in the same rank would ultimately receive, taking into consideration, among other things, whether the claim bears interest until payment.

The Winding-up Committee may not make any decisions regarding the sale of assets for the payment of claims. It is only the Resolution Committee that may make decisions regarding the sale of the Bank's assets, in accordance with Act no. 161/2002 on Financial Undertakings and subsequent amendments in Act no. 44/2009.

The Winding-up Committee shall also oversee possible composition negotiations, following an evaluation of the Resolution Committee on whether the Bank has sufficient assets to meet its obligations. This entails, among other things, the Winding-up Committee having to prepare a composition proposal, submitting it to a creditors' meeting and obtaining the creditors' approval of it and having the composition agreement confirmed by the District Court of Reykjavik if it has been approved by the required number of creditors. If the composition proposal is approved by the creditors and it is confirmed by the District Court of Reykjavik, the Winding-up Committee must ensure that the agreement is performed.

6.6 Creditors' meetings

According to the new Act no. 44/2009 the matters considered at creditors' meetings are mainly twofold, firstly there are matters concerning the management of the Resolution Committee of the interests of the Bank and secondly, the recognition of claims by the Winding-up Committee.

The Resolution Committee can convene creditors' meetings, as it deems appropriate, to introduce measures taken in regard to the Bank's interests. The Resolution Committee may seek proposals or decisions regarding measures that have yet to be taken, and provide for opportunities for making such proposals. The creditors' meeting cannot affect measures already carried out by the Resolution Committee. The Resolution Committee is allowed to confer with individual creditors in matters concerning the relevant creditors' interests.

A creditor is entitled to attend a creditors' meeting if the creditor has filed a claim against the Bank with the Winding-up Committee and if such claim has not been finally dismissed by the Winding-up Committee. Creditors' meetings regarding the management of the Bank's interests and the recognition claims will not be held until the deadline for filing claims has passed. If a creditor does not attend a meeting, the relevant creditor may lose the right to oppose matters or present claims regarding matters which were decided or presented at the meeting.

Voting rights are determined by the amount of each creditors claim if matters regarding the management of the Bank's interests are put to a vote. For a creditors' meeting to be quorate, creditors holding at least a third of the total voting rights must be present at the meeting. To disregard a decision of the majority of creditors, the Resolution Committee must in most cases have specific reasons. The Resolution Committee can thus disregard decisions of a creditors' meeting if they are contrary to law,

dishonest, cannot be executed, contrary to interests of creditors not attending, discriminate against the minority or if the decisions are contrary to the goal of maximising the value of the Bank's assets.

The Winding-up Committee handles the aspect of the creditors' meetings which has to do with the recognition of claims. The Winding-up Committee shall submit its registry of claims to the creditors' meeting as well as any objections which the Winding-up Committee may have received in regard to submitted claims. The Winding-up Committee shall offer explanations as to the recognition of claims and any objections which have been made against recognition of specific claims. If a protest is made in regard to the recognition of claims at a creditors' meeting, the Winding-up Committee will endeavour to resolve the dispute. If such a dispute cannot be resolved at the creditors' meeting, the Winding-up Committee shall convene a separate meeting between the disputing parties. If the dispute cannot be resolved at such separate meetings, then the dispute will be referred to the District Court of Reykjavík. As far as protests are not made against the recognition of claims, then such recognition shall be considered accepted.

In addition, the moratorium supervisor shall convene meetings as appropriate to consider applications to the District Court of Reykjavík for the extension of the moratorium.

6.7 Icelandic composition legislation overview

Composition (scheme of arrangement) has the same objective as a moratorium: to react to financial difficulties of a debtor. Unlike composition, a moratorium gives the debtor a certain grace period for financial reorganisation with the long term goal of increasing, or at least preserving the value of the debtor's financial interests. Composition on the other hand, seeks to redress the negative asset position or insolvency of a debtor through an agreement with his creditors with general terms that equally apply to all creditors that have composition claims against the debtor.

The new Act no. 44/2009 amending Act no. 161/2002 on Financial Undertakings, which came into effect last April, contains rules governing composition negotiations for financial undertakings that are in a wind-up process. According to these rules, the Winding-up Committee of a financial undertaking may seek composition if it considers that the assets of the undertaking are not sufficient to fully satisfy all claims, that have not been finally rejected in the winding-up process. The general rule is that prior to seeking composition, a request must be submitted to a district court for its approval. However, that does not apply to financial undertakings in a winding-up process. When a financial undertaking in a winding-up process seeks composition, the Winding-up Committee serves the same role as a supervisor of composition negotiations or a liquidator of an estate would normally do and is responsible for holding creditor meetings.

