Consolidated Financial Statements 2009

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Endorsement and Statement by the Board of Directors and the CEO

The Consolidated Financial Statements of NBI hf. (also referred to below as the "Bank") for the financial year 2009 include the Bank and its subsidiaries (together referred to as the "Group").

Foundation and ownership

On 6 October 2008 the Board of Directors of Landsbanki Íslands hf. requested intervention by the Icelandic Financial Supervisory Authority (FME) on the basis of new legislation which had just been passed by the Parliament of Iceland on the same date. This legislation authorised the Minister of Finance, on behalf of the State Treasury, to provide the necessary funds for establishing a new financial undertaking or for taking over a financial undertaking or its bankruptcy estate, in whole or in part, due to special or very unusual circumstances in the financial market.

The Bank was founded by the Ministry of Finance on 7 October 2008 and had initial capital of ISK 775 million, paid in cash. The Bank commenced operations on the basis of a decision by the FME on 9 October 2008. Originally the Bank was named New Landsbanki Íslands hf., but at a shareholders' meeting held on 21 October 2008 resolution was passed to change the name to NBI hf. The Bank has nevertheless operated under the trade name of Landsbankinn. The Group's primary lines of business are corporate and retail banking, investment banking, asset management and leasing services.

Upon foundation of the Bank, an interim Board of Directors was elected, consisting of five Board Members and five Alternate Board Members, which was replaced at a shareholder's meeting on 8 November 2008. Ásmundur Stefánsson became chairman of the Board with Haukur Halldórsson becoming vice-chairman. With the resignation of Elín Sigfúsdóttir in February 2009 Ásmundur was hired as interim CEO and Haukur became chairman of the Board. Erlendur Magnússon at the same time became vice-chairman. Ásmundur took a leave of absence from his board duties and his alternate therefore participated in meetings after that. On 7 January 2010 Erlendur resigned from the Board of Directors and his alternate participated in board meetings after that. At a shareholders' meeting held on 18 February 2010, a new Board of Directors was elected replacing four out of five Board members. The majority of the current Board of Directors signing this endorsement and statement was therefore not involved in the governance of the Bank during the financial year 2009.

Following the transfer of assets and liabilities from Landsbanki Íslands hf. to the Bank, the Government of Iceland committed itself to providing the Bank with the necessary capital to meet the relevant requirements of the FME. To this end the Icelandic Parliament approved a 2008 disbursement of State Treasury funds. Accordingly, the Bank has recognised an asset for this unpaid capital contribution amounting to ISK 149,225 million at year-end 2008. Capital amounting to ISK 121,225 million was subsequently paid-in on 30 December 2009 through a government bond with a nominal amount of ISK 121,225 million and ISK 18,588 million in cash representing due interest payments on the bond from 9 October 2008.

After extensive negotiations agreements were signed on 15 December 2009, compensation for the net value of the assets and liabilities transferred from Landsbanki Íslands hf. was determined by the Bank, the Government of Iceland and Landsbanki Íslands hf. and consists of the following: (i) senior secured bonds denominated in EUR, GBP and USD with an aggregate principal amount equal to ISK 260 billion and bearing interest from 9 October 2008, (ii) contingent bond for the amount of up to ISK 92 billion to be issued no later than 15 April 2013 and (iii) a cash claim of ISK 28 billion converted into ordinary shares in accordance with the requirements of the agreements.

At a shareholders meeting on 15 December 2009 the share capital of the Bank was increased by ISK 121,225 million in the form of new share capital with the issue of 18,745 million new shares at a price amounting to ISK 6.47 per share. All new shares were subscribed to and subsequently paid by the Ministry of Finance on behalf of the State Treasury.

At a shareholders meeting on 22 January 2010 the share capital was further increased by ISK 28,000 million with the issue of 4,480 million new shares at a price amounting to ISK 6.25 per share. The shares were subscribed to by Landskil ehf., a wholly owned subsidiary of Landsbanki Íslands hf. The shares were paid for by a conversion of debt in the amount of 28,000 million to equity. After this capital increase the total share capital of NBI hf. is ISK 24,000 million with a total of ISK 126,000 million being booked as additionally paid in capital.

Due to the current economic conditions in Iceland there is rather high uncertainty as to borrowers' ability to pay back their loans to the Group, especially in the case of loans denominated in foreign currencies granted to borrowers with limited or no income in foreign currencies. Furthermore a recent ruling of the district court of Reykjavík in which it was held that a loan granted by Lýsing hf. denominated in a foreign currency was in fact indexed to a foreign currency. The court further held that such indexation was not in accordance with Icelandic law. The decision has been appealed to the Supreme Court of Iceland and is still pending increasing uncertainty as to the true value of such loans for the Bank and its subsidiaries.

To reduce the foreign exchange risk related to fluctuation in the ISK exchange rate, the Bank has agreed to issue to Landsbanki Íslands hf. bonds denominated in EUR, USD and GBP. Foreign exchange exposure is nevertheless a significant risk factor in the operations of the Bank. Since the opening balance sheet date, the Bank's management has taken measures to mitigate that risk, for example by converting loans in foreign currencies to ISK.

As discussed in note 53 to the accounts the current discussion on possible changes to the fishing quota may result in an adverse effect on the value of the Bank's loan book. At the moment any such effect is impossible to determine.

The Bank's management has carried out an assessment of the Bank's ability to continue as a going concern and is satisfied that the Bank has resources to continue its operations. Accordingly, these consolidated financial statements have been prepared on a going concern basis. However, there are certain risk factors inherent in the Bank's assets and liabilities that may hinder the Bank's ability to continue as a going concern. Based on the assumptions used in the Bank's management stress tests, the Bank is sufficiently capitalised to continue as a going concern. Significant market shocks during the financial year of realigning the Bank's risk profile also pose some uncertainty. Of critical importance is the Bank's access to funding in relation to the maturity of existing short-term liabilities and any need to finance the assets of the Bank. Further information regarding the nature and extent of the risks arising from the Group's financial assets and liabilities and off-balance sheet exposures are provided in the notes to the consolidated financial statements.

Operations for the period

Consolidated profit amounted to ISK 14,332 million for the financial year 2009. The Board of Directors proposes that no dividend will be paid. Consolidated total equity amounted to ISK 157,592 million at the end of the year, including share capital amounting to ISK 24,000 million. The capital adequacy ratio of the Group, calculated according to the Act on Financial Undertakings, was 15,0 % at year-end 2009. In a letter dated 11 September 2009 the Financial Supervisory Authority of Iceland stipulated that as part of its valuation of the Bank's ability to operate as a going concern was that the Bank should maintain a Core Tier I capital ratio of 12% and CAD ratio of 16%. At 31 December 2009 the Core Tier I ratio was at 15.2% and the CAD ratio at 15.0%. The Bank has been in discussions with the State Banking Agency (Bankasýslan) in order to meet this additional requirement.

A number of solutions have been enacted in order to assist individuals who have run into financial difficulties. Situations may differ between households and this calls for varying solutions, customised to fit the needs of each customer. A considerable portion of the loan book was restructured during 2009 and this work will continue during the year 2010. For corporations, the Group also enacted remedies for those experiencing financial difficulties. The Group has laid down transparent procedures for corporate restructuring.

Due to the fact that a significant part of the loans were acquired from Landsbanki Íslands hf. at a substantial discount which reflected incurred credit losses, the need for recognising further loan impairment in the consolidated financial statement was based on loss events occurring after the transfer of these loans to the Bank. Accordingly, the allowance account for credit losses on loans and advances reflects only the impairment loss recognised by the Group. Any subsequent increases in the recoverability of the transferred loans will be recognised by the Group as income.

Due to differing financial capacities of the customers, the Bank must assess the increased risk of foreign exchange fluctuations in its foreign-currency-denominated loan portfolios. Some of the Bank's customers have their sole or partial income in a foreign currency whereas other customers have limited or no income in foreign currencies. The latter group of customers will in many instances encounter difficulties in meeting their obligations if the ISK depreciates. Therefore, the foreign exchange gain arising on loans and advances to these customers are presented in the income statement net of the amount of foreign exchange gain which is deemed uncollectible. The amount of such foreign exchange gain deemed uncollectible for the period ended 31 December 2009 amounted to ISK 9,244 million.

Endorsement and Statement by the Board of Directors and the CEO

Statement by the Board of Directors and the CEO

The Consolidated Financial Statements for the year ended 31 December 2009 have been prepared on a going concern basis in accordance with International Financial Reporting Standards as adopted by the EU.

In our opinion the Consolidated Financial Statements give a true and fair view of the consolidated financial performance of the Group for the year 2009, its consolidated financial position as at 31 December 2009 and its consolidated cash flows for the year 2009.

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

The Board of Directors and the CEO have today discussed the Consolidated Financial Statements of NBI hf. for the year 2009 and confirm them by their signatures. The Board of Directors and the CEO recommend that the Consolidated Financial Statements be approved at the Annual General Meeting of NBI hf.

Reykjavík, 8 April 2010.

Board of Directors

Gunnar Helgi Hálfdánarson

Chairman

Haukur Halldórsson

Sigríður Hrólfsdóttir

Guðríður Ólafsdóttir

Friðrik Pálsson

CEO

Ásmundur Stefánsson

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Independent Auditor's Report

To the Board of Directors and Shareholders of NBI hf.

We have audited the accompanying consolidated financial statements of NBI hf. and its subsidiaries (the "Group"), which comprise the endorsement and statement by the Board of Directors, the balance sheet as at December 31 2009, and the consolidated income statement, consolidated statement of changes in equity and consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the Consolidated Financial Statements give a true and fair view of the consolidated financial position of NBI hf. as at 31. December 2009, of its consolidated financial performance and its consolidated cash flows for the period then ended in accordance with International Financial Reporting Standards as adopted by the EU.

Emphasis of Matter

Without qualifying our opinion we draw attention to Note 2 in the consolidated financial statements. The Bank´s management has made an assessment of the Bank´s ability to continue as a going concern and is satisfied that the Bank has the resources to continue its operations. However, as discussed in the note, there are certain risk factors in the Bank´s assets and liabilities that may hinder the Bank´s ability to continue as a going concern.

Reykjavik, 8 April 2010

KPMG hf.

Reynir Stefán Gylfason

Reynir Stefán Gylfason

Helgi F. Arnarson

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Consolidated Balance Sheet as at 31 December 2009

Notes		2009	2008
	Assets		
7	Cash and balances with Central Bank	26,174	30,071
6, 8	Bonds and debt instruments	165,721	39,896
6, 8	Equities and equity instruments	23,411	39,681
6, 9	Derivative instruments	971	0
10	Loans and advances to financial institutions	83,129	8,845
11	Loans and advances to customers	667,122	705,182
12	Investments in associates	2,945	2,518
13	Property and equipment	6,030	6,864
14	Intangible assets	1,058	1,220
23	Deferred tax assets	6,682	7,347
15	Unpaid capital contribution	0	149,225
16	Other assets	13,980	38,958
		997,223	**1,029,807**
17	Assets classified as held for sale	63,878	7,584
	Total assets	**1,061,101**	**1,037,391**
	Liabilities		
18	Due to financial institutions and Central Bank	98,228	132,219
19	Deposits from customers	452,655	431,006
6, 9	Derivative instruments and short positions	5,943	746
23	Tax liabilities	83	845
4, 20	Provisional liability due to Landsbanki Íslands hf.	0	305,057
21	Borrowings	306,493	0
4,6, 22	Contingent bond	10,241	0
24	Other liabilities	8,177	19,793
		881,820	**889,666**
17	Liabilities associated with assets classified as held for sale	21,689	4,440
	Total liabilities	**903,509**	**894,106**
25	**Equity**		
	Share capital	24,000	24,000
	Share premium	123,898	125,898
	Statutory reserve	741	0
	Retained earnings (accumulated deficit)	6,791	(6,945)
	Total equity attributable to owners of the Bank	**155,430**	**142,953**
	Non-controlling interests	2,162	332
	Total equity	**157,592**	**143,285**
	Total liabilities and equity	**1,061,101**	**1,037,391**

The notes on pages 10 to 74 are an integral part of these consolidated financial statements.

NBI hf. Consolidated Financial Statements 2009 5 All amounts are in ISK million

Consolidated Income Statement for the Year ended 31 December 2009

Notes		2009	7.10-31.12. 2008*
	Interest income	105,248	27,076
	Interest expense	(77,143)	(23,730)
26	**Net interest income**	**28,105**	**3,346**
27, 62	Net impairment loss on loans and advances	(6,577)	(1,256)
	Net interest income less net impairment loss on loans and advances	**21,528**	**2,090**
	Fee and commission income	6,835	1,710
	Fee and commission expense	(2,622)	(723)
28	**Net fee and commission income**	**4,213**	**987**
29	Net gain (loss) on financial assets designated as at fair value through profit or loss	4,020	(39,664)
30	Net gain on financial assets and liabilities held for trading	2,876	805
31	Net foreign exchange (loss) gain	(2,814)	32,869
32	Other income and expenses	902	521
	Other net operating income	**4,984**	**(5,469)**
	Total operating income	**30,725**	**(2,392)**
33	Salaries and related expenses	8,468	1,874
34	Other administrative expenses	6,064	2,481
13	Depreciation and amortisation	1,278	294
35	Acquisition-related costs	1,044	3,072
	Total operating expenses	**16,854**	**7,721**
12	Share of profit of associates, net of income tax	383	193
	Profit (loss) before income tax	**14,254**	**(9,920)**
36	Income tax	(615)	2,941
	Profit (loss) for the period from continuing operations	**13,639**	**(6,979)**
17	Profit for the period from discontinued operations, net of income tax	693	43
	Profit (loss) for the period	**14,332**	**(6,936)**
	Profit (loss) for the period attributable to:		
	Owners of the Bank		
	Profit (loss) for the period from continuing operations	13,639	(6,979)
	Profit for the period from discontinued operations	838	34
	Profit (loss) for the period attributable to owners of the Bank	**14,477**	**(6,945)**
	Non-controlling interests		
	Profit for the period from continuing operations	0	0
	(Loss) profit for the period from discontinued operations	(145)	9
	(Loss) profit for the period attributable to non-controlling interests	**(145)**	**9**
	Profit (loss) for the period	**14,332**	**(6,936)**

* The comparative amounts are for the period 7.10. - 31.12.2008 only as the Bank was founded on 7 October 2008.

The notes on pages 10 to 74 are an integral part of these consolidated financial statements.

NBI hf. Consolidated Financial Statements 2009 6 All amounts are in ISK million

Consolidated Statement of Changes in Equity for the Year ended 31 December 2009

Notes		Attributable to owners of the Bank						
	Change in equity for the period 7.10 - 31.12.2008	**Share capital**	**Share premium**	**Statutory reserve**	**Retained earnings**	**Total**	**Non-controlling interests**	**Total**
25	Paid-in share capital upon foundation of the Bank	775				775		775
15	Unpaid share capital	23,225	126,000			149,225		149,225
	Transaction costs related to issue of share capital, net of income tax		(102)			(102)		(102)
4	Non-controlling interests in acquired subsidiaries					0	168	168
	Changes in ownership interests in subsidiaries that do not result in loss of control					0	155	155
	Loss for the period				(6,945)	(6,945)	9	(6,936)
	Balance at 31 December 2008	**24,000**	**125,898**	**0**	**(6,945)**	**142,953**	**332**	**143,285**
	Change in equity for the year 2009							
	Profit for the year			0	14,477	14,477	(145)	14,332
25	Transfer to statutory reserve			741	(741)	0		0
4	Deemed capital distribution		(2,000)			(2,000)		(2,000)
	Changes in ownership interests in subsidiaries that do not result in loss of control					0	1,975	1,975
	Balance at 31 December 2009	**24,000**	**123,898**	**741**	**6,791**	**155,430**	**2,162**	**157,592**

The notes on pages 10 to 74 are an integral part of these consolidated financial statements.

NBI hf. Consolidated Financial Statements 2009 7 All amounts are in ISK million

Consolidated Statement of Cash Flows for the Year ended 31 December 2009

Notes		2009	7.10-31.12. 2008*
	Operating activities		
	Profit (loss) for the period	14,332	(6,936)
	Adjustments for non-cash items included in profit (loss) for the period	(25,654)	1,552
	Changes in operating assets and liabilities	(29,770)	5,725
	Interest received	94,024	9,451
	Interest paid	(56,303)	(17,861)
	Dividends received	785	0
	Income tax paid	(461)	(27)
	Net cash used in operating activities	**(3,047)**	**(8,096)**
	Investing activities		
4	Cash and cash equivalents included in the net assets acquired from Landsbanki Íslands hf.	0	29,829
12	Acquisition of additional shares in associates	(44)	0
13	Purchase of property and equipment	(299)	(203)
13	Proceeds from sale of property and equipment	129	4
14	Acquisition of intangible assets	(112)	(66)
	Net cash (used in) from investing activities	**(326)**	**29,564**
	Financing activities		
25	Proceeds from issue of share capital upon foundation of the Bank	0	775
	Proceeds from issue of share capital in subsidiaries	88	162
	Net cash from financing activities	**88**	**937**
	Net change in cash and cash equivalents	(3,285)	22,405
	Cash and cash equivalents at the beginning of the period	22,897	0
31	Effect of exchange rate changes on cash and cash equivalents held	1,554	492
	Cash and cash equivalents at 31 December	**21,166**	**22,897**

* The comparative amounts are for the period 7.10 - 31.12.2008 only as the Bank was founded on 7 October 2008.

Notes		2009	7.10-31.12. 2008*
	Investing and financing activities not affecting cash flows		
15	Unpaid capital contribution		149,225
25	Unpaid share capital		149,225
4	Assets acquired and liabilities assumed from Landsbanki Íslands hf.		274,968
4	Non-controlling interests		(168)
20	Provisional liability due to Landsbanki Íslands hf.		274,800
4, 25	Settlement of capital contribution through receipt of Icelandic government bonds	121,225	
4, 20	Settlement of capital contribution through offset against provisional liability due to Landsbanki Íslands hf.	28,000	
20	Settlement of interest on capital contribution through offset against provisional liability due to Landsbanki Íslan(	4,270	
4, 20	Settlement of provisional liability due to Landsbanki Íslands hf. through borrowings	312,168	

The notes on pages 10 to 74 are an integral part of these consolidated financial statements.

NBI hf. Consolidated Financial Statements 2009 8 All amounts are in ISK million

Consolidated Statement of Cash Flows for the Year ended 31 December 2009 (continued)

Notes		2009	7.10-31.12. 2008*
	Adjustments for non-cash items included in profit (loss) for the period		
26	Net interest income	(28,105)	(3,346)
27	Net impairment loss	6,577	1,256
13	Depreciation and amortisation	1,278	294
36	Income tax	615	(2,941)
12	Share of profit of associates, net of income tax	(383)	(193)
29	Net (gain) loss on financial assets designated as at fair value through profit or loss	(4,020)	39,664
30	Net gain on financial assets held for trading	(2,876)	(805)
31	Net foreign exchange loss (gain)	1,260	(32,377)
		(25,654)	**1,552**
	Changes in operating assets and liabilities		
	Change in reserve requirement with Central Bank	(719)	(918)
	Change in loans and advances to financial institutions	(21,895)	3,934
	Change in loans and advances to customers	(6,172)	12,299
	Change in bonds and equities	8,829	(45,447)
	Change in other assets	5,003	(25,636)
	Change in due to financial institutions and Central Bank	(31,019)	47,566
	Change in deposits from customers	24,493	9,544
	Change in repossessed collateral	(4,419)	0
	Change in other liabilities	(3,871)	4,383
		(29,770)	**5,725**
	Cash and cash equivalents at 31 December		
7	Cash and unrestricted balances with Central Bank	16,538	21,154
10	Bank accounts with financial institutions	4,628	1,743
	Cash and cash equivalents at 31 December	**21,166**	**22,897**

* The comparative amounts are for the period 7.10 - 31.12.2008 only as the Bank was founded on 7 October 2008.

The notes on pages 10 to 74 are an integral part of these consolidated financial statements.

NBI hf. Consolidated Financial Statements 2009 9 All amounts are in ISK million

Notes to the Consolidated Financial Statements

Notes to the Consolidated Financial Statements

1. Reporting entity

NBI hf. (hereinafter referred to as the "Bank") was founded on 7 October 2008 by the Ministry of Finance on behalf of the Icelandic State Treasury. The Bank is a limited liability company incorporated and domiciled in Iceland. The Bank operates based on Act No. 161/2002, on Financial Undertakings. The Bank has a licence to operate based on Act No. 125/2008, on the Authority for Treasury Disbursements due to Unusual Financial Market Circumstances and it is supervised by the Financial Supervisory Authority of Iceland. The registered address of the Bank's office is Austurstræti 11, 155 Reykjavík. The consolidated financial statements of the Bank for the year ended 31 December 2009 include the Bank and its subsidiaries (together referred to as the "Group" and individually as "Group entities"). The Group's primary lines of business are corporate and retail banking, investment banking and asset management. The Group operates solely in Iceland.

Based on Act No. 125/2008, which was passed by the Parliament of Iceland on 6 October 2008 and due to unusual and extraordinary circumstances in the financial market, the Financial Supervisory Authority of Iceland (FME) took over the operations of Landsbanki Íslands hf. on 7 October 2008. FME formally decided, on 9 October 2008 and as later amended, to transfer specific operations together with assets and liabilities from Landsbanki Íslands hf. to the Bank. The guiding principle was to transfer most of the domestic operations of Landsbanki Íslands hf. along with related assets and liabilities to the Bank so as to ensure continuing banking operations for Icelandic households and businesses. Further information is provided in Note 4 on the assets and liabilities transferred to the Bank and on the consideration paid by the Bank to Landsbanki Íslands hf.

The issue of these consolidated financial statements was authorised by the Bank's Board of Directors on 8 April 2010.

2. Basis of preparation

Statement of compliance

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS), as adopted by the EU. The consolidated financial statements reflect IFRS effective as of 31 December 2009, except that the Group has early adopted some standards (see Note 3).

Going concern

The Bank's management has assessed the Group's ability to continue as a going concern and it is satisfied that the Group has the resources to continue its operations. Accordingly, these consolidated financial statements have been prepared on a going concern basis. However, there are certain risk factors inherent in the Group's assets and liabilities that may hinder the ability of the Bank or its subsidiaries to continue as a going concern.

The uncertainty about borrowers' ability to pay back their loans to the Group is rather high, due to current economic conditions in Iceland, especially in the case of loans denominated in foreign currencies and granted to borrowers with limited or no income in foreign currency. To reduce the foreign exchange risk related to fluctuating ISK exchange rates, the Bank agreed to issue to Landsbanki Íslands hf. bonds denominated in EUR, USD and GBP. Foreign exchange exposure is nevertheless a significant risk factor in the operations of the Group. Since the opening balance sheet date, the Bank's management has taken measures to mitigate that risk, for example by converting loans in foreign currencies to ISK. In addition, the District Court of Reykjavik has on two occasions ruled about the legality of foreign currency loans with conflicting verdicts. Both rulings have been appealed to the Supreme Court of Iceland. There is a possibility that the Supreme Court will rule that some of the Group's foreign currency loans to individuals and corporations are in fact ISK denominated loans which could affect other foreign currency loans of the Group.

It is the view of the Bank's management that the Group's foreign currency loans are in accordance with Icelandic law. Based on the management's judgement about the legality of the foreign currency loans and on the results of the stress tests performed by the Bank, it is the management's view that the Group is sufficiently capitalised to continue as a going concern. Significant market shocks during the realignment period of the Group's risk profile pose some uncertainty. Of critical importance is the Group's access to funding to fulfil the maturity of existing short-term liabilities and to continue financing the Group's assets. Further information regarding the nature and extent of risks arising from the Group's financial assets and liabilities and from off-balance sheet exposures is provided in Notes 37 and 45-79.

Basis of measurement

The consolidated financial statements have been prepared on a historical cost basis except for:
- Financial assets and liabilities classified as at fair value through profit or loss, which are measured at fair value;
- Non-current assets and disposal groups classified as held for sale, which are measured at the lower of carrying amount or fair value less costs to sell.

Functional and presentation currency

Items included in the financial statements of each individual entity of the Group are measured using the currency of the economic environment in which the respective entity operates (its functional currency). All amounts are presented in Icelandic króna (ISK), which is also the Bank's functional currency, rounded to the nearest million unless otherwise stated.

2. Basis of preparation (continued)

Use of estimates and judgements

The preparation of financial statements requires the management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

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

Note 3 discusses estimates and assumptions which involve a substantial risk which could result in material adjustments to the carrying amounts of assets and liabilities during the next financial year.

Changes in accounting policies

From 1 January 2009 the Group has changed its accounting policies in the following areas:
• Interest income from financial assets held for trading is now presented in the income statement in the line item "Net gain on financial assets and liabilities held for trading" but it was previously included in the line item "Interest income";
• Interest income from financial assets designated as at fair value through profit or loss is now presented in the income statement in the line item "Net gain (loss) on financial assets designated as at fair value through profit or loss" but it was previously included in the line item "Interest income";
• Net foreign exchange difference arising from derivative assets and liabilities, other than currency forwards, is now presented in the line item "Net gain on financial assets and liabilities held for trading" in the income statement but it was previously included in the line item "Net foreign exchange gain". However, net foreign exchange difference arising from derivative currency forwards continues to be presented in the line item "Net foreign exchange gain" in the income statement.

The comparison amounts in the income statement have been adjusted in conformity with the changes described above. The line items affected and the amounts of the adjustments are the following:
• The line item "Interest income" decreased by ISK 945 million;
• The line item "Net gain on financial assets and liabilities held for trading" increased by ISK 338 million;
• The line item "Net gain (loss) on financial assets designated as at fair value through profit or loss" increased by ISK 321 million;
• The line item "Net foreign exchange (loss) gain" increased by ISK 286 million.

The reason for these changes in presentation is that the changed presentation provides more relevant information about the performance of the financial assets and liabilities involved.

At the beginning of the year 2009, revised IAS 1 Presentation of Financial Statements (2007) became effective. The standard prohibits the presentation of items of income and expenses (that is, "non-owner changes in equity") in the statement of changes in equity, requiring "non-owner changes in equity" to be presented separately from owner changes in equity in a statement of comprehensive income. The adoption of IAS 1 (revised 2007) did not have any effect on the consolidated financial statements of the Group because there are no items of revenue or expense recognised by the Group in other comprehensive income. Therefore, the Group only presents an income statement in these consolidated financial statements.

Other accounting developments

The Group has applied Improving Disclosures about Financial Instruments (Amendments to IFRS 7), issued in March 2009, that require enhanced disclosures about fair value measurements and liquidity risk in respect of financial instruments.

The amendments require that fair value measurement disclosures use a three-level fair value hierarchy that reflects the significance of the inputs used in measuring fair values of financial instruments. Specific disclosures are required when fair value measurements are categorised as Level 3 (significant unobservable inputs) in the fair value hierarchy. The amendments require that any significant transfers between Level 1 and Level 2 of the fair value hierarchy be disclosed separately, distinguishing between transfers into and out of each level. In addition to that, changes in valuation techniques from one period to another, including the reasons therefore, are required to be disclosed for each class of financial instruments.

The definition of liquidity risk has been amended and it is now defined as the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset. The amendments require disclosure of a maturity analysis for non-derivative and derivative financial liabilities, but contractual maturities are required to be disclosed for derivative financial liabilities only when contractual maturities are essential for an understanding of the timing of cash flows. For issued financial guarantee contracts, the amendments require the maximum amount of the guarantee to be disclosed in the earliest period in which the guarantee could be called.

3. Significant accounting policies, estimates and judgements

These consolidated financial statements have been prepared using uniform accounting policies for like transactions and other events in similar circumstances. The accounting policies have been applied consistently to all periods presented. As explained in note 2 certain changes were made to the accounting policies which the Group applied in its consolidated financial statements for the period from 7 October to 31 December 2008. These changes relate to the presentation of certain items of income and expense in the income statement. The principal accounting policies used in preparing these consolidated financial statements are set out below.

Consolidation

(a) Subsidiaries

Subsidiaries are entities over which the Group has the power to govern financial and operating policies so as to obtain benefits from their activities, generally accompanied by a shareholding of over half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls an entity. Subsidiaries are fully consolidated from the date on which control is obtained, and are de-consolidated from the date on which control ceases.

The acquisition method is used to account for business combinations by the Group. The consideration transferred for the acquisition of a subsidiary is the fair value of the assets transferred, the liabilities incurred and the equity interests issued by the Group. The consideration transferred includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Acquisition-related costs are expensed as incurred, except for costs related to the issue of debt and equity instruments. Identifiable assets acquired and liabilities assumed in a business combination are initially measured at their fair value on the acquisition date. A contingent liability of an acquiree is only recognised in a business combination if such a liability represents a present obligation and arises from a past event, and its fair value can be measured reliably. More information about how the Group accounts for goodwill acquired in a business combination is disclosed further in this note.

Inter-company transactions, balances, and unrealised gains on transactions between Group entities are eliminated in the consolidated financial statements. Unrealised losses are also eliminated unless the transaction provides evidence of impairment of the asset transferred. The accounting policies of subsidiaries have been changed where this was necessary to ensure consistency with the accounting policies adopted by the Group.

(b) Non-controlling interests

Non-controlling interests represent the portion of profit or loss and equity not owned, directly or indirectly, by the Bank; such interests are presented separately in the consolidated income statement and are included in equity in the consolidated balance sheet, separately from equity attributable to owners of the Bank. The Group chooses on an acquisition-by-acquisition basis whether to measure non-controlling interests in an acquiree at fair value or according to the proportion of non-controlling interests in the acquiree's net assets. Changes in the Bank's ownership interest in a subsidiary that do not result in a loss of control are accounted for as equity transactions. In such circumstances the carrying amounts of the controlling and non-controlling interests are adjusted to reflect the changes in their relative interests in the subsidiary. Any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received is recognised directly in equity and attributed to the owners of the Bank.

(c) Associates

Associates are those entities in which the Group has significant influence, but not control, over the financial and operating policies. Significant influence is presumed to exist when the Group holds between 20 and 50 percent of the voting power of another entity. Investments in associates are accounted for using the equity method as of the date on which significant influence is obtained and are initially recognised at cost. Goodwill relating to an associate is included in the carrying amount of the investment. Amortisation of goodwill is not permitted. Any excess of the Group's share of net fair value of the associate's identifiable assets and liabilities over the cost of the investment is included as income in the determination of the Group's share of the associate's profit or loss in the period which the investment is acquired.

Because goodwill included in the carrying amount of an investment in an associate is not recognised separately, it is not separately tested for impairment according to the requirements for goodwill impairment testing in IAS 36 *Impairment of Assets*. Instead, the entire carrying amount of the investment is tested for impairment under IAS 36 by comparing its recoverable amount with its carrying amount, whenever application of the requirements in IAS 39 *Financial Instruments: Recognition and Measurement* indicates the investment may be impaired.

The Group's share of its associates' post-acquisition profits or losses is recognised in the income statement, and its share of movements in their reserves is recognised in the Group's equity reserves. Cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When the Group's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the associate.

Unrealised gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. The accounting policies of associates have been changed where this was necessary to ensure consistency with the accounting policies adopted by the Group.

3. Significant accounting policies, estimates and judgements (continued)

Foreign currency translation

Transactions in foreign currencies are translated into the functional currency of the respective Group entity at the spot exchange rate at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the reporting date are measured at amortised cost or fair value, as applicable, in their respective foreign currencies and are retranslated into the functional currency at the spot exchange rate at that date. The foreign currency gain or loss on monetary items is the difference between amortised cost in the functional currency at the beginning of the period, adjusted for effective interest and payments during the period, and the amortised cost in foreign currency translated at the exchange rate at the end of the period. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are first measured at fair value in their respective foreign currencies and then retranslated into the functional currency at the spot exchange rate at the date that the fair value was determined. All foreign currency differences arising on retranslation are recognised in the income statement.

Due to varying customer financial strength, the Group has assessed the increase in credit risk due to exchange fluctuations in the foreign currency denominated loan portfolio. While some customers have part of or all of their income in foreign currency, other customers have very limited or no income in foreign currency. In many instances, customers with limited or no income in foreign currency will encounter difficulty in meeting their obligations if the ISK depreciates. Therefore, for customers who have limited or no income in foreign currency, the foreign exchange differences arising through loans and advances to these customers is presented in the income statement net of the amount of foreign exchange difference deemed to be uncollectible.

Financial assets and liabilities

(a) Recognition

The Group initially recognises loans and advances, deposits and debt securities issued on the date at which they are originated. All other financial assets and liabilities are initially recognised on the date at which the Group becomes a party to contractual provisions of the instrument. Regular way purchases and sales of financial assets are recognised on the date at which the Group committed itself to purchasing or selling the asset.

A financial asset or financial liability is initially measured at fair value plus, for an item not subsequently measured at fair value through profit or loss, transaction costs that are directly attributable to its acquisition or issue.

(b) Classification

The Group classifies all financial assets either as loans and receivables or as at fair value through profit or loss. The Group classifies all financial liabilities either as at fair value through profit or loss or at amortised cost.

A financial asset or liability is classified as held for trading if it is acquired or incurred principally for the purpose of selling or repurchasing it in the near term or if it is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking. Financial assets held for trading consist of debt, equity and derivative instruments. Financial liabilities held for trading consist of derivative liabilities and short positions, i.e. obligations to deliver financial assets borrowed by the Group and sold to third parties.

The Group designates certain financial assets upon initial recognition as at fair value through profit or loss when the financial assets are part of a portfolio of financial instruments which is risk managed and reported to senior management on a fair value basis.

Loans and advances are financial assets with fixed or determinable payments that are not quoted in an active market which the Group originates or acquires with no intention of trading them.

(c) Derecognition

The Group derecognises a financial asset when contractual rights to cash flows from the asset expire, or when the Group transfers the rights to receive contractual cash flows relating to the financial asset in a transaction which substantially transfers all the risks and rewards of owning that asset. Any interest in transferred financial assets created or retained by the Group is recognised as a separate asset or liability.

The Group enters into transactions whereby it transfers assets recognised on its balance sheet, but retains either all or substantially all of the risks and rewards of the transferred assets, or a portion of them. In cases where all or substantially all of the risks and rewards are retained, then transferred assets are not derecognised. Asset transfers whereby all or substantially all risks and rewards are retained include, for example, securities lending and repurchase transactions.

The Group derecognises a financial liability when its contractual obligations are discharged or cancelled or when they expire.

(d) Offsetting

Financial assets and liabilities are set off and the net amount presented in the balance sheet when, and only when, the Group has a legal right to set off these amounts and intends either to settle on a net basis or to realise the asset and simultaneously settle the liability.

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

3. Significant accounting policies, estimates and judgements (continued)

Financial assets and liabilities (continued)

(e) Amortised cost measurement

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

(f) Fair value measurement

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction at the measurement date.

The Group measures the fair value of an instrument using quoted prices in an active market for that instrument, if available. A market is regarded as active if quoted prices are readily and regularly available and represent actual and regularly occurring market transactions on an arm's length basis. Where available, the relevant market's closing price determines the fair value of financial assets held for trading and of assets designated at fair value through profit or loss; this will generally be the last trading price.

If a market for a financial instrument is not active, the Group establishes fair value using a valuation technique. Valuation techniques include using recent arm's length transactions between knowledgeable, willing parties, if available, reference to the current fair value of other instruments that are substantially the same, discounted cash flow analyses and option pricing models. The chosen valuation technique makes maximum use of market inputs, relies as little as possible on estimates specific to the Group, incorporates every factor that market participants would consider in setting a price, and is consistent with accepted economic methodologies for pricing financial instruments. Inputs to valuation techniques reasonably represent market expectations and measures of the risk-return factors inherent in the financial instrument. The Bank has a valuation committee which estimates fair value by applying models and incorporating observable market information and professional judgement. The Group calibrates valuation techniques and tests them for validity using prices from observable current market transactions in the same instrument or based on other available, observable market data.

Should the transaction price differ from the fair value of other observable, current market transactions in the same instrument or be based on a valuation technique whose variables include only data from observable markets, the Group immediately recognises the difference between the transaction price and fair value (a Day 1 profit or loss). In cases where fair value is determined using data which is not observable, the difference between the transaction price and the model value is recognised in the income statement depending on the individual circumstances of the transaction but not later than when the inputs become observable, or when the instrument is derecognised.