If the Winding-up Committee decides to seek composition, it prepares a composition proposal. It must state to what extent the debtor offers payment of the composition claims and the form of payments, the dates of the payments, whether interest, and if so, at what rate, will be paid on the composition claims from the date a composition agreement is concluded and until the date of payment, if deferred payment is envisaged, whether security, and if so of what kind, will be placed to secure performance of the composition agreement.

Composition agreement only affects claims against the debtor which are referred to as composition claims. The term is defined in a negative manner and applies to all the claims against the debtor which are not exempted from the composition. Composition agreement does not affect the following claims:

- Claims originating after a court order has been issued granting a debtor licence to seek composition;
- Claims for performance other than payment of money, which can be performed in substance;

- Claims that would be ranked as provided for in Articles 109, 110 or 112 of Act no. 21/1991 on insolvency etc. if the debtor had been declared bankrupt at the date when a court order providing the debtor with a licence to seek composition was issued;
- Claims that could have been settled by set-off had the debtor been declared bankrupt, and
- Any claims particularly exempted from composition under the terms of the composition agreement by reason of their full payment, cf. Paragraph 2 of Article 36 of Act no. 21/1991 on insolvency etc.
- A creditor, who has claims against the debtor which the composition agreement does not affect, can relinquish that right, so that the composition agreement does affect its claims.
- Composition also cancels any debts that would be ranked as provided for in Article 114 of Act no. 21/1991 on insolvency etc. if the debtor's estate had been declared bankrupt.

When a Winding-up Committee decides that voting shall take place on the composition proposal, it convenes a meeting of creditors for that purpose. The meeting shall be convened with a notification in the "Legal Gazette" with at least two weeks notice. The Winding-up Committee shall prepare a register of the rights to vote on the proposal, specifying the voting rights attached to each claim, both by number of creditors and by the value of their claims. The register shall include only the claims that have been recognised and to which voting rights are attached in the opinion of the Winding-up Committee. Each creditor with a composition claim against the debtor shall have one vote in number and a voting power proportionate to the value of his composition claim against the total value of all the composition claims. If a creditor has two composition claims or more, they shall be added together and counted as one claim and one vote in number will be attached to the claims as a whole. One vote in number can also be divided between more than one creditor, if an assignment of a composition claim has taken place in the three months prior to the reference date. Voting creditors may vote on a composition proposal in writing, and such votes shall be taken into account if received by the Winding-up Committee no later than when the voting is completed and no one is in attendance on the relevant creditor's behalf. A vote in writing shall only be valid if it expresses the stand the voting creditor has taken with respect to the proposal unequivocally and unconditionally, and the creditor's signature is confirmed by two witnesses, a district court or Supreme Court lawyer, or a public notary.

A composition proposal shall be deemed approved if supported by the same proportion of votes by creditors in number and by value of their claims, as the proportion of composition claims to be relinquished according to the proposal, provided this reaches 60 per cent at a minimum. If the composition agreement stipulates something other than relinquishment, e.g. the exchange of debt claims for shares, it requires approval of 60 per cent of the creditors in number and by value of their claims.

If the composition proposal is approved by the creditors, the Winding-up Committee must obtain a confirmation of the District Court of Reykjavik of the composition agreement. If it obtains this confirmation a composition settlement is considered to be concluded. The settlement will only be binding for creditors that have composition claims as defined above. If the composition settlement is confirmed, the Winding-up Committee shall, as necessary, fulfil any obligations to creditors in accordance with the settlement and then conclude the winding-up proceedings. The settlement of a composition claim shall have the same effect as its settlement in its original form.

If, on the other hand, the composition proposal is not approved by the creditors or its confirmation has been rejected, the Winding-up Committee shall request that the undertaking be declared bankrupt. A creditor may do the same if its claim has been recognised in the winding-up proceedings and either the composition negotiations have not yielded any results or the creditor demonstrates that the legal requirements for composition negotiations to take place are not fulfilled or that such a large number of creditors are opposed to composition that there is no possibility of achieving composition based on available information on the undertaking's financial situation. In order to uphold this claim, the creditor

must, however, establish a legitimate interest for the insolvency proceedings to go ahead rather than continuing the winding-up proceedings.

6.8 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 Luxembourg. Further freezing orders are being opposed in the Netherlands and Luxembourg. 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.

6.9 Potential closing of the moratorium process

As previously outlined, the Bank was first 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.

When an authorisation for moratorium concludes, a financial undertaking shall enter a winding up process according to Act no. 44/2009 amending Act no. 161/2002 on Financial Undertakings. Many of

the rules governing the moratorium, and which are mentioned above, would continue to apply in a winding-up process. The Resolution Committee continues to operate under a winding-up process with the same aim as before to maximise the value of assets. That includes waiting for the maturity of assets rather than disposing of them immediately.