(g) Impairment of financial assets

Impairment of loans and advances

At each balance sheet date, the Group assesses whether there is any objective evidence that a loan or loan portfolio is impaired. A loan or loan portfolio is considered impaired and impairment losses are incurred only when there is objective evidence of impairment as a result of one or more events occurring after initial recognition of the asset ("loss events") and this or these loss events impact future cash flows that can be estimated reliably for the loan or group of loans. Objective evidence of impairment includes observable data on the following loss events:

• significant financial difficulties of the borrower;
• a breach of contract, such as defaulting on instalments or on interest or principal payments;
• the Group granting to the borrower, for economic or legal reasons relating to the borrower's financial difficulty, a refinancing concession that the lender would not otherwise consider;
• it becomes probable that the borrower will enter into bankruptcy or undergo other financial reorganisation; or
• observable data indicate a measurable decrease in estimated future cash flows from a group of loans since the initial recognition of those assets, even if the decrease cannot yet be identified with individual financial assets within the group, including adverse changes in the payment status of borrowers in the group or a general deterioration of economic conditions connected to that group of loans.

The Group defines loans that are individually significant and assesses first whether objective evidence of their impairment exists, and then makes individual or collective assessments for loans and advances that have not been defined as individually significant. If the Group determines that no objective evidence of impairment exists for a significant loan, it includes this loan in a group of loans with similar credit risk characteristics and collectively assesses them for impairment. Individual significant assets for which an impairment loss is recognised are not included in collective impairment assessments.

If there is objective evidence that an impairment loss has been incurred on loans or advances, the amount of the loss is measured as the difference between the asset's carrying amount and its recoverable value. The recoverable value is the present value of estimated future cash flows, excluding future credit losses that have not been incurred, discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced by the amount of impairment, using an allowance account, and the amount of the loss is recognised in the line item "Net impairment loss on loans and advances" in the income statement. In the case of loans with variable interest rates, the discount rate for measuring impairment losses is the current effective interest rate.

The present value calculated for estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure, less the costs involved in obtaining and selling the collateral, whether or not foreclosure is probable.

3. Significant accounting policies, estimates and judgements (continued)

Financial assets and liabilities (continued)

(g) Impairment of financial assets (continued)

Impairment of loans and advances (continued)

In order to conduct a collective evaluation of impairment, loans are grouped on the basis of similar credit risk characteristics on the basis of the Group's grading process, which considers asset type, collateral type, industry, past-due status and other relevant factors. These characteristics are appropriate for estimating future cash flows in groups of such loans by indicating the debtors' ability to pay every amount due according to contractual terms.

Groups of loans are collectively evaluated for impairment on the basis of expected cash flows and of peer review regarding assets with similar credit risk characteristics. Such peer review is also adjusted on the basis of current observable data, in order to reflect the effects of current conditions that did not affect the period on which peer review was originally based and to remove the effects of previous loss factors which no longer exist.

Estimates of changes in future cash flows in groups of assets are consistent with changes in observable data from period to period, for example changes in property prices, payment status, or other factors indicative of trends in the probability and magnitude of Group losses. The Group regularly reviews its methodology and assumptions for estimating future cash flows in order to minimise discrepancies between estimated losses and actual loss experience.

When a loan is uncollectible, it is written off against the provision for loan impairment on the balance sheet. Loans are written off after all the necessary procedures have been completed, as set out in Group lending policies, and the amount of loss has been determined. Any subsequent recovery of an amount previously written off is recognised in the income statement in the line item "Impairment loss on loans and advances".

If the amount of the impairment loss decreases in the subsequent period and the decrease can be related objectively to an event occurring after the original impairment was recognised, the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of reversal is recognised in the income statement in the line item "Net impairment loss on loans and advances".

Renegotiated loans

Where possible, the Group seeks to restructure loans rather than to take possession of collaterals. This may involve extending the payment arrangements and an agreement of new loan terms. Loans which are impaired and whose terms are renegotiated are not considered to be new loans. Once the terms have been renegotiated these loans are no longer considered past due and any subsequent impairment is measured using the original effective interest rate as calculated before the modification of terms. Management continuously reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. These loans continue to be subject to individual or collective impairment assessment. Loans which are not individually impaired and whose terms are renegotiated are accounted for as new loans. Accordingly, the original loans are derecognised and the renegotiated loans are recognised as new loans.

Cash and cash equivalents

For the purpose of the statement of cash flows, cash and cash equivalents are defined as cash, unrestricted balances with the Central Bank and unrestricted balances with financial institutions.

Bonds and equities

Bonds and equities which are classified as at fair value through profit or loss are recognised at fair value in the balance sheet both initially and subsequently to initial recognition. Transaction costs are recognised directly in the income statement. Gains and losses arising from changes in fair value are recognised directly in the consolidated income statement in the line items "Net gain on financial assets and liabilities held for trading" and "Net gain (loss) on financial assets designated as at fair value through profit or loss", respectively. The gains and losses include interest income on bonds but exclude foreign exchange gains and losses, which are included in the line item "Net foreign exchange (loss) gain".

Bonds which are classified as loans and receivables are initially measured at fair value plus directly attributable transaction costs, and are subsequently measured at amortised cost using the effective interest method. Accrued interest is included in the carrying amount of the bonds and it is recognised in the line item "Interest income" in the income statement.

Derivative instruments

Derivatives are initially recognised in the balance sheet at fair value, with transaction costs being recognised in the income statement. Subsequently, derivatives are carried at fair value, with all fair value changes recognised in the line item "Net gain on financial assets and liabilities held for trading" in the income statement, except for fair value changes of derivative currency forwards, which are included in the line item "Net foreign exchange gain (loss)" in the income statement. In the balance sheet, derivatives with positive fair values are recognised as assets and derivatives with negative fair values are recognised as liabilities. The Group does not apply hedge accounting.

3. Significant accounting policies, estimates and judgements (continued)

Loans and advances

Loans and advances are initially measured at fair value plus directly attributable transaction costs, and are subsequently measured at amortised cost using the effective interest method. Accrued interest is included in the carrying amount of loans and advances. Interest income on loans and advances is recognised in the line item "Interest income" in the income statement and foreign exchange differences in the line item "Net foreign exchange (loss) gain".

Loans and advances acquired at a deep discount

The Bank acquired loans from Landsbanki Íslands hf. at a deep discount that reflected incurred credit losses. The initial fair value of these loans was determined by using various valuation methods as further described in Note 4.

Interest income arising from loans acquired at a deep discount and measured at amortised cost is recognised in the income statement using the effective interest method based on the loan acquisition price and estimated future cash flows, taking into account the deep discount.

At each balance sheet date, the Group's management compares estimated cash flows to actual cash flows. If the difference is favourable and stems from changes in the macro environment, such as an increase in either variable interest rates or inflation, this favourable increase is recognised as interest income. If on the other hand the favourable increase stems from micro changes, i.e. an increased ability of the borrower to repay debt, the Group adjusts the carrying amount of the loans to reflect the expected increase in future cash flows, by computing the present value of the revised estimated future cash flows discounted by using the effective interest rate of the loans. The adjustment to the carrying amounts is recognised as a reversal of any impairment amount previously recognised by the Group, with any excess amount being recognised as interest income in the income statement.

The excess of the contractually required payments receivable over the Bank's initial acquisition price, whether accretable yield or non-accretable difference, for a specific loan or a pool of loans with one set of common risk characteristics is not considered available to "offset" changes in cash flows that are expected from another loan or assembled pool of loans with a different set of common risk characteristics.

If there are unfavourable differences between the expected and actual cash flows and these differences are due to changes in the macro environment, such as deflation or decreasing variable interest rates, the differences are netted against interest income. If these unfavourable differences are on the other hand due to micro changes which are impairment related, i.e. decreasing ability of the borrower to repay debt which results in impairment, the decrease in expected cash flows is discounted by the effective interest rate of the loan and recognised as impairment in the income statement.

Due to varying customer financial strength, the Group has assessed the increase in credit risk due to exchange fluctuations in the foreign currency denominated loan portfolio. While some customers have part of or all of their income in foreign currency, other customers have very limited or no income in foreign currency. In many instances, customers with limited or no income in foreign currency will encounter difficulty in meeting their obligations if the ISK depreciates. Therefore, for customers who have limited or no income in foreign currency, the foreign exchange differences arising through loans and advances to these customers is presented in the income statement net of the amount of foreign exchange difference deemed to be uncollectible.

The amount of foreign exchange difference deemed to be uncollectible is calculated based on the estimated FX-delta on the FX loan book. The Bank implemented the FX-delta methodology during the valuation process of the loans acquired from Landsbanki Íslands hf. During that process the Bank analysed its largest corporate customers in great detail and estimated the FX-delta by analysing major customers which have loans denominated in foreign currency. Industry specialists performed this estimate by reviewing financial strength, collaterals and the currency composition of cash flows. The Group estimated the ability of customers to raise income in foreign currencies and to fulfil their obligations in regard to foreign currency dominated loans. The Group revises its estimated FX-delta at each balance sheet date if changes occur in the circumstances on which the FX-delta is based or as a result of new information or more experience.

3. Significant accounting policies, estimates and judgements (continued)

Property and equipment

All property and equipment is recognised at cost, less accumulated depreciation and accumulated impairment losses. The cost includes expenditures directly attributable to acquiring these assets.

Subsequent costs are included in an asset's carrying amount only if it is probable that future economic benefits associated with the item will flow to the Group and if these costs can be reliably measured. All other repairs and maintenance are charged to the income statement of the financial period in which their costs are incurred.

Depreciation of any property and equipment is calculated using the straight-line method; this method is applied to the depreciable amount of the assets, which is their cost less their residual value over their estimated useful lives, as follows:

Buildings	25-50 years
Computer hardware	3 years
Other equipment and motor vehicles	3-10 years

The assets' residual values and useful lives are reviewed annually and adjusted where appropriate.

Gains and losses on disposals are determined by comparing the sale price of an asset with its carrying amount on the date of sale. Gains and losses are included in the item "Other administrative expenses" in the consolidated income statement.

Intangible assets

(a) Computer software licenses

Acquired computer software licenses are capitalised on the basis of the costs incurred to acquire and bring them into service. Computer software licenses recognised as intangible assets are amortised over their useful life, which is estimated to be 3 - 5 years.

The costs associated with maintaining computer software are recorded as expenses at the time they are incurred.

(b) Goodwill

Goodwill is recognised as an asset only if acquired in a business combination. It is recognised as of the acquisition date and measured as the aggregate of (a) the fair value of the consideration transferred, (b) the recognised amount of any non-controlling interest in the acquiree, and (c) the fair value of any previously held equity interest in the acquiree, less the net recognised amount (generally fair value) of the identifiable assets acquired and liabilities assumed, all measured as of the acquisition date. The consideration transferred includes the fair value of assets transferred, liabilities incurred and equity interests issued by the Group. In addition, consideration transferred includes the fair value of any contingent consideration.

Following initial recognition, goodwill is measured at cost, less any accumulated impairment losses. Goodwill is generally reviewed for impairment annually, but more frequently if events or changes in circumstances indicate a potential impairment of the carrying amount. For the purpose of impairment testing, goodwill is allocated as of the acquisition date to each of the Group's cash-generating units (CGUs) or group of CGUs which are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units. Each unit to which this goodwill is allocated represents the lowest level within the Group at which the goodwill is monitored for internal management purposes. Where goodwill is attached to a particular unit of a CGU (or of a group of CGUs) and part of the operations within that unit is disposed of, the goodwill that is associated with the operations disposed of is included in the carrying amount of these operations when determining the gain or loss incurred upon disposing of the operations.

Impairment of non-financial assets

Assets with an indefinite useful life are not subject to amortisation but are tested annually for impairment. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is either an asset's fair value less selling costs or its value in use, whichever is higher. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). With the exception of goodwill, non-financial assets are reviewed at each reporting date for any possible reversal of impairment.

3. Significant accounting policies, estimates and judgements (continued)

Deferred income tax

Deferred tax assets are recognised when it is probable that future taxable profit will be available against which deductible temporary differences can be utilised.

Deferred income tax is recognised in full as a liability, based on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, deferred income tax is not recognised if it arises from the initial recognition of an asset or liability in a transaction other than a business combination, which at the time of the transaction affects neither the Group's accounting nor its taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

The principal temporary differences arise from fair value changes in various financial assets and liabilities and the difference between the fair values of acquired assets and their tax base.

Assets and liabilities classified as held for sale

The Group classifies non-current assets (or groups of assets together with related liabilities) as held for sale when their carrying amount will be recovered principally through a sale transaction. This is usually the case with collateral foreclosed by the Group which it holds as security for loans and advances, including assets and liabilities of subsidiaries over which the Group obtains control through foreclosure of collateral and/or financial restructuring.

A non-current asset (or group of assets together with related liabilities) is considered to be recovered principally through a sale transaction when the asset's sale is highly probable and it is available for immediate sale in its present condition, subject to ordinary and customary terms on the sale of such assets. Management must be committed to the sale and must actively market the asset for sale at a price that is reasonable in relation to its current fair value. A further condition is that the sale is expected to qualify for recognition as completed within one year from the date of classification.

Assets and disposal groups classified as held for sale are measured at the lower of their carrying amount and their fair value less costs to sell. Additional net assets that become part of a disposal group, for example due to profits generated by the disposal group, increase the carrying amount of the disposal group but not in excess of the fair value less costs to sell of the disposal group as determined at each balance sheet date.

In the case of single assets classified by the Group as held for sale the Group determines their fair value less costs to sell by reference to the current market price at each balance sheet date. In the case of subsidiaries classified as held for sale, the Group determines the fair value of disposal groups based on discounted cash flows methodologies. Costs to sell are deemed to be only the costs which are incremental and directly attributable to the disposal of the disposal groups, excluding finance costs and income tax expense.

Deposits and borrowings

The Group's sources of debt funding consist of deposits, loans from financial institutions and debt securities.

When the Group sells a financial asset and simultaneously enters into an agreement to repurchase the asset or a similar asset at a fixed price on a future date ("repo"), this arrangement is accounted for as an amount due to financial institutions or the Central Bank, and the underlying asset continues to be recognised in the Group's financial statements.

The Group classifies financial instruments as financial liabilities or equity instruments in accordance with the substance of the contractual arrangement and the definitions of a financial liability, a financial asset or an equity instrument.

Deposits and borrowings are initially measured at fair value plus any directly attributable transaction costs. Subsequently, they are measured at their amortised cost using the effective interest method. The fair value of a financial liability with a demand feature such as a demand deposit, is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid.

Contingent bond

The contingent bond is a contingent obligation of the Bank to issue a bond to Landsbanki Íslands hf. on 31 March 2013 as an additional consideration for the assets and liabilities transferred from Landsbanki Íslands hf. on 9 October 2008. The issue of the bond and its nominal amount are contingent on the excess of the value of certain pools of assets, to be determined as at 31 December 2012, over the future value of the acquisition price of those assets as at 9 October 2008, subject to specified adjustments.

The contingent obligation of the Bank is classified as a financial liability and measured initially at fair value. Subsequently, it is measured at fair value, with any resulting gain or loss recognised in the line item "Interest expense" in the income statement.

3. Significant accounting policies, estimates and judgements (continued)

Short positions

Short positions are obligations of the Group to deliver financial assets borrowed by the Group and sold to third parties. These obligations are initially recognised in the balance sheet at fair value, with transaction costs being recognised in the income statement. Subsequently, they are carried at fair value, with all fair value changes recognised in the income statement in the line item "Net gain on financial assets and liabilities held for trading".

Financial guarantee contracts

Financial guarantee contracts are contracts requiring the issuer to make specified payments to reimburse the holder for a loss it will incur if a specified debtor fails to make payments when due, in accordance with the terms of a debt instrument. Such financial guarantees are issued by the Group to banks, financial institutions or other parties on behalf of Group customers so that they can secure loans, overdrafts and other banking facilities.

Financial guarantees issued by the Group are initially recognised in the financial statements at fair value on the date the guarantee was given. Subsequent to initial recognition, the Group’s liability under such a guarantee is determined as the initial measurement, less amortisation of fee income earned on a straight line basis over the life of the guarantee, or the best estimate for settling any financial obligation that has arisen through the guarantee by the balance sheet date, whichever is higher. These estimates are determined on the basis of experience with similar transactions and the history of past losses, supplemented by management judgement.

Contingent liabilities and provisions

The Group does not recognise contingent liabilities as liabilities in the balance sheet, other than contingent liabilities which are assumed in a business combination and which have a fair value that can be measured reliably. A contingent consideration transferred by the Group in a business combination is recognised at its acquisition-date fair value. The Group classifies the obligation to pay contingent consideration as liability or equity and accounts for changes in fair value in accordance with applicable IFRSs.

Provisions for expenditures such as those related to legal claims or restructuring are recognised as incurred when (i) the Group has as a result of past events a present legal or constructive obligation to pay, (ii) it is more likely than not that an outflow of resources will be required to settle the obligation, and (iii) the amount has been reliably estimated.

Provisions are measured at the present value of the expenditures expected for settling the obligation. A pre-tax rate is used which reflects current market assessments of the time value of money and the risks specific to the obligation. Any increase in the provision due to the passage of time is recognised as interest expense.

Employee benefits

All Group entities have defined contribution plans, with the entities paying a fixed contribution to publicly or privately administered pension plans on a mandatory and contractual basis. The Group has no further payment obligations once these contributions have been paid. The contributions are recognised as an expense when they become due. The Group has no defined benefit pension plan.

Share capital

(a) Share issue costs

Costs directly attributable to the issue of new shares are presented separately in equity as a deduction from share premium, net of any related income tax benefits.

(b) Dividends on ordinary shares

Dividends on ordinary shares are recognised in equity during the period in which they are approved by the Bank's shareholders' meeting.

Fiduciary activities

The Group acts as a custodian, holding or placing assets on behalf of individuals, institutions and pension funds, including various mutual funds managed by the Group. These assets, together with the income arising from them, are excluded from these financial statements, since they are not assets of the Group.

3. Significant accounting policies, estimates and judgements (continued)

Interest income and expense

The interest income and expense presented in the income statement include:
• Interest on financial assets and liabilities measured at amortised cost, calculated on an effective interest rate basis;
• Positive and negative adjustments to the carrying amount of loans and advances measured at amortised cost arising from revisions of estimates of future cash flow receipts which are not impairment related;
• Interest on unpaid capital contribution, calculated on an accrual basis;
• Interest on provisional liabilities, calculated on an accrual basis; and
• Changes in the fair value of the contingent bond obligation.

Interest income and expense on financial assets and liabilities measured at amortised cost are recognised in the income statement using the effective interest method. The effective interest rate is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial asset or liability (or, where appropriate, a shorter period) to the carrying amount of the financial asset or liability. When calculating the effective interest rate, the Group estimates future cash flows considering all contractual terms of the financial instrument and it does not consider any future credit losses. The calculation of the effective interest rate includes all fees and points paid or received that are an integral part of the effective interest rate. Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial asset or liability.

Net impairment loss on loans and advances

Impairment charges relating to loans and advances to financial institutions and customers are presented in the consolidated income statement under the item "Net impairment loss on loans and advances". After impairment has been recognised, interest income is recognised at the rate of interest used for discounting future cash flows when measuring impairment losses.

Fee and commission income and expense

Fees and commissions are generally recognised on an accrual basis as the related services are performed. Arrangement fees are generally deferred together with related direct costs and recognised as an adjustment to the effective interest rate on the loan. Commissions and fees for participation in negotiating a transaction for a third party – such as arrangement of transactions with equities or other securities or the purchase or sale of businesses – are recognised upon completion of the underlying transaction. Portfolio and other management advisory and service fees are recognised based on the applicable service contracts, usually on a time-apportioned basis. Asset management fees related to investment funds are recognised rateably over the period when the service is provided. The same principle for reporting income is applied to other custody services that are continuously provided over an extended period of time.

Net gain (loss) on financial assets designated as at fair value through profit or loss

The net gain (loss) on financial assets designated as at fair value through profit or loss relates to financial assets designated by the Group as at fair value through profit or loss and includes:
• All realised and unrealised changes in fair value;
• Interest income on an accrual basis; and
• Dividend income, which is recognised when the Group's right to receive payment is established.

Net gain on financial assets and liabilities held for trading

The net gain on financial assets and liabilities held for trading relates to financial assets and liabilities classified by the Group as held for trading and includes:
• All realised and unrealised changes in fair value;
• Interest income on an accrual basis;
• Dividend income, which is recognised when the Group's right to receive payment is established; and
• Foreign exchange gains and losses arising from derivative financial assets and liabilities, except for changes in fair value of derivative currency forwards, which are included in the line item "Net foreign exchange (loss) gain" in the income statement.

3. Significant accounting policies, estimates and judgements (continued)

Net foreign exchange (loss) gain

Net foreign exchange (loss) gain includes all gains and losses arising from settlement of transactions in foreign currencies and translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies, including non-derivative financial assets and liabilities classified as held for trading and financial assets designated as at fair value through profit or loss. Foreign exchange gains and losses arising from derivative financial assets and liabilities are included in the line item "Net gain on financial assets and liabilities held for trading", except for fair value changes of derivative currency forwards, which are included in the line item "Net foreign exchange (loss) gain" in the income statement.

Other income and expenses

Other income and expenses include revenue arising from recharging agreements and gains and losses on repossessed collateral and property and equipment.

Leases

(a) When a Group entity is the lessee

The leases into which the Group enters are primarily operating leases. Over the period of the lease, payments for operating leases are charged to the income statement on a straight-line basis, in the line item "Other administrative expenses".

If an operating lease is terminated before the lease period has expired, any payment to the lessor required by way of penalty is recognised as an expense in the period in which termination occurs.

(b) When a Group entity is the lessor

When assets are held subject to a finance lease, the present value of lease payments is recognised as a receivable, under loans and advances to customers. Finance income from such a lease is recognised over the term of the lease, using a method that reflects a constant periodic rate of return on the Group's net investment in the lease.

Discontinued operations

The Group presents discontinued operations in a separate line of the consolidated income statement if an entity or a component of an entity has been disposed of or is classified as held for sale and:
- Represents a major separate line of business;
- Is a part of a single co-ordinated plan to dispose of a major separate line of business; or
- Is a subsidiary acquired exclusively with a view to resale.

The profit from discontinued operations disclosed in the consolidated income statement consists of (a) post-tax profit or loss from discontinued operations and (b) post-tax gain or loss recognised on the measurement to fair value less costs to sell or on the disposal of the assets or the disposal groups constituting the discontinued operation. A component of an entity comprises operations and cash flows that can be clearly distinguished, operationally and for financial reporting, from the rest of the Group's operations and cash flows.

3. Significant accounting policies, estimates and judgements (continued)

Critical accounting estimates and judgements in applying accounting policies

(a) Effective interest rate on loans and advances

The Bank acquired loans and advances from Landsbanki Íslands hf. at a deep discount, reflecting incurred credit losses. The effective interest rate is computed for these loans by estimating their future cash flows and comparing it with their acquisition prices. Estimating the cash flows involves management judgements about the debtors' financial situation and ability to pay their debts, the net realisable value of any underlying collateral and the timing of any potential cash flows. These estimates have a significant risk of resulting in material adjustments to the carrying amounts of loans within the next financial year.

(b) Impairment losses on loans and advances

To assess impairment, the Group reviews its loan portfolios on at least a quarterly basis. To determine whether an impairment loss should be recognised, the Group judges whether there is any observable data indicating a measurable decrease in estimated future cash flows from a portfolio of loans, before any decreases in individual loans become identifiable within that portfolio. The evidence may include either observable data indicating that an adverse change has occurred in the payment status of the borrowers in a group, or national or local economic conditions correlating with defaults on assets in the group. In order to schedule its future cash flows, management uses estimates based on historical loss experience, together with objective evidence of impairment in homogenous portfolios. The methodology and assumptions for estimating both the amount and timing of future cash flows are reviewed regularly in order to reduce potential discrepancies between loss estimates and actual loss experience.

(c) Denomination currency of loans

The Group acquired loans from Landsbanki Íslands hf. some of which being denominated in various foreign currencies. Due to challenges by clients through legal proceedings, there is a possibility that the Supreme Court of Iceland will rule that some or all of the Group's foreign currency loans to individuals and corporations are in fact ISK denominated loans. However, it is the view of the Bank's management that the foreign currency loans of the Group are in accordance with Icelandic law. The Bank's management expects the Supreme Court of Iceland to rule on this legal issue during the year 2010. If the ruling by the Supreme Court of Iceland will be unfavourable it will increase the uncertainty about the currency of denomination of the Group's loans. The Bank's management has estimated that if all of the Group's foreign currency denominated loans are considered to be ISK loans, it could lead to a decrease in the carrying amount of these loans by ISK 30 to 100 billion, with an equivalent negative impact on equity. The effect would depend on whether the interest rates on these loans would be considered to have been the foreign currency rates or the Icelandic rate since the origination of the loans until year-end 2009. The effect on the carrying amount of the loans is estimated to be lesser if the loans are considered to have carried Icelandic floating interest rate (i.e. REIBOR plus the contractual margin) than if the loans are considered to have carried foreign currency interest rates.

(d) Foreign exchange gains and losses on loans and advances

Due to varying customer financial strength, the Bank needs to assess risk increases occurring in the foreign currency denominated loan portfolio through foreign exchange fluctuation. Some Bank customers have partial or full income in foreign currencies, while other customers have very limited or no income in foreign currency. Customers with limited or no income in foreign currency will in many instances encounter difficulties in meeting their obligations, should the ISK depreciate. Therefore, concerning customers with limited or no income in foreign currency, the foreign exchange difference arising from loans and advances is presented in the income statement net of the amount of foreign exchange difference deemed to be uncollectible.

(e) Valuation of financial instruments

The fair value of financial instruments where no active market exists or where quoted prices are not otherwise available are determined by using valuation techniques. In these cases, the fair values are estimated from observable data in respect of similar financial instruments or using models. Where market observable inputs are not available, they are estimated based on appropriate assumptions. Where valuation techniques (for example, models) are used to determine fair value, they are validated and periodically reviewed by qualified personnel who are independent of the area that created them. All models are certified before use, and calibrated to ensure that the outputs reflect actual data and comparative market prices. Wherever practical, models are confined to observable data; however, areas such as volatility, correlation and credit risk, whether own or counterparty, require management to make estimates. Changing assumptions on these factors could affect the reported fair value of financial instruments.

The largest class of assets transferred from Landsbanki Íslands hf. was loans and advances to customers, where the most significant risk for the Bank is that they were valued too high at the acquisition date. Due to the effects of the financial crisis, a rather high uncertainty exists as to borrowers' ability to pay back their loans to the Bank, especially in the case of loans denominated in foreign currency which were granted to borrowers with limited or no income in foreign currencies. Other factors are also important for recovering the loan portfolio. Soon after the Bank acquired the loans on 9 October 2008, the Icelandic State mandated that borrowers were to be granted payment holidays on principal and/or interest. Many borrowers have taken advantage of this opportunity. Information about this influential factor on the fair value of loans was available during the valuation process and was accounted for where possible in the fair value as at 9 October 2008.

3. Significant accounting policies, estimates and judgements (continued)

Critical accounting estimates and judgements in applying accounting policies (continued)

(f) Financial asset and liability classification

The Group´s accounting policies provide scope for assets and liabilities to be classified at initial recognition into different categories in certain circumstances:

- Where financial assets or liabilities have been classified as "held for trading", the Group has determined that they meet the description of such assets and liabilities set out in its accounting policies.
- Where financial assets have been designated as at fair value through profit or loss, the Group has determined that they meet the criteria set out in the accounting policies.
- Where financial assets have been classified as loans and receivables, the Group has determined that they meet the criteria set out in the accounting policies.

(g) Assets classified as held for sale

The Group classifies assets (and groups of assets together with related liabilities) as held for sale if such assets or disposal groups are immediately available for sale in their present condition, subject to terms that are usual and customary for selling such assets or disposal groups, if management is committed to selling such assets and is actively looking for a buyer, if the assets are being actively marketed at a reasonable sales price in relation to their fair value, if completion of the sale is expected within one year and if sale is considered highly probable. However, events and circumstances may extend the period to complete the sale beyond one year. An extension of the period required to complete the sale does not preclude an asset (or disposal group) from being classified as held for sale if the delay is caused by events or circumstances beyond the Group's control and the Group remains committed to its plan to sell the asset (or disposal group).

When classifying assets as held for sale the Group has determined that the classification criteria have been met.

(h) Deferred tax assets

Deferred tax assets are recognised in the consolidated balance sheet. In respect of tax losses carried forward, they are recognised to the extent that it is probable that taxable profits will be available against which to utilise the losses. Judgement is required to determine the amount of deferred tax assets that may be recognised, based upon the likely timing and level of future taxable profits, as well as tax-planning strategies.

(i) Liquidity

The key measure used by the Group for monitoring liquidity risk is the ratio of core liquid assets to deposits. The calculation of this ratio requires judgements of which assets to consider liquid. Furthermore, the maturity of some assets included in the maturity analysis of the financial assets and liabilities disclosed in the notes, such as loans acquired from Landsbanki Íslands hf., is based on expected future cash flows rather than contractual maturities. The estimation of the amount and timing of the cash flows from these financial assets involves management judgements about the debtors' financial situations and their abilities to repay their debts, the net realisable value of any underlying collateral and the timing of any possible cash flows.

New standards and amendments to standards early adopted by the Group

The consolidated financial statements have been prepared in accordance with IFRS as adopted by the European Union effective as of 31 December 2009 except that the Group has early adopted the following standards as permitted:

Amendments to IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* (issued as part of the Improvements to IFRSs issued in May 2008) clarify that the Group must classify all the assets and liabilities of a subsidiary as held for sale when the criteria set out in IFRS 5 are met and the Group is committed to a sale plan involving loss of control of a subsidiary, regardless of whether the Group will retain a non-controlling interest in its former subsidiary after the sale.

The Group early adopted IFRS 3 *Business Combinations* (2008) and the amendments to IAS 27 *Consolidated and Separate Financial Statements* (2008) in its consolidated financial statements for the period ended 31 December 2008. The revised standard continues to apply the acquisition method to business combinations, with some significant changes. For example, all payments to purchase a business are to be recorded at fair value at the acquisition date, with contingent payments classified as debt being subsequently re-measured in the income statement. There is a choice, on an acquisition-by-acquisition basis, between measuring a non-controlling interest in the acquiree at fair value or at the non-controlling interest's proportionate share of the acquiree's net assets. All acquisition-related costs are expensed as incurred except costs related to the issue of debt and equity instruments.

3. Significant accounting policies, estimates and judgements (continued)

New standards, amendments to standards and interpretations not yet adopted

A number of new standards, amendments to standards and interpretations are not yet effective for the year ended 31 December 2009, and have not been applied in preparing these consolidated financial statements. None of these will have an effect on the consolidated financial statements of the Group, with the exception of:

IFRS 9 *Financial instruments*, Part 1: Classification and measurement. IFRS 9 was issued in November 2009 and replaces those parts of IAS 39 relating to the classification and measurement of financial assets. The key features are as follows:
• Financial assets are required to be classified into two measurement categories: those to be measured subsequently at fair value, and those to be measured subsequently at amortised cost. The decision is to be made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument.
• An instrument is subsequently measured at amortised cost only if it is a debt instrument and both the objective of the entity's business model is to hold the asset to collect the contractual cash flows, and the asset's contractual cash flows represent only payments of principal and interest (that is, it has only 'basic loan features'). All other debt instruments are to be measured at fair value through profit or loss.
• All equity instruments are to be measured subsequently at fair value. Equity instruments held for trading will be measured at fair value through profit or loss. For all other equity investments, an irrevocable election can be made at initial recognition, to recognise unrealised and realised fair value gains and losses through other comprehensive income rather than profit or loss. There is to be no recycling of fair value gains and losses to profit or loss. This election may be made on an instrument-by-instrument basis. Dividends are to be presented in profit or loss, as long as they represent a return on investment. If endorsed by the EU, IFRS 9 will become mandatory in financial statements for 2013.

IAS 24 *Related Party Disclosures* (revised 2009) amends the definition of a related party and modifies certain related party disclosure requirements for government-related entities. If endorsed by the EU the revised IAS 24 will become mandatory for the Group's 2011 consolidated financial statements, with retrospective application required. Earlier application is permitted, either of the whole standard or of the partial exemption for government-related entities. The Group is currently evaluating the possible impact of these amendments on its consolidated financial statements.

4. Business combination - 2008

On 9 October 2008 and as later amended, the Financial Supervisory Authority in Iceland (FME) issued its decision on transferring the domestic assets, liabilities and operations of Landsbanki Íslands hf. to the Bank in order to ensure the provision of normal banking services and the safety of deposits in Iceland. This decision was based on Act No. 125/2008, passed by the Icelandic Parliament on 6 October 2008, due to unusual and extraordinary financial market circumstances. In accordance with this FME decision, the Bank took over the following activities previously carried out by Landsbanki Íslands hf. and its subsidiaries:

- Retail banking, which included services provided through the Icelandic branch network of Landsbanki Íslands hf. to individuals and small and medium-size businesses, as well as leasing services.
- Corporate banking, which included services provided to large and medium-size corporate clients by the Corporate Division of Landsbanki Íslands hf., Reykjavik.
- Asset management and private banking, which included fund and wealth management services provided by divisions of Landsbanki Íslands hf. in Reykjavik and by the Landsbanki subsidiary Landsvaki hf.
- Investment banking, which included the trading and corporate finance activities of Landsbanki Íslands hf., Reykjavik.

The Bank took over obligations of the branches of Landsbanki Íslands hf. in Iceland due to deposits from financial undertakings, the Icelandic Central Bank and other customers, and also the bulk of its assets related to its Icelandic operations, such as loans and other claims. The assets included property, liquid assets, cash, shares in other companies and claims, and intangible assets and rights, including trademarks, registered and unregistered, co-brands, databases, software and related licenses, as well as all comparable rights whether based on a contract, registration, public permits or other.

The Bank also took over all rights used to secure the performance of obligations of the debtors of Landsbanki Íslands hf., including all liens, guarantees and other comparable rights connected to the claims.

Furthermore, the Bank took over obligations according to import and export guarantees, guarantees due to discharge of contract by companies and individuals regarding regular activities. The Bank did not take over the obligations of Landsbanki Íslands hf. due to: a) commitments of subsidiaries abroad, b) companies under moratorium, composition or in bankruptcy, c) commitments of the owners of Landsbanki Íslands hf. and connected parties, d) commitments to Icelandic financial undertakings e) rights and obligations according to derivative contracts and f) obligations to the Depositors' and Investors' Guarantee Fund.

The Bank decided that 9 October 2008 was the acquisition date of Landsbanki Íslands hf. domestic assets, liabilities and operations, in accordance with IFRS 3 (revised 2008).

Identifiable assets acquired and liabilities assumed in the business combination as at 9 October 2008	**Acquiree's carrying amounts***	**Fair value adjustments**	**Fair value**
Cash and balances with Central Bank	37,827	-	37,827
Bonds and debt instruments	31,838	(7,214)	24,624
Equities and equity instruments	65,707	(29,549)	36,158
Loans and advances to financial institutions	5,813	(522)	5,291
Loans and advances to customers	1,241,307	(585,582)	655,725
Investments in associates	2,565	(240)	2,325
Property and equipment	8,065	(1,156)	6,909
Intangible assets	3,690	(2,484)	1,206
Deferred tax assets	0	4,935	4,935
Other assets	1,369	(92)	1,277
Assets classified as held for sale	10,436	(3,938)	6,498
	1,408,617	**(625,842)**	**782,775**
Due to financial institutions and Central Bank	(82,517)	-	(82,517)
Deposits from customers	(418,045)	-	(418,045)
Current tax liabilities	(1,218)	(202)	(1,420)
Other liabilities	(2,785)	1,479	(1,306)
Liabilities associated with assets classified as held for sale	(4,519)	0	(4,519)
	(509,084)	**1,277**	**(507,807)**
Total identifiable net assets			**274,968**
Non-controlling interests			(168)
Provisional liability due to Landsbanki Íslands hf.			**274,800**

*Unaudited financial information representing the carrying amounts of assets and liabilities transferred from Landsbanki Íslands hf. immediately before the acquisition date.