According to Act no. 44/2009, there are two possibilities to conclude the Bank's operations if the assets of the Bank are found to be of less value than the amount of its liabilities. This applies both while in the moratorium or winding-up process:

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 on 13 November 2009 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 6.7 *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 and liabilities transferred to New Kaupthing and the financial instrument*

According to the FME, a financial instrument will be issued to compensate for the net asset transfer to New Kaupthing. 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 appointed Deloitte, UK, to prepare an independent net asset valuation for New Kaupthing and Oliver Wyman was appointed to co-ordinate the valuation process 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". According to the FME, the valuation criteria seek to consider the long-term economic environment in Iceland and not the immediate market value of Icelandic loans. Part I of the Deloitte report and the Oliver Wyman report were made available to the Bank and Morgan Stanley, its financial advisor, on 23 April 2009. However, the Deloitte report does not reflect the final separation decision by the FME between the Bank and New Kaupthing as a list of assets and liabilities were transferred back to the Bank. Based on the FME decision the Bank and Morgan Stanley were granted access after signing the relevant confidentiality agreements and hold harmless letters to part II of the Deloitte report from 12 June and had a separation and question and answers sessions on both reports with Oliver Wyman and Deloitte. Creditors have read only access to part I of the Deloitte report and the Oliver Wyman report in a separate data room provided the respective confidentiality agreements and hold harmless letters are signed. Creditors interested in accessing these reports, should send an email to creditorcontact@kaupthing.com.

On 15 June 2009, the FME announced that the deadline for agreeing the terms of the financial instrument for the compensation of the net asset transfer to the New Banks is the 17 July 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. Preliminary alternative structure options were 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 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. Reaching a positive agreement with creditors of Kaupthing may 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.

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, worked with New Kaupthing on addressing key issues identified and preparing a customary information package for review by Kaupthing and Morgan Stanley before negotiations of the structure and terms of a financial instrument could commence including:

- (i) solutions to imbalances in the net assets transferred to New Kaupthing;
- (ii) business plan for New Kaupthing including impact of the SPRON and SPM transactions;

- (iii) audit of financial statements until 31 December 2008 and review of financial statements until 31 March 2009
- (iv) Final Deloitte asset valuation report.

The negotiation process started on 4 June, when New Kaupthing management presented to the Resolution Committee and Morgan Stanley its preliminary business plan and opening balance sheet as well as its solution to any imbalances in the assets and liabilities transferred. On the same day, Thorsteinn Thorsteinsson and Hawkpoint presented to the Resolution Committee and Morgan Stanley, the Government's proposal on compensation. It was agreed in the meeting that any negotiation of any proposal could only commence once the separation of the banks was completed and due diligence had been carried out.

Accordingly, on 11 June the FME finalized the separation of the banks. Due diligence commenced with New Kaupthing's management being available for questions in various expert sessions regarding the presented asset valuation, business plan including imbalances and the SPM and SPRON transactions. The due diligence process is still ongoing.

7.4 Consideration of wider restructuring options

It is the ultimate role of 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 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. 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.

Ólafur 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

Disclaimer

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.

Where information in this report is based on information from third parties the Bank believes such sources to be reliable. The Bank however accepts no responsibility for the accuracy of its sources. Furthermore, without prejudice to liability for fraud, the Bank accepts no responsibility for the accuracy or completeness of any information contained in this report and, without limitation to the foregoing, disclaims any liability which may be based on the accuracy or completeness of this report. The Bank is under no obligation to make amendments or changes to this publication if errors are found or opinions or information change. The fact that the Bank has made certain additions and amendments does not create any obligation on the Bank to make amendments or changes to this publication in respect of any other developments, errors or changes in opinion or information, regardless of whether such development or changes occur after or before the date of publication of the revised report. In respect of additions and amendments made to this publication, the Bank is under no obligation to draw such additions and/or amendments to the attention of the intended recipients of this report.

The actual realisable value of the Bank's assets and liabilities may differ materially from the values set forth herein. Factors which may lead to material differences include:

- (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

It is not intended that the information contained herein should be relied upon by any person in connection with trading decisions relating to the Bank. Neither the Bank nor the Moratorium Supervisor accepts any responsibility for any such reliance.

The use of the Bank's material, works or trademarks is forbidden without written consent except where otherwise expressly stated. Furthermore, it is prohibited to publish material made or gathered by the Bank without written consent.

Morgan Stanley is acting as financial adviser to the Resolution Committee of Kaupthing Bank hf in relation to these matters, will not regard any other person (whether a recipient of this document or not) as a client in relation to these matters and will not be responsible to anyone other than the Resolution Committee of Kaupthing Bank hf for providing the protections afforded to clients of Morgan Stanley nor for providing advice to any such other person. Without prejudice to liability for fraud, each member of the Morgan Stanley Group disclaims any liability to any such other person in connection with these matters.