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4. Business combination - 2008 (continued)

	At 9 October 2008			
Loans and advances to customers	**Acquiree's carrying amounts***	**Contractual cash flows****	**Cash flows expected to be collected****	**Fair value**
Corporations and public entities	1,003,957	1,222,767	778,278	497,337
Individuals	237,350	368,613	283,677	158,388
Total	**1,241,307**	**1,591,380**	**1,061,955**	**655,725**
Loans and advances to financial institutions				
Bank accounts	89	89	89	89
Money market loans	1,501	1,569	1,371	1,304
Overdrafts	4,066	4,066	3,778	3,777
Other loans	157	219	168	121
Total	**5,813**	**5,943**	**5,406**	**5,291**
Bonds and debt instruments				
Financial institutions	4,681	5,966	5,966	3,575
Holding companies	3,659	4,469	1,370	902
Other	23,498	27,602	27,602	20,147
Total	**31,838**	**38,037**	**34,938**	**24,624**

*Unaudited financial information representing the carrying amounts of assets and liabilities transferred from Landsbanki Íslands hf. immediately before the acquisition date.

**The cash flows presented in the table above consist of undiscounted principal and interest receivable.

Acquired subsidiaries

The following where the main subsidiaries acquired from Landsbanki Íslands hf.:

Name of subsidiary	Ownership interest	Activity
Landsvaki hf. (Iceland)	100%	Management company for mutual funds
Landsbankinn eignarhaldsfélag ehf. (Iceland)	100%	Holding company
SP-fjármögnun hf. (Iceland)	100%	Leasing company
Vörður tryggingar hf. (Iceland)	73%	Insurance company
Vörður líftrygging ehf. (Iceland)	70%	Insurance company
Verðbréfun hf. (Iceland)	100%	Securitisation company
Landsbanki Vatnsafl ehf. (Iceland)	100%	Holding company
Stofnlánadeild Samvinnufélaga (Iceland)	100%	Holding company
Span ehf. (Iceland)	100%	IT-services
Landsbanki Holdings (UK) plc.	100%	Holding company

The ownership interest in SP-fjármögnun hf., which previously belonged to Landsbanki Íslands hf. and was transferred to the Bank, was 51%. However, the financial condition of SP-fjármögnun hf. made it clear from the date of transfer that the Bank had to refinance operations and that the remaining 49% non-controlling shareholder's interest in SP-fjármögnun hf. would have to be written down to zero, subject only to formalities. The Bank therefore considers itself to have acquired in substance the entire interest in SP-fjármögnun hf. on 9 October 2008 and does not recognise any non-controlling interest in that company. The remaining 49% share in SP-fjármögnun hf. was formally acquired at the SP-fjármögnun hf. shareholders' meeting on 13 March 2009.

The loss relating to the domestic operations and related assets and liabilities taken over from Landsbanki Íslands hf. since the acquisition date is the same as the Group's loss for the comparative period disclosed in the consolidated income statement.

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4. Business combination - 2008 (continued)

Valuation methods for assets acquired and liabilities assumed by the Bank from Landsbanki Íslands hf.

The valuation of assets and liabilities transferred to the Bank is based on the Bank's management valuation, reviewed and reassessed through the negotiation process between the Bank and Landsbanki Íslands hf. finalised on 15 December 2009.

The largest asset class valued were loans and advances to customers. There is rather high uncertainty on recovery for that asset class due to the extraordinary conditions in the Icelandic economy. Uncertainty in recovery value and limited treasury product availability for the Bank creates uncertainty in various asset and liability risk factors such as foreign currency imbalance risk, indexation imbalance risk and liquidity risk.

The methodology used for the valuation of the largest asset class, loans and advances to customers, can be split into three areas: a) Loans to customers – Corporate loans; b) Loans to customers – Retail loans; and c) Other assets.

Assets and liabilities denominated in foreign currency were valued based on exchange rates at 30 September 2008 (see note 79).

a) Corporate loans

The corporate loan portfolio was split into two groups; large corporate customers, that were reviewed on a case-by-case basis, and a small and medium size enterprises (SME) pool that was assessed on a portfolio basis. Large corporate customers were defined as customers with loan exposure above ISK 500 million and SME customers as customers with loan exposure ranging from ISK 50 to 500 million.

Large corporate customers were assessed by using a cash flow based method and a collateral based method:
• Cash flow based method: The cash flow method, used for corporate customers generating positive cash flows and where the estimated value is greater than collateral value method, analyses the company's capacity to meet its obligations towards the Bank. Final value was derived through an iteration process. Initial value estimate was based on a EBITDA multiple value which was derived from established EBITDA multiple ranges for four industry categories: fisheries, general industry, real estate and services. For each corporate, the Bank's valuation team selected an EBITDA multiplier used from the appropriate range based on corporate profile and credit history. Initial value was compared to results from the Banks effective interest rate model (EIR) and revised if effective rate of return was below the Bank's required minimum return. The input in the Bank's EIR is forecasted EBITDA, established investment horizon for each industry sector and contractual loan profile.
• Collateral based method: The collateral based method assesses loan valuation based on collateral held by the Bank, used for loans where the underlying collateral value is greater than the value under the cash flow based method. Collateral value estimates were based on adjusted market prices multiplied with collateral coefficients (haircuts) depending on type of collateral. The most common types of collateral are fishing vessels with fishing rights, real estate, shares, inventory and receivables.

The SME part of the corporate loan portfolio was estimated on a homogenous pool basis, divided into segments based on sectors and loan product types and supported by collateral value based sampling of the portfolio.

b) Retail loans

Retail loans, comprising loans to individuals and small corporates (with loan exposure below ISK 50 million) were valued on a homogenous pool basis, divided into segments based on sectors and product types and supported by collateral value based sampling of the portfolio. The nature of the customers was considered the best proxy for estimating their payment ability, along with considering the reference portfolio and expert judgements for each segment.

c) Other financial assets

Other financial assets were valued using quoted prices in active markets if available. Otherwise they were valued using various valuation techniques developed by the Bank, estimates by third party or expert judgement. Investments in associates were valued on an enterprise value basis. Loans to credit institutions were valued using methods similar to those for corporate loans.

d) Other assets

Property and equipment were valued by a depreciated replacement cost approach. Intangible assets were valued by using the replacement cost approach. Deferred tax assets consist mainly of tax losses carried forward of subsidiaries deemed by the Bank's management to be recoverable.

e) Non-controlling interests

Non-controlling interests were measured at the non-controlling interest's proportionate share in the identifiable net assets acquired.

4. Business combination - 2008 (continued)

Consideration transferred by the Bank

According to FME's decision on the transfer of assets and liabilities from Landsbanki Íslands hf. on 9 October 2008 and as later amended, the Bank was required to pay to Landsbanki Íslands hf. the difference between the worth of assets and liabilities and issue a bond as payment of the remuneration. FME appointed recognised appraisers to evaluate the true worth of assets and liabilities and their valuation was completed on 20 April 2009. After that the negotiation process between the Bank and Landsbanki Íslands hf. started. On 10 October 2009, the Bank and Ministry of Finance signed a "Head of Terms" agreement with Landsbanki Íslands hf. regarding the issue of compensation instruments to Landsbanki Íslands hf. in respect of the net assets transferred to the Bank. The Head of Terms were formally reflected in the final agreements signed on 15 December 2009 between the Bank, the Ministry of Finance and Landsbanki Íslands hf.

As a part of the settlement, several agreements were signed on 15 December 2009 relating to certain aspects of the financial settlement between the Bank and Landsbanki Íslands hf. in order to indicate how shared collateral, inter-company claims and claims subject to set-off are to be treated. The set-off agreement addresses certain actual and potential third party set-off claims and Landsbanki Íslands hf. undertakes to pay to the Bank an amount equal to the loss suffered by the Bank due to accepted third party set-off until 15 December 2010. After 15 December 2010 until 31 December 2012 any loss suffered by the Bank due to accepted third party set-off shall be deducted from the principal amount of the contingent bond, if such bond will be issued. After 31 December 2012 any loss due to third party set-off claims will be suffered by the Bank.

Completion of the above agreements is subject to the fulfilment of the following conditions: that no event of default has occurred; that government counsel has provided a legal opinion satisfactory to Landsbanki Íslands hf.; and that the Bank and Landsbanki Íslands hf. have entered into a pledge agreement granting a valid, enforceable pledge of certain assets. If the conditions have not been fulfilled by 15 April 2010, both parties may terminate the agreements.

Provisional liability due to Landsbanki Íslands hf.

The form of the consideration to be issued by the Bank to Landsbanki Íslands hf. was agreed upon on 15 December 2009, approximately 14 months after the acquisition date. Because the settlement occurred outside the 12 month measurement period specified in IFRS 3 (revised 2008), the Bank is not allowed to account for the actual form of the consideration agreed upon on 15 December 2009 as if it were issued from the acquisition date on 9 October 2008. The impact of the agreements having been entered into outside the IFRS 3 measurement period is that instead of accounting for the liability based on the actual form of the consideration agreed upon (i.e. senior secured bonds, amounting to ISK 246,800 million and ordinary shares in the Bank for the amount of ISK 28,000 million), the Bank recognises its share in the fair value of the net assets as at 9 October 2008 (i.e. ISK 274,800 million) as a provisional liability in accordance with IAS 37 until 15 December 2009. After 15 December 2009, the Bank accounts for the liability in accordance with the actual form of the consideration according to the agreements.

The provisional liability is measured at the Bank's management best estimate of the expenditure required to settle the obligation at each balance sheet date. For this purpose the liability is assumed to be denominated in currencies in the same proportions as the senior secured bonds and the ordinary shares issued by the Bank. The liability is assumed to bear market interest rate in the respective currencies, which is recognised in the income statement as interest expense.

Senior secured bonds

In the settlement agreement signed on 15 December 2009 the Bank agreed to issue senior secured bonds equivalent to a fair value of ISK 246,800 million and bearing interest from 9 October 2008. These bonds will be denominated in EUR, GBP and USD and carry interest as of 9 October 2008 with nominal amounts of EUR 871 million, GBP 275 million and USD 734 million. Maturing in October 2018, the bonds provide for not having instalment payments during the first 5 years. The interest rates are 3 months EURIBOR for the EUR-denominated bond and 3 months LIBOR for the GBP and USD-denominated bonds, plus a margin of 1.75% for the first 5 years and a margin of 2.90% for the remaining 5 years.

On or after 30 June 2010, bondholders have the right to require the Bank to convert the bonds into Eurobonds. Upon such conversion, the Bank will make reasonable endeavours to list such Eurobonds on a qualified stock exchange, as soon as feasible following conversion.

Ordinary shares

Part of the consideration agreed upon on 15 December 2009 was a cash claim in the amount of ISK 28,000 million that was converted into 4,480 million ordinary shares in the Bank at the nominal value ISK 1 per share. The issue of the shares was conditional upon FME's approval of Landsbanki Íslands hf. as a qualified shareholder of the Bank, which was received on 20 January 2010.

According to the terms of the agreements signed on 15 December 2009 Landsbanki Íslands hf. is required to surrender to the Icelandic Government all or some of the shares in the Bank upon the issue of the contingent bond. The number of the shares to be surrendered depends on and is directly proportional to the nominal value of the contingent bond.

4. Business combination - 2008 (continued)

Consideration transferred by the Bank (continued)

Contingent bond

According to provisions of the settlement agreement signed on 15 December 2009, the Bank might have to issue to Landsbanki Íslands hf. on 31 March 2013 a bond as an additional consideration for the assets and liabilities transferred from Landsbanki Íslands hf. on 9 October 2008. This contingent bond can have a nominal amount of up to ISK 92 billion, with the amount being contingent on whether the value of certain pools of assets to be determined as at 31 December 2012 exceeds the future value of the acquisition price of those assets agreed for as at 9 October 2008, subject to specified adjustments. The value will be determined by a third-party valuation agent based on agreed-upon valuation procedures. The additional value at year-end 2012 that might exceed the future value of the 2008 acquisition price would be divided between Landsbanki Íslands hf., which would be assigned 85% (though no higher than ISK 92 billion) and the Bank, 15%. If issued, this bond would be denominated in EUR or such other currencies as may be agreed between the Bank and Landsbanki Íslands hf. whereby the ISK nominal amount would be converted into EUR using the exchange rate at 31 December 2012. The bond would bear floating interest rate and it would mature in October 2018 with quarterly instalments starting in 2014.

Knock-in forward derivative

Upon the issue of the contingent bond Landsbanki Íslands hf. is required by the terms of the agreements signed on 15 December 2009 to surrender to the Icelandic Government all or some of the shares in the Bank that Landsbanki Íslands hf. has received as compensation for the assets and liabilities transferred to the Bank. The number of the shares to be surrendered depends on and is directly proportional to the nominal value of the contingent bond. The management of the Bank has concluded that the Icelandic Government's right to receive the shares from Landsbanki Íslands hf. is a knock-in forward derivative paid for by the Bank indirectly, as part of the consideration transferred to Landsbanki Íslands hf. Accordingly, the Bank accounts for the fee that the Icelandic Government would have paid in an arm's length transaction as a deemed capital distribution in the amount of ISK 2 billion.

Acquisition-related costs

Integral to the negotiation process was an agreement between the Bank and Landsbanki Íslands hf. regarding the net claim that the Bank had on Landsbanki Íslands hf. relating to the Bank's opening balance sheet. As a result of this agreement, ISK 2 billion was expensed as acquisition-related cost in the 2008 consolidated income statement (see Note 35).

Performance-based employee incentive scheme

According to the agreements signed on 15 December 2009, the Bank committed itself to establishing a performance-based employee incentive scheme for all staff of the Bank. These incentives will be based on the value of shares in the Bank that Landsbanki Íslands hf. is required to surrender to the Icelandic Government, depending on the increase in value of the predefined asset pools. While the maximum number of shares to be transferred for the purpose of this incentive scheme is 500 million, the final number of shares will depend on the increase in value of the asset pools.

The employee incentive scheme had not been established at the time these consolidated financial statements were authorised for issue. Indeed, the Bank's management has concluded that the grant date for the employee incentive scheme has not yet been reached, as the Remuneration Committee has a considerable degree of discretion in establishing the final terms and conditions of the scheme.

5 Operating segments

Management is working towards organising the Group's main business units along five avenues of commercialisation:

- Retail banking, which includes services provided through the Bank's Icelandic branch network to individuals and to small and medium-size businesses as well as leasing services provided by the subsidiary SP-fjármögnun hf.
- Corporate banking, which includes services provided to large and medium-size corporate clients through the Bank's Corporate Division.
- Asset management and private banking, which includes fund and wealth management services provided by divisions of the Bank and its subsidiary Landsvaki hf.
- Investment banking, which includes the Group's capital markets and corporate finance activities, including the subsidiary Horn Fjárfestingarfélag ehf.
- Treasury operations, which undertakes Group funding and centralised risk management activities by borrowing, issuing debt securities, using derivatives for risk management purposes and investing in liquid assets such as short-term placements along with corporate and government debt securities.

From the foundation of the Bank, the financial information available for evaluation by management in deciding how to allocate resources and assess performance is that of the business as a whole. For this reason the Group had a single reportable segment during the period from 7 October 2008 to 31 December 2009.

Notes to the Consolidated Balance Sheet

6. Classification and fair value of financial assets and liabilities

According to IAS 39, financial assets and liabilities are classified into specific categories which affect how they are measured after initial recognition. Each category's basis of subsequent measurement is specified below:
- Loans and receivables, measured at amortised cost;
- Financial assets and liabilities held for trading, measured at fair value;
- Financial assets designated as at fair value through profit or loss, measured at fair value;
- Other financial liabilities, measured at amortised cost.

The following table shows the classification of the Group's financial assets and liabilities according to IAS 39 and their fair values as at 31 December 2009:

Financial assets	Loans and receivables	Held for trading	Designated as at fair value	Liabilities at amortised cost	Other liabilities at fair value*	Total carrying amount	Fair value
Cash and balances with Central Bank	26,174	-	-	-	-	26,174	26,174
Bonds and debt instruments	100,661	32,305	32,755	-	-	165,721	165,721
Equities and equity instruments	-	1,615	21,796	-	-	23,411	23,411
Derivative instruments	-	971	-	-	-	971	971
Loans and advances to financial institutions	83,129	-	-	-	-	83,129	83,129
Loans and advances to customers	667,122	-	-	-	-	667,122	684,118
Other financial assets	6,990	-	-	-	-	6,990	6,990
Total	**884,076**	**34,891**	**54,551**	**0**	**0**	**973,518**	**990,514**
Financial liabilities							
Due to financial institutions and Central Bank	-	-	-	98,228	-	98,228	98,228
Deposits from customers	-	-	-	452,655	-	452,655	452,655
Derivative instruments and short positions	-	5,943	-	-	-	5,943	5,943
Borrowings	-	-	-	306,493	-	306,493	306,493
Contingent bond	-	-	-	-	10,241	10,241	10,241
Other financial liabilities	-	-	-	2,138	-	2,138	2,138
Total	**0**	**5,943**	**0**	**859,514**	**10,241**	**875,698**	**875,698**

* The contingent bond has been recognised in the year 2009 as part of the settlement for the assets acquired and liabilities assumed from Landsbanki Íslands hf. (see Note 4). The bond is a financial liability which the Group is required to measure at fair value in accordance with IFRS 3 (2008), with any resulting gain or loss to be recognised in income statement.

The following table shows the classification of the Group's financial assets and liabilities according to IAS 39 and their fair values as at 31 December 2008:

Financial assets	Loans and receivables	Held for trading	Designated as at fair value	Other liabilities at amortised cost	Other liabilities at fair value	Total carrying amount	Fair value
Cash and balances with Central Bank	30,071	-	-	-	-	30,071	30,071
Bonds and debt instruments	-	3,523	36,373	-	-	39,896	39,896
Equities and equity instruments	-	2,582	37,099	-	-	39,681	39,681
Loans and advances to financial institutions	8,845	-	-	-	-	8,845	8,845
Loans and advances to customers	705,182	-	-	-	-	705,182	705,182
Other financial assets	34,579	-	-	-	-	34,579	34,579
Total	**778,677**	**6,105**	**73,472**	**0**	**0**	**858,254**	**858,254**
Financial liabilities							
Due to financial institutions and Central Bank	-	-	-	132,219	-	132,219	132,219
Deposits from customers	-	-	-	431,006	-	431,006	431,006
Derivative instruments and short positions	-	746	-	-	-	746	746
Other financial liabilities	-	-	-	15,319	-	15,319	15,319
Total	**0**	**746**	**0**	**578,544**	**0**	**579,290**	**579,290**

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6. Classification and fair value of financial assets and liabilities (continued)

The fair value of financial assets and liabilities was determined based on the following methods and assumptions. For all financial assets and liabilities foreign currency exchange rates are from observable markets both for spot and forward contracts and futures in the world's major currencies.

Balances with Central Bank

The carrying amount of balances with Central Bank is a reasonable approximation of their fair value.

Bonds and debt instruments

Quoted prices are generally available for government bonds and certain corporate securities. Where this information is not available, fair value is estimated by adding credit spreads to quoted market rates for similar bonds or relevant interest rate curves.

For bonds issued by defaulting or greatly distressed parties recovery values are used for estimating the fair value. These are published by the defaulting issuers resolution committee or equivalent, estimated based on balance sheet information or expert opinion.

Interest rates are principally benchmark interest rates such as the London Inter-Bank Offered Rate (LIBOR) and quoted interest rates in the swap, bond and futures markets.

Where available, credit spreads are derived from prices of credit default swaps (CDS) or other credit based instruments, such as debt securities. For others, credit spreads are obtained from pricing services. Counterparty credit spreds are estimated based on the creditworthness of the counterparty when differing from the assumed counterparty in the market.

Equities and equity instruments

Quoted prices are generally readily available for equity shares listed on the world's major stock exchanges and for major indices on such shares. When this information is not available the fair value is estimated based on market prices and earning multiples from similar securities, recent transactions or by using discounted cash flow methods.

Derivative instruments

The fair value of derivative instruments is determined using valuation methods whose most significant inputs are volatility and correlation values, which are obtained from broker quotations, pricing services or derived from option prices.

Loans and advances to financial institutions

Loans and advances to banks include inter-bank placements and items in the course of collection. The carrying amount of floating rate placements and overnight deposits is a reasonable approximation of their fair value.

Loans and advances to customers

The estimated fair value of loans and advances represents the discounted amount of estimated future cash flows expected to be received based on future recovery of the loans. The recovery rates and loss given default are used as input to valuation models as an indicator of severity of losses on default. The loans are grouped by type and for each loan the estimated cash flows to be received during each month until end of 2011 are estimated and payments after 2011 are estimated to be received in end of June each year. Expected cash flows are discounted at current market rates to determine fair value. Interest rates are principally benchmark interest rates such as London Inter-Bank Offered Rate (LIBOR), quoted interest rates in the swap, bond and future markets or the Group's current rates for new loans.

Due to financial institutions and Central Bank

Amounts due to financial institutions and Central Bank are repriced at least monthly and therefore their estimated fair value is the same as their carrying amount.

Deposits from customers

Deposits from customers are repriced at least monthly in accordance to changes in interest rates set by the Bank's treasury. The estimated fair value of the deposits is therefore the same as their carrying amount.

6. Classification and fair value of financial assets and liabilities (continued)

Short positions

The short positions are in Icelandic government bonds with readily available quoted market prices.

Borrowings

The fair value of the borrowings at year-end 2009 equals their carrying amount since the borrowings have been discounted upon initial recognition as at 15 December 2009 using market interest rate.

Contingent bond

The fair value of the contingent bond is based on the expected value of the underlying loan portfolios and on how much it will exceed its expected return which is defined as 400 basis points over the relevant interbank rate. The estimate of the expected value is based on log-normal distribution where the minimum payment is ISK 0 and maximum payment is ISK 92 billion. Key input and assumptions used in the valuation model at 31 December 2009 include expected volatility for the loan portfolio of 7.0% and a risk free rate of 7.6%. However, the issue and amount of the bond is subject to considerable outperformance of the underlying loan portfolios. Therefore, the obligation of the Bank is considered to be subordinated.

Fair value hierarchy

The Group has used a valuation hierarchy for disclosure of inputs to valuation used to measure fair value. This hierarchy prioritises the inputs into three broad levels as follows:
• Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities;
• Level 2: Valuation technique using observable inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and
• Level 3: Valuation technique with significant unobservable inputs for the asset or liability that are not based on observable market data (unobservable inputs). Level 3 includes all instruments that are valued according to quoted prices for similar instruments where significant unobservable adjustments or assumptions are required to reflect the differences between instruments.

A financial assets or liability's classifications within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement in its entirety.

The following table shows the level in the hierarchy into which the fair value of financial assets and liabilities carried at fair value in the consolidated balance sheet are categorised as at 31 December 2009:

Financial assets	Level 1	Level 2	Level 3	Total
Bonds and debt instruments	6,304	122,046	37,371	165,721
Equities and equity instruments	6,154	13,702	3,555	23,411
Derivative instruments	-	971	-	971
Total	**12,458**	**136,719**	**40,926**	**190,103**
Financial liabilities				
Derivative instruments	-	675	-	675
Short positions	5,268	-	-	5,268
Contingent bond	-	-	10,241	10,241
Total	**5,268**	**675**	**10,241**	**16,184**

The following table shows the level in the hierarchy into which the fair value of financial assets and liabilities carried at fair value in the consolidated balance sheet are categorised as at 31 December 2008:

Financial assets	Level 1	Level 2	Level 3	Total
Bonds and debt instruments	4,068	9,082	26,746	39,896
Equities and equity instruments	22,029	12,645	5,007	39,681
Total	**26,097**	**21,727**	**31,753**	**79,577**
Financial liabilities				
Derivative instruments	**0**	**746**	**0**	**746**

During 2009 there were no transfers into or out of Level 1 and no transfers into Level 2.

Financial assets and liabilities were transferred into Level 3 from Level 2 because significant inputs used in their fair value measurement became unobservable during 2009, such as market prices or rates. There was a single transfer within Level 3, from bonds and debt instruments to equities and equity instruments due to a conversion of a convertible bond into equity during 2009.

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6. Classification and fair value of financial assets and liabilities (continued)

The following table shows the reconciliation for fair value measurement in Level 3 for the year 2009:

	Bonds and debt instruments	Equities and equity instruments	Total financial assets	Contingent bond
Carrying amount at 1 January 2009	26,746	5,007	31,753	-
Total gains (losses) recognised in income statement	8,572	202	8,774	(10,241)
Purchases	20,313	3,144	23,457	-
Sales	(17,000)	(5,361)	(22,361)	-
Settlements	(1,697)	-	(1,697)	-
Transfers into Level 3	962	563	1,525	-
Transfers out of Level 3	(525)	-	(525)	-
Carrying amount at 31 December 2009	**37,371**	**3,555**	**40,926**	**(10,241)**

The following table shows the line items in the income statement where the total gains (losses) were recognised during the year 2009 for fair value measurements in Level 3:

	Bonds and debt instruments	Equities and equity instruments	Contingent bond	Total
Interest expense	-	-	(10,241)	(10,241)
Net gain (loss) on financial assets designated as at fair value through profit or loss	7,733	174	-	7,907
Net gain on financial assets and liabilities held for trading	665	28	-	693
Net foreign exchange (loss) gain	174	-	-	174
Total	**8,572**	**202**	**(10,241)**	**(1,467)**

The change in fair value estimated using valuation techniques that was recognised in the income statement during the year 2008 totalled to a net loss of ISK 46,597 million.

The following table shows the line item in the income statement where gains (losses) relating to Level 3 financial assets and liabilities which are held by the Group at 31 December 2009:

	Bonds and debt instruments	Equities and equity instruments	Contingent bond	Total
Interest expense	-	-	(10,241)	(10,241)
Net gain (loss) on financial assets designated as at fair value through profit or loss	10,505	351	-	10,856
Net gain on financial assets and liabilities held for trading	665	(90)	-	575
Net foreign exchange (loss) gain	187	-	-	187
Total	**11,357**	**261**	**(10,241)**	**1,377**

Although the Group believes that its estimates of fair value are appropriate, the use of different valuation methodologies and assumptions could lead to different measurements of fair value. The following table shows how profit (loss) before income tax would have been affected if one or more of the inputs for fair value measurements in Level 3 were changed to reasonably possible alternatives:

	Effect on profit (loss) before income tax	
Financial assets	Favourable	Unfavourable
Bonds and debt instruments	1,674	(1,584)
Equities and equity instruments	756	(474)
Total	**2,430**	**(2,058)**
Financial liabilities		
Contingent bond	**2,800**	**(6,400)**

The effect on profit (loss) was calculated using methods suitable for the models used. For equities valued using discounted cash flows the yield was shifted by +/-300 basis points and when comparables or recent transactions are used the price was changed by +/-10%. For bonds the recovery value was changed by +/-10%. For the contingent bond the volatility of the value of the underlying assets was changed by +/-500 basis points.

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7. Cash and balances with Central Bank

	2009	2008
Cash on hand	1,506	1,916
Unrestricted balances with Central Bank	15,032	19,238
Total cash and unrestricted balances with Central Bank	**16,538**	**21,154**
Reserve requirement with Central Bank	9,636	8,917
Total cash and balances with Central Bank	**26,174**	**30,071**

The Bank holds a mandatory reserve deposit account with the Central Bank of Iceland. The average balance of this account for each month must be equivalent to at least mandatory reserve deposits. Any excess balance is available for use by the Group. Other cash and balances with the Central Bank are available for the Group's immediate use.

8. Bonds and equities

	2009				2008			
Bonds and debt instruments	Loans and receivables	Held for trading	Designated as at fair value	Total	Loans and receivables	Held for trading	Designated as at fair value	Total
Domestic								
Listed	-	10,953	9,272	20,225	-	3,523	8,909	12,432
Unlisted	100,661	21,352	17,761	139,774	-	-	21,420	21,420
	100,661	**32,305**	**27,033**	**159,999**	**0**	**3,523**	**30,329**	**33,852**
Foreign								
Listed	-	-	3,958	3,958	-	-	5,787	5,787
Unlisted	-	-	1,764	1,764	-	-	257	257
	0	**0**	**5,722**	**5,722**	**0**	**0**	**6,044**	**6,044**
Total bonds and debt instruments	**100,661**	**32,305**	**32,755**	**165,721**	**0**	**3,523**	**36,373**	**39,896**
Equities and equity instruments								
Domestic								
Listed	-	774	9,198	9,972	-	586	5,843	6,429
Unlisted	-	-	2,864	2,864	-	108	601	709
	0	**774**	**12,062**	**12,836**	**0**	**694**	**6,444**	**7,138**
Foreign								
Listed	-	841	9,482	10,323	-	1,557	22,733	24,290
Unlisted	-	-	252	252	-	331	7,922	8,253
	0	**841**	**9,734**	**10,575**	**0**	**1,888**	**30,655**	**32,543**
Total equities and equity instruments	**0**	**1,615**	**21,796**	**23,411**	**0**	**2,582**	**37,099**	**39,681**
Total bonds and equities	**100,661**	**33,920**	**54,551**	**189,132**	**0**	**6,105**	**73,472**	**79,577**

Bonds and equities are classified as "domestic" or "foreign" according to the country of incorporation of the issuer.

Bonds and debt instruments classified as loans and receivables at year-end 2009 consist of part of the government bonds which the Bank received in settlement of the capital contribution (see Note 15). The bonds are in the process of being listed on the OMX stock exchange in Iceland.

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9. Derivative instruments and short positions

	2009			2008		
	Notional	Fair value		Notional	Fair value	
Foreign exchange derivatives	amount	Assets	Liabilities	amount	Assets	Liabilities
Currency forwards	9,323	262	1	-	-	-
Cross-currency interest rate swaps	2,415	-	672	2,923	-	746
OTC currency options*	59,703	700	-	-	-	-
	71,441	**962**	**673**	**2,923**	**0**	**746**
Interest rate derivatives						
Interest rate swaps	3,318	9	2	-	-	-
	3,318	**9**	**2**	**0**	**0**	**0**
Short positions - listed bonds	**-**	**-**	**5,268**	**-**	**-**	**-**
Total	**74,759**	**971**	**5,943**	**2,923**	**0**	**746**

* The Bank has bought out-of-the-money OTC currency options to hedge its foreign currency imbalance against excessive adverse movements in some of the major foreign currencies. The delta of these options amounted to ISK 9,989 million at 31 December 2009.

10. Loans and advances to financial institutions

	2009	2008
Bank accounts with financial institutions	4,628	1,743
Money market loans	58,488	1,447
Overdrafts	6,247	4,774
Other loans	13,766	881
Total	**83,129**	**8,845**

11. Loans and advances to customers

	2009	2008
Public entities	10,582	11,529
Individuals	177,561	170,052
Corporations	486,739	524,784
Less: Allowance for impairment	(7,760)	(1,183)
Total	**667,122**	**705,182**

During the reporting period the Group was not permitted to sell or repledge any collateral in absence of default by the owner of the collateral.

Further disclosures on loans and advances are provided in the risk management section of the notes.

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12. Investments in associates

	2009	7.10–31.12. 2008
Carrying amount at the beginning of the period	2,518	0
Acquisitions through business combination	0	2,325
Other acquisitions	44	0
Share of profit of associates, net of income tax	383	193
Total	**2,945**	**2,518**

At 31 December 2009	Total assets	Total liabilities	Profit/ (loss)	Ownership interest	Share of profit of associates	Carrying amount
Valitor Holding hf.	37,699	32,554	1,008	38%	383	1,955
Kredikort hf.	8,365	7,514	2	20%	-	170
Borgun hf.	15,340	14,325	177	20%	34	206
Reiknistofa bankanna	1,772	254	0	34%	-	515
Intrum hf.	795	506	(108)	33%	(34)	99
Total	**63,971**	**55,153**	**1,079**		**383**	**2,945**
At 31 December 2008						
Valitor Holding hf.	33,780	29,643	2,222	38%	155	1,572
Kredikort hf.	4,068	3,219	77	20%	11	170
Borgun hf.	9,980	9,341	71	20%	(19)	128
Reiknistofa bankanna	1,855	337	0	34%	27	515
Intrum hf.	992	599	28	33%	19	133
Total	**50,675**	**43,139**	**2,398**		**193**	**2,518**

All associates are unlisted companies. The share of profit of associates is for the year 2009 and for the period 9 October to 31 December 2008.

13. Property and equipment

	2009			7.10 – 31.12.2008		
	Buildings	Fixtures, equipment and vehicles	Total	Buildings	Fixtures, equipment and vehicles	Total
Carrying amount at the beginning of the period	3,422	3,442	6,864	-	-	0
Acquisitions through business combination	-	-	0	3,418	3,491	6,909
Additions during the period	125	174	299	25	178	203
Sold during the period	(24)	(105)	(129)	-	(4)	(4)
Depreciation	(76)	(928)	(1,004)	(21)	(223)	(244)
Carrying amount at 31 December	**3,447**	**2,583**	**6,030**	**3,422**	**3,442**	**6,864**
Gross carrying amount	3,529	3,521	7,050	3,443	3,665	7,108
Accumulated depreciation	(82)	(938)	(1,020)	(21)	(223)	(244)
Carrying amount at 31 December	**3,447**	**2,583**	**6,030**	**3,422**	**3,442**	**6,864**
Depreciation rates	2-4%	10-33%		2-4%	10-33%	

Official assessment value of buildings at 31 December	2009	2008
Official assessment value used for tax purposes	3,913	4,163
Replacement value used for insurance purposes	7,179	7,049

Depreciation and amortisation presented in the income statement consists of:	2009	7.10-31.12. 2008
Depreciation of property and equipment	1,004	244
Amortisation of intangible assets	274	50
Total	**1,278**	**294**

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14. Intangible assets

Computer software licenses	2009	7.10-31.12. 2008
Carrying amount at the beginning of the period	1,220	0
Acquisitions through business combination	0	1,206
Additions	112	66
Disposals	0	(2)
Amortisation	(274)	(50)
Carrying amount at 31 December	**1,058**	**1,220**
Amortisation rates	20-33%	20-33%
Gross carrying amount	1,335	1,270
Accumulated amortisation	(277)	(50)
Carrying amount at 31 December	**1,058**	**1,220**

15. Unpaid capital contribution

In 2008, the Icelandic State committed itself to fund the Bank by a capital contribution amounting to ISK 149,225 million. The equity contribution was finalised in the Government Capitalisation Agreement as of 15 December 2009, according to which the Icelandic State provided a government bond to the Bank on 30 December 2009 which had a nominal value of ISK 121,225 million plus the interest accrued since 9 October 2008 in the amount of ISK 18,588 million. The remaining ISK 28,000 million plus the interest accrued since 9 October 2008 in the amount of ISK 4,270 million was settled through offset against provisional liability with Landsbanki Íslands hf. (see Note 20). Any interest accrued on unpaid capital contribution at year-end is included in the line item "Other assets" in the balance sheet.

16. Other assets

	2009	2008
Claims on Landsbanki Íslands hf.	5,167	18,652
Unsettled securities trading	1,089	9,323
Accrued interest on unpaid capital contribution	0	5,699
Accounts receivable and prepayments	734	905
Sundry assets	6,990	4,379
Total	**13,980**	**38,958**

17. Assets and liabilities classified as held for sale

Assets classified as held for sale	2009	2008
Repossessed collateral	33,673	2,150
Assets of disposal groups classified as held for sale	30,205	5,434
Total	**63,878**	**7,584**

Repossessed collateral consists mainly of property and equipment resulting from collateral foreclosed by the Group as security for loans and advances. The Group's policy is to pursue timely realisation of the repossessed collateral in an orderly manner. The Group generally does not use the non-cash repossessed collateral for its own operations.

Repossessed collateral	2009	7.10-31.12. 2008
Carrying amount at the beginning of the period	2,150	0
Acquisitions through business combination	-	1,433
Repossessed during the period	33,626	869
Impairment	-	(25)
Disposed of during the period	(2,103)	(127)
Total	**33,673**	**2,150**

Disposal groups classified as held for sale

Disposal groups classified as held for sale consist of the assets and liabilities of subsidiaries acquired by the Group exclusively with a view to resale. Because these subsidiaries meet the definition of discontinued operations in IFRS 5, the Group has presented the results of their operations as discontinued in the consolidated income statement, as required by IFRS 5 and IAS 1.

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18. Due to financial institutions and Central Bank

	2009	2008
Loans and repurchase agreements with Central Bank	66	18,655
Loans and deposits from financial institutions	98,162	113,564
Total	**98,228**	**132,219**

19. Deposits from customers

	2009	2008
Demand deposits	317,330	320,837
Time deposits	135,325	110,169
Total	**452,655**	**431,006**

20. Provisional liability due to Landsbanki Íslands hf.

	Carrying amount
Recognised due to acquisition of net assets from Landsbanki Íslands hf. on 9 October 2008	274,800
Accrued interest	6,611
Foreign exchange difference	23,646
At 31 December 2008	**305,057**
Additional provision made in the period	2,000
Accrued interest	13,148
Foreign exchange difference	24,233
Settlement through borrowings	(312,168)
Settlement through offset against capital contribution	(28,000)
Settlement through offset against interest on capital contribution	(4,270)
At 31 December 2009	**0**

Further information about the provisional liability is disclosed in Note 4.

21. Borrowings

	Nominal amounts			Carrying amount	
Senior secured bonds	**Foreign currency**	**ISK**	**Contractual interest rate (%)**	**2009**	**2008**
EUR	871 million	156,519	EURIBOR + 1.75/2.90	158,573	-
GBP	275 million	55,316	LIBOR + 1.75/2.90	56,086	-
USD	734 million	91,456	LIBOR + 1.75/2.90	91,834	-
Total		**303,291**		**306,493**	**0**

The senior secured bonds mature in October 2018 and do not have instalment payments during the first 5 years. The interest rates are 3 months EURIBOR for the EUR-denominated bond and 3 months LIBOR for the GBP and USD-denominated bonds, plus a margin of 1.75% for the first 5 years and a margin of 2.90% for the remaining 5 years. On or after 30 June 2010, bondholders have the right to require the Bank to convert the bonds into Eurobonds. Upon such conversion, the Bank will make reasonable endeavours to list such Eurobonds on a qualified stock exchange, as soon as feasible following conversion.

The Group did not default on any principal and interest nor breached any covenants with respect to liabilities during the reporting period.

22. Contingent bond

According to the provisions of the settlement agreement signed on 15 December 2009, the Bank might have to issue to Landsbanki Íslands hf. a bond on 31 March 2013 as an additional consideration for the assets and liabilities transferred from Landsbanki Íslands hf. on 9 October 2008. The contingent bond can have a nominal amount of up to ISK 92 billion, with the amount being contingent on whether the value of certain pools of assets to be determined as at 31 December 2012 exceeds the future value of the acquisition price of those assets agreed for as at 9 October 2008, subject to specified adjustments. The value will be determined by a third-party valuation agent based on agreed-upon valuation procedures. The additional value at year-end 2012 that might exceed the future value of the 2008 acquisition price would be divided between Landsbanki Íslands hf., which would be assigned 85% (though no higher than ISK 92 billion) and the Bank, 15%. If issued, this bond would be denominated in EUR or such other currencies as may be agreed between the Bank and Landsbanki Íslands hf. whereby the ISK nominal amount would be converted into EUR using the exchange rate at 31 December 2012. The bond would bear floating interest rate and it would mature in October 2018 with quarterly instalments starting in 2014.

The contingent obligation of the Bank is classified as a financial liability and measured initially at fair value. Subsequently, it is measured at fair value, with any resulting gain or loss recognised in the line item "Interest expense" in the income statement.

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23. Tax assets and liabilities

Tax assets and liabilities are specified as follows:

Tax assets	2009	2008
Deferred tax assets	6,682	7,347
Tax liabilities		
Current tax liabilities	83	762
Deferred tax liabilities	0	83
Total	**83**	**845**

Recognised deferred tax assets and liabilities are attributable to the following:

	2009			2008		
	Assets	Liabilities	Net	Assets	Liabilities	Net
Property and equipment	-	(2,342)	(2,342)	-	(173)	(173)
Equities and equity instruments	-	-	0	-	(45)	(45)
Investments in associates	-	(140)	(140)	-	(57)	(57)
Other assets	6,382	(321)	6,061	441	-	441
Derivative instruments and short positions	-	-	0	112	-	112
Deferred foreign exchange differences	357	-	357	-	(83)	(83)
Other items	-	-	0	-	(102)	(102)
Tax losses carried forward	2,746	-	2,746	7,171	-	7,171
	9,485	**(2,803)**	**6,682**	**7,724**	**(460)**	**7,264**
Set-off of deferred tax assets together with liabilities of the same taxable entities	(2,803)	2,803	0	(377)	377	0
Total	**6,682**	**0**	**6,682**	**7,347**	**(83)**	**7,264**

The deferred tax assets and liabilities are measured based on the tax rates and tax laws enacted by the end of 2009, according to which the domestic corporate income tax rate was 18.0%. In December 2009 the corporate income tax rate was increased from 15.0% to 18.0%. This change is effective for the fiscal year starting on 1 January 2010.

The amount of tax losses carried forward at year-end 2009 was ISK 15,256 million (2008: ISK 47,807 million) which was incurred in the fiscal year 2009 and it expires on 1 January 2019. The recognised deferred tax asset arising from these tax losses carried forward amounts to ISK 2,746 million (2008: ISK 7,171 million), of which ISK 1,192 million (2008: 2,148 million) is attributable to the Bank and ISK 1,554 million (2008: ISK 4,930 million) to its subsidiary SP-fjármögnun hf. The recognition of this deferred tax asset is supported by the business plan of the Group, according to which it is probable that future taxable profit will be available against which the unused tax losses can be utilised before they expire.

The movements in temporary differences during the period were as follows:

		Recognised in income statement			
2009	**Balance 1.1.2009**	**Tax (expense) income**	**Changes from prior year**	**Recognised directly in equity**	**Balance 31.12.2009**
Property and equipment	(173)	(2,169)	-	-	(2,342)
Equities and equity instruments	(45)	45	-	-	0
Investments in associates	(57)	(83)	-	-	(140)
Other assets	441	5,874	-	-	6,315
Derivative instruments and short positions	112	(112)	-	-	0
Deferred foreign exchange differences	(83)	458	(18)	-	357
Other items	(102)	(119)	(32)	-	(253)
Tax losses carried forward	7,171	(4,426)	-	-	2,745
Total	**7,264**	**(532)**	**(50)**	**0**	**6,682**

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23. Tax assets and liabilities (continued)

2008	Acquisitions through business combination	Recognised in income statement: Tax (expense) income	Recognised in income statement: Exchange differences*	Recognised directly in equity**	Balance 31.12.2008
Property and equipment	-	(173)	-	-	(173)
Equities and equity instruments	(883)	837	1	-	(45)
Investments in associates	-	(57)	-	-	(57)
Other assets	-	441	-	-	441
Derivative liabilities	-	112	-	-	112
Deferred foreign exchange differences	-	(83)	-	-	(83)
Other items	-	(120)	-	18	(102)
Tax losses carried forward	4,935	2,236	-	-	7,171
Total	**4,052**	**3,193**	**1**	**18**	**7,264**

* The exchange differences arising from translation of foreign currency deferred tax assets and liabilities are recognised in the line item "Net foreign exchange (loss) gain".

** The deferred tax income recognised directly in equity relates to the transaction costs related to issuing share capital.

The aggregate amount of temporary differences associated with the Bank's investments in subsidiaries for which no deferred tax liability is recognised in the consolidate financial statements amounted to ISK 3,882 million at year-end 2009 (2008: ISK 993 million). If the Bank were to sell its subsidiaries at their carrying amounts the gains from their sale would have been used to offset any tax losses carried forward by the Bank in the year of sale. However, according to current tax legislation, the gains are tax-deductible if the Bank has not incurred a tax loss in the year of sale or it has no tax loss carried forward at the time.

24. Other liabilities

	2009	2008
Unsettled securities trading	872	10,368
Withholding tax	3,927	3,511
Accounts payable	586	775
Unpaid contribution to the Depositors' and Investors' Guarantee Fund*	680	665
Sundry liabilities	2,112	4,474
Total	**8,177**	**19,793**

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

*According to Act No. 98/1999 on Deposit Guarantees and Investor Compensation Schemes, the Bank must, by 1 March of each year, contribute to the Depositors' and Investors' Guarantee Fund ("the Fund") an amount equivalent to 0.15% of the average of guaranteed deposits in the Bank, in the event of total Fund assets not equalling a minimum of 1% of the average amount of guaranteed deposits in commercial banks and savings banks during the preceding year. At the same time, the Bank must also submit to the Fund a declaration of liability whereby the Bank undertakes to render a special contribution to the Fund should the Fund become obliged to refund deposits to customers. This declaration of liability covers the proportion of the amount required to make up the minimum 1% of the average amount of guaranteed deposits. However, demands for contributions to the Fund based on declarations of liability may not exceed the equivalent of one-tenth of the Fund's minimum total assets.

The Bank's management has concluded that the liability amount to be recognised regarding the 0.15% yearly contribution shall only equal the amount that the Bank has no realistic alternative but to settle at each balance sheet date in accordance with the Act. This is the amount of the 0.15% contribution to be made by the Bank during the following calendar year, in respect of the current calendar year. Other regular contributions to be made by the Bank to the Fund in future years do not exist independent of the Bank's future actions and therefore do not represent a present obligation of the Bank at the balance sheet date. Accordingly, they are not recognised as part of the liability towards the Fund. Therefore, the amount recognised as liability at 31 December 2009 is the ISK 680 million which the Bank paid to the Fund in March 2010 (ISK 665 million at 31 December 2008, which the Bank paid to the Fund in September 2009).

In respect of the declaration of liability of the Bank, the management of the Bank has concluded that a liability should be recognised in the balance sheet in respect of its declaration outstanding at each balance sheet date only if an outflow of Bank resources is at the respective balance sheet date deemed more likely than not to occur. As the Bank had no such declaration of liability outstanding as of 31 December 2008, no related liability was recognised in the consolidated financial statements for the period from 7 October to 31 December 2008. The Bank issued its first declaration of liability to the Fund in November 2009, for a maximum amount of ISK 3,769 million, of which no more than ISK 1,610 million may be requested as a special contribution to the Fund according to the Act. The Bank issued in 2010 a new declaration of liability to the Fund for a maximum amount of ISK 3,851 million, of which no more than ISK 1,611 million may be requested as a special contribution to the Fund according to the Act. The Group did not recognise any liability in these consolidated financial statements in respect of the declaration of liability outstanding at year-end 2009.

The Government of Iceland is currently working on changing the Act and a bill has been presented for approval by the Icelandic Parliament. Based on the current draft of this bill, the Bank's management expects its yearly contributions to increase as a result of changes in legal requirements.

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25. Equity

Share capital

The total number of ordinary shares authorised and issued by the Bank is 24 billion shares, with par value of ISK 1 per share. One vote is attached to each share of one ISK and the holders of ordinary shares are entitled to one vote per share at general meetings of the Bank. The shares issued to the Icelandic State were paid in in two instalments: with a cash payment on 7 October 2008 amounting to ISK 775 million and with a government bond on 30 December 2009 with a nominal value of ISK 121,225 million. The Bank has also issued ordinary shares for an amount of ISK 28,000 million to Landsbanki Íslands hf. as part of the consideration paid by the Bank for the assets and liabilities transferred from Landsbanki Íslands hf. (see Note 4).

Restriction of dividend payments

As part of the acquisition price for the Icelandic operations of Landsbanki Íslands hf., the Bank issued senior secured bonds amounting to ISK 260 billion. If the Bank makes any dividend payments, it shall thereby redeem the bond on a pro-rata basis in amounts equal to the dividend payments. The bonds mature in 2018 (see Note 4).

According to the Company Act No. 2/1995, it is only permissible to allocate as dividend profit in accordance with approved annual financial statements for the immediate past financial year, profit brought forward from previous years and free funds after deducting loss which has not been met and the moneys which according to laws or Articles of Association must be contributed to a reserve fund or for other use.

Share premium

Share premium represents the difference between the ISK amount received by the Bank when issuing share capital and the nominal amount of the shares issued, less costs directly attributable to issuing the new shares, net of any related tax benefit.

Statutory reserve

The statutory reserve is created in accordance with requirements of the Company Act No. 2/1995, according to which at least 10% of the profit of the Bank, which is not devoted to meeting losses of previous years and is not contributed to other legally stipulated reserves must be contributed to the statutory reserve until it amounts to 10% of the share capital of the Bank. When that limit has been reached the contribution to the statutory reserve must be at a minimum 5% until the reserve amounts to a quarter of the share capital of the Bank.

Retained earnings

Retained earnings consist of undistributed profits and losses accumulated by the Group since the foundation of the Bank, less transfers to the statutory reserve of the Bank.

Notes to the Consolidated Income Statement

26. Net interest income

Interest income	2009	7.10-31.12. 2008
Cash and balances with Central Bank	3,344	782
Loans and advances to financial institutions	1,749	808
Loans and advances to customers	58,518	19,779
Net adjustments to the carrying amount of loans and advances*	23,772	0
Unpaid capital contribution	17,796	5,699
Other interest income	69	8
Total	**105,248**	**27,076**

Interest expense		
Due to financial institutions and Central Bank	(10,243)	(1,882)
Deposits from customers	(43,005)	(15,186)
Provisional liability due to Landsbanki Íslands hf.	(13,148)	(6,611)
Borrowings	(445)	0
Fair value change of contingent bond	(10,241)	0
Other interest expense	(61)	(51)
Total	**(77,143)**	**(23,730)**
Net interest income	**28,105**	**3,346**

* Net adjustments to the carrying amount of loans and advances consist of adjustments to reflect actual and revised estimated cash flows.

	2009	2008
Interest spread (as the ratio of net interest income to the average carrying amount of total assets during the period)	**2.8%**	**1.5%**

Interest income accrued on impaired financial assets amounted to ISK 124 million in 2009 (2008: ISK 21 million).

Total interest income recognised in respect of financial assets not carried at fair value through profit or loss amounts to ISK 89,407 million (2008: ISK 22,377 million). Total interest expense recognised in respect of financial liabilities not carried at fair value through profit or loss amounts to ISK 68,902 million (2008: ISK 17,119 million).

27. Net interest income less net impairment loss on loans an advances

	2009	7.10-31.12. 2008
Net interest income	28,105	3,346
Net impairment loss on loans and advances	(6,577)	(1,256)
Net interest income less net impairment loss on loans and advances	21,528	2,090
Interest spread (as the ratio of net interest income less net impairment loss on loans and advances to the average carrying amount of total assets during the period)	**2.1%**	**0.9%**

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28. Net fee and commission income

Fee and commission income	2009	7.10–31.12. 2008
Investment banking and capital markets	943	437
Asset management	878	360
Lending	1,266	282
Cards	1,402	148
Interbank clearing	859	104
Collection and payment services	704	103
Foreign trade	471	180
Other commissions and fees	312	96
Total	**6,835**	**1,710**
Fee and commission expense		
Investment banking and capital markets	(230)	(44)
Interbank clearing	(832)	(142)
Other fees	(1,560)	(537)
Total	**(2,622)**	**(723)**
Net fee and commission income	**4,213**	**987**

The net fee and commission income above excludes amounts that are included in determining the effective interest rate for financial assets and liabilities that are not at fair value through profit or loss. It also does not include any net fee and commission income relating to such financial assets and liabilities.

29. Net gain (loss) on financial assets designated as at fair value through profit or loss

	2009	7.10–31.12. 2008
Bonds and debt instruments	850	(42,833)
Equities and equity instruments	3,170	3,169
Total	**4,020**	**(39,664)**

Dividend income from equities and equity instruments designated as at fair value through profit or loss amounted to ISK 730 million (2008: ISK 0 million).

On 28 October 2008 the Bank acquired bonds from several money market funds which were managed by the subsidiary Landsvaki hf. when the funds were dissolved. The issuers of these bonds were mainly domestic corporations, some of which developed into liquidating estates, and the purchase price of the bonds was ISK 61.6 billion. A net loss of ISK 38.2 billion on these bonds was recognised as fair value change in the income statement for the period from 7 October to 31 December 2008, mainly due to changes in credit risk of the counterparties. The three largest losses stemmed from Baugur Group hf., Kaupthing Bank hf. and Eimskipafélag Íslands hf. In addition there was a net loss on bonds to the amount of ISK 5.0 billion, which is related to the fair value adjustment of a claim that the Bank has on Landsbanki Íslands hf. due to a netting agreement between Landsvaki hf. and Landsbanki Íslands hf.

30. Net gain on financial assets and liabilities held for trading

	2009	7.10–31.12. 2008
Bonds and debt instruments	3,646	706
Equities and equity instruments	(670)	385
Derivatives instruments	(100)	(286)
Total	**2,876**	**805**

Dividend income from equities and equity instruments classified as held for trading amounted to ISK 55 million (2008: ISK 2 million).

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31. Net foreign exchange (loss) gain

	2009	7.10-31.12. 2008
Assets:		
Cash and balances with Central Bank	38	(21)
Bonds and debt instruments	1,017	2,875
Equities and equity instruments	1,719	2,049
Derivative instruments	1,486	0
Loans and advances to financial institutions	2,783	1,260
Loans and advances to customers	17,975	59,099
Other assets	(260)	728
Total	**24,758**	**65,990**
Liabilities:		
Due to financial institutions and Central Bank	0	13
Deposits from customers	(9,436)	(9,447)
Provisional liability due to Landsbanki Íslands hf.	(24,233)	(23,646)
Borrowings	6,119	0
Other liabilities	(22)	(41)
Total	**(27,572)**	**(33,121)**
Net foreign exchange (loss) gain	**(2,814)**	**32,869**

The foreign exchange differences which were recognised in the income statement and arose on financial instruments not measured at fair value through profit or loss amounted to a ISK 20,535 million gain for financial assets (2008: gain of ISK 60,167 million) and loss of ISK 9,465 million for financial liabilities (2008: loss of ISK 32,984 million). As disclosed in Note 3, the Group applied the average FX-delta ratio to foreign exchange differences arising on loans and advances to customers that were acquired from Landsbanki Íslands hf. on 9 October 2008. The amount of foreign exchange difference arising on loans and advances to customers for the period ending 31 December 2009, which is deemed to be uncollectible and is therefore offset by the FX-delta ratio, amounted to a gain of ISK 9,244 million (2008: gain of ISK 43,372 million).

32. Other income and expenses

	2009	7.10-31.12. 2008
Recharged expenses	965	450
Gain on sale of property and equipment	23	0
(Loss) gain on sale of repossessed collateral	(132)	54
Other	46	17
Total	**902**	**521**

33. Salaries and related expenses

	2009	7.10-31.12. 2008
Wages and salaries	6,969	1,519
Contributions to defined contribution pension plans	955	232
Other personnel expenses	544	123
Total	**8,468**	**1,874**
Number of full-time employment positions at year-end	1,161	1,182

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34. Other administrative expenses

	2009	7.10-31.12. 2008
Advertising and marketing	355	71
Contribution to the Depositors' and Investors' Guarantee Fund	680	665
Software licensing and other information technology costs	727	326
Audit and related services	116	8
Other professional services	613	89
Operating lease rentals	484	126
Other administrative expenses	3,089	1,196
Total	**6,064**	**2,481**

Audit and related services	2009	7.10-31.12. 2008
Audit of the financial statements	96	0
Other services	20	8
Total	**116**	**8**

35. Acquisition-related costs

	2009	7.10-31.12. 2008
Cost of acquisition of assets and liabilities from Landsbanki Íslands hf.	886	1,072
Claims on Landsbanki Íslands hf. which were written off due to a settlement agreement with Landsbanki Íslands hf.	158	2,000
Total	**1,044**	**3,072**

Integral to the negotiation process was an agreement between the Bank and Landsbanki Íslands hf. regarding the net claim that the Bank had on Landsbanki Íslands hf. relating to the Bank's opening balance sheet. As a result of this agreement, ISK 2 billion was expensed as acquisition-related cost in the 2008 consolidated income statement.

36. Income tax

Income tax recognised in the income statement is specified as follows:

	2009	7.10-31.12. 2008
Current tax expense	(83)	(252)
Effect of increase in tax rate	295	-
Deferred tax income	(827)	3,193
Total	**(615)**	**2,941**

Further information on deferred income tax is presented in Note 23. The tax on Group losses differs to the following extent from the amount that would theoretically arise by the domestic corporate income tax rate:

	2009		7.10-31.12.2008	
Profit (loss) before income tax		14,254		(9,920)
Income tax calculated using the domestic corporate income tax rate	15.0%	(2,138)	15.0%	1,488
Effect of increase in tax rate	(2.1%)	296	-	-
Effect of different tax rates in other countries	0.3%	(38)	(7.4%)	(737)
Income not subject to tax	(9.0%)	1,289	20.5%	2,032
Non-deductable expenses	0.8%	(110)	(0.4%)	(37)
Other	(0.6%)	86	2.0%	195
Effective income tax	**4.4%**	**(615)**	**29.7%**	**2,941**

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Other notes

37. Litigation

Other than claims and legal proceedings that arise from time to time in the ordinary course of business and are not material here, the Group has no pending legal proceedings other than the following:

1) In January 2009, litigation commenced before the District Court of Reykjavík against Landsvaki hf., a subsidiary of the Bank, and Landsbanki Íslands hf. The plaintiffs demanded that the respondents pay the amount by which fund payments were reduced during the winding up of Landsbanki's Money Market fund. When this fund was dissolved, the plaintiffs received 68% of the value of their investment in it, as of 3 October 2008. Alternatively, the plaintiffs requested that the court acknowledge the respondents' obligation to pay damages on the basis of tort. The district court has since reached a decision in this litigation, acknowledging that fund investments were within the limits stipulated by fund rules and applicable law. Furthermore, fund marketing was confirmed not to have been misleading in connection to risk and investment guarantees, since the marketing material had been easily accessible and promotions had been in compliance with rules, prospectuses and applicable law. The court found that Landsvaki hf. and Landsbanki Íslands hf. were liable for damages incurred by the unit holders, because those redeeming their units between 10 September and 6 October 2008 received amounts exceeding the actual value of their investments. The board of Landsvaki has decided to appeal this aspect of the judgment to the Icelandic Supreme Court, maintaining that even though the decision of the district court were confirmed, it would be difficult to establish the actual damage incurred by each unit holder. The Supreme Court decision will create a precedent for similar court proceedings that are expected to begin soon. While Landsvaki hf. will continue to carry on this action vigorously, the final resolution of this matter cannot yet be determined.

2) In March 2009 Aresbank, a Spanish bank, commenced litigation against the Bank, submitting claims to the District Court of Reykjavík. Aresbank demanded that the Bank pay EUR 30 million, in addition to interests and litigation costs. Alternatively, the Icelandic Financial Supervisory Authority (FME) and the Icelandic government were subpoenaed for the acknowledgment of their obligation to pay damages on the basis of tort. The case involves two money market loans which each amount to EUR 15 million and have reached maturity. In addition, the case involves a third money market loan amounting to GBP 7 million. In short, Aresbank claims that money market loans are to be considered deposits according to the Act on Deposit Insurance, No. 98/1999. Aresbank cites the Icelandic government's declaration from 6 October 2008, which states that the Icelandic government insures all deposits in domestic commercial banks and their branches in Iceland. Any judgment will most probably create a precedent. This case is pending before the District Court of Reykjavík. The Bank believes that the claim against it is without merit and has carried on a vigorous defence. Nonetheless, the final resolution of this matter cannot yet be determined.

3) In September 2009, Handelsbanken AB, a Swedish bank, commenced litigation before the District Court of Reykjavík against the Bank, demanding a payment of SEK 42.4 million plus interest. The claim was based on a sub-guarantee issued by Landsbanki Íslands hf. to the plaintiff in 2003. In 2007, the guarantee was extended to 2013, and the court claim is that according to the decision of 9 October 2008 by the Financial Supervisory Authority (FME), Iceland, on the disposal of assets and liabilities of Landsbanki Íslands hf., the Bank is now obliged to pay according to this guarantee. The Bank has responded to this claim by stating that according to an FME decision of 19 October 2008, the sub-guarantee in question was actually not transferred from Landsbanki Íslands hf. to the Bank Even though the Bank believes that the claim is without merit and should be directed at Landsbanki Íslands hf., the final resolution of this matter cannot yet be determined.

4) On 3 December 2009 the District Court of Reykjavik ruled in a case between SP-fjármögnun hf., a subsidiary of the Bank, and one of its clients. The District Court ruled that the foreign currency denomination of the loan granted by SP-fjármögnun hf. to this client is legal. The client did not appeal this ruling to the Supreme Court.

On 12 February 2010 the District Court of Reykjavik ruled in another case between Lýsing hf., a leasing company unrelated to the Group, and one of its clients. In this case the District Court ruled that the linkage to foreign currencies of the loan granted by Lýsing hf. to its client is not in accordance with the Act No. 38/2001. This case has been appealed to the Supreme Court of Iceland and there is a possibility that the Supreme Court of Iceland will rule that the foreign currency linkage of that loan is not in accordance with Icelandic law. If the linkage is ruled illegal, it could have a wider impact on other financial institutions, including the Bank and some of its subsidiaries, which have similar loans to individuals and corporations. It is the view of the Bank's management that the Group's foreign currency loans are in accordance with Icelandic law and, if challenged, it intends to defend its view vigorously. However, the ultimate resolution of this matter cannot yet be determined.

5) In December 2009 documents were served on the Bank by Basler Kantonalbank (BKB), a bank of the Swiss canton Basel City, as the initial step in starting ordinary proceedings against the Bank before the Commercial Court of the Swiss canton Zurich. BKB's claim amounts to CHF 19.2 million plus 5% interest since 9 October 2008, and is for the non-performance of FX Swap transactions by Landsbanki Íslands hf. BKB argues that according to an FME decision, the Bank took over Landsbanki Íslands hf. rights and obligations according to derivatives contracts. BKB also argues that the FME decision of 12 October 2008, whereby the decision of 9 October was amended so that derivative contracts were not transferred to the Bank, should be interpreted to apply only to derivative contracts after 12 October 2008. The Bank believes that the claim is without merit and should be directed at Landsbanki Islands hf. the Bank intends to defend its position vigorously, although the final resolution of this matter cannot yet be determined.

6) In the notes to its 9-month financial statement for 2009, published on 10 December 2009, the City of Reykjavík announced its intention to file a lawsuit against the Bank to have a claim recognised for ISK 1,223 million. The City of Reykjavík maintains that the Bank is liable for the settlement of transactions related to asset management services. Countering that this claim is without merit and should be directed at Landsbanki Íslands hf., the Bank intends to defend itself vigorously. However, the final resolution of this matter cannot yet be determined.

37. Litigation (continued)

7) In January 2010 Soffanías Cecilsson hf., an Icelandic limited liability company, commenced litigation before the District Court of Reykjavik against the Bank and demanded that two loan agreements and the distribution of the proceeds of the loans were declared null and void. The loan agreements are denominated in foreign currencies and the Bank claim according to the agreements is equivalent to ISK 7.4 billion. To support its case the company puts forward various arguments mainly relating to the possibility for the company to enter into loan agreements to finance securities transactions and the conduct and advice of the employees of Landsbanki Islands hf. in relation to the transactions. The Bank considers the claim to be without merit and will defend this claim vigorously before court; however the ultimate resolution of this matter cannot yet be determined.

38. Pledged assets

Certain pools of loans to customers will be pledged as collateral for the senior secured bonds, amounting to ISK 260 billion, to be issued and the contingent bond that the Bank might issue to Landsbanki Íslands hf. as a part of the acquisition price for its Icelandic operations. The Bank is obliged to maintain a cover ratio of 127.5% with an appropriate adjustment period.

39. Leasing

Operating lease commitments where the Group is lessee

In cases where the Group is a lessee, the future minimum lease payments under non-cancellable operating leases were as follows on 31 December:

	2009	2008
No later than 1 year	169	54
Later than 1 year and no later than 5 years	55	207
Later than 5 years	267	273
Total	**491**	**534**

Operating lease commitments where the Group is legal lessor

Here the Group acts as the legal lessor, through its subsidiary SP-fjármögnun hf., whereby tools and equipment have been purchased and leased to third parties under arrangements that in substance are loans and advances accounted for under IAS 39 in the consolidated financial statements of the Group.

The future minimum lease payments expected to be received under non-cancellable operating leases were as follows on 31 December:

	2009	2008
Less than 1 year	5,281	6,401
More than 1 year and less than 5 years	6,945	11,621
More than 5 years	985	1,377
Total	**13,211**	**19,399**

Finance lease commitments where the Group is lessor

Here the Group acts as lessor, through its subsidiary SP-fjármögnun hf., whereby items of plant and equipment have been leased to third parties under arrangements qualifying as finance leases. Finance lease receivables are included within loans and advances to customers.

The net investment in finance lease receivables was as follows:

At 31 December 2009	Gross investment in finance lease	Future finance income	Present value of minimum lease
Less than 1 year	12,962	(1,269)	11,692
More than 1 year and less than 5 years	32,850	(2,662)	30,187
More than 5 years	6,433	(365)	6,068
Total	**52,245**	**(4,296)**	**47,947**
At 31 December 2008			
Less than 1 year	15,750	(2,721)	13,029
More than 1 year and less than 5 years	44,598	(5,129)	39,469
More than 5 years	5,992	(408)	5,584
Total	**66,340**	**(8,258)**	**58,082**

Unguaranteed residual value at year end 2009 is nil (2008: nil).

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40. Fiduciary activities

The Group provides asset custody, asset management, investment management and advisory services. All of them require the Group to make decisions on the handling, acquisition or disposal of financial instruments. Assets in Bank custody are not reported in the consolidated financial statements, since they are not assets of the Bank. One aspect of these services is that the Group is involved in approving objectives and criteria for investing assets in its custody. As of 31 December 2009, financial assets managed by the Group amounted to ISK 142 billion (2008: 238 billion). Custody accounts amounted to ISK 1,209 billion (2008: 1,403 billion).

41. Related-party transactions

The Bank was the parent company of the Group at 31 December 2009. The Government of Iceland holds 81% of the shares in the Bank on behalf of the State Treasury at year-end 2009. The Group's products and services are offered to the Icelandic State, State authorities and State companies (including other State-owned banks) in competition with other vendors and under generally accepted commercial terms. In a similar manner, the Bank and other Group entities purchase products and services from State authorities and companies at market price and otherwise under generally accepted commercial terms. No significant share of the Group's net interest, expenditure or earnings is attributable to the Icelandic State or any of its authorities or companies. The transactions involved are related-party transactions as defined in IAS 24, Related-Party Disclosures, but are not disclosed owing to the volume of transactions conducted.

The Bank has a related-party relationship with its associates, the Board of Directors of the Bank, the key management personnel of the Bank and close family members of the individuals just referred to.

No unusual transactions took place with related parties during the periods presented in these financial statements. Transactions with related parties have been conducted on an arm's length basis.

Subsidiaries

Transactions between the Bank and its subsidiaries meet the definition of related-party transactions. All transactions with subsidiaries are eliminated on consolidation and are thus not disclosed in the Group's consolidated financial statements. The main subsidiaries of the Bank at 31 December 2009 were the following:

Company	Ownership interest	Activity
Landsvaki hf. (Iceland)	100%	Management company for mutual funds
Landsbankinn eignarhaldsfélag ehf. (Iceland)	100%	Holding company
Horn fjárfestingarfélag ehf. (Iceland)	100%	Investment company
Reginn ehf.	100%	Real estate company
Eignarhaldsfélagið Vestia ehf.	100%	Holding company
Hömlur ehf.	100%	Holding company
SP-fjármögnun hf. (Iceland)	100%	Leasing company
Vörður líftrygging ehf. (Iceland)	63%	Insurance company
Verðbréfun hf. (Iceland)	100%	Securitisation company
Landsbanki Vatnsafl ehf. (Iceland)	100%	Holding company
Stofnlánadeild Samvinnufélaga (Iceland)	100%	Holding company
Span ehf. (Iceland)	100%	IT-services
Landsbanki Holdings (UK) plc	100%	Holding company

Associates and government-controlled entities

The Group provides banking services to its associates, government entities and government controlled companies and is provided with various goods and services by these entities. All transactions are conducted on the same terms as third-party transactions.

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41. Related-party transactions (continued)

Key management personnel

(a) Compensation to Directors of the Doard, CEOs and Managing Directors of the Bank

Salary and benefits for the year 2009, in thousands of ISK	Total
Haukur Halldórsson, Chairman of the Board of the Bank	3,173
Erlendur Magnússon, Vice-chairman of the Board of the Bank	2,295
Stefanía K. Karlsdóttir, member of the Board of the Bank	1,620
Salvör Jónsdóttir, member of the Board of the Bank	1,620
Ása Richardsdóttir, alternate Director of the Board of the Bank	1,485
Alternate directors of the board of directors of the Bank	188
Ásmundur Stefánsson, CEO	17,540
Elín Sigfúsdóttir, Former CEO	19,332
Managing Directors of the Bank's divisions	102,099
Managing Directors of subsidiaries	66,206
Board members of subsidiaries	9,871

The Annual Meeting of Shareholders of the Bank was held at the Bank's office at Austurstræti 11, 155 Reykjavík on 18 February 2010. At the meeting 5 board members were elected for a term of one year. They are Gunnar Helgi Hálfdánarson, as the Chairman of the Board, Haukur Halldórsson, as the Vice-chairman of the Board, Guðríður Ólafsdóttir, Sigríður Hrólfsdóttir and Friðrik Pálsson as Board members.
No termination or post-employmetn benefits were paid during the year

Salary and benefits for the period 7 October - 31 December 2008, in thousands of ISK	Total
Ásmundur Stefánsson, Chairman of the Board of Directors of the Bank	540
Haukur Halldórsson, Vice-chairman of the Board of the Bank	405
Stefanía K. Karlsdóttir, member of the Board of the Bank	270
Salvör Jónsdóttir, member of the Board of the Bank	270
Erlendur Magnússon, member of the Board of the Bank	270
Alternate directors of the Board of the Bank	344
Elín Sigfúsdóttir, CEO	4,107
Managing Directors of the Bank's divisions	18,838

(b) Loans

The following table presents the total amounts of loans to board directors, CEO, managing directors and parties related to them:

Loans in ISK million	
Loans outstanding on 31 December 2008	584
Loans outstanding on 31 December 2009	587

No specific allowance for impairment was recognised in respect of loans to Board Directors, CEO, Managing Directors and parties related to them. The main collateral types for these loans were residential properties and vehicles.

42. Events after balance sheet date

As a result of foreclosing collaterals set by customers as security for the Group's loans and advances, the largest possession taken by the Group during the year 2010 was 100% shareholding in Icelandic Group.
The Group's objective in respect of these shares is to maximise the Group's return on these assets within a reasonable time period.

Capital management

43. Capital management

(a) BASEL II

The Group uses the standardised approach for regulatory calculations of capital. The BASEL II capital requirements directive consists of three pillars, as follows:

• Pillar 1 - Rules for calculating capital, based on risk weights for credit, market and operational risks.
• Pillar 2 - Framework for the internal capital adequacy assessment process (ICAAP), whereby the Bank describes its risk appetite, risk profile and risk mitigation strategies. The output of the ICAAP process is a Bank estimate of current and future capital needs. In addition, Pillar 2 includes the supervisory review and evaluation process (SREP).
• Pillar 3 - Description of market discipline and disclosure requirements.

The Financial Supervisory Authority (FME) has decided that the Group is to maintain a Tier 1 capital ratio of at least 12% which must be maintained for at least 3 years after the initial capitalisation unless revised by FME. Furthermore, the Group must maintain a capital adequacy ratio (CAD ratio) above 16% unless FME approves a lower CAD ratio on the basis of additional capital resources available for the Group. A formal confirmation of such additional capital resourses has been discussed with the State Banking Agency (Bankasýslan) as 81% shareholder in NBI hf.

(b) ICAAP

The Internal Capital Adequacy Assessment Process (ICAAP) report is a risk-focused, forward-looking description of the Bank's capital adequacy planning process. The report covers the Bank's governance structure, risks and capital adequacy assessment.

The FME has decided that the Bank shall maintain a capital ratio of at least 16%. This is higher than the current ICAAP capital requirement estimated by the Bank. It is the aim of the Bank to always comply with decisions of the FME.

44. Capital base and capital adequacy ratio

The Group's equity at year-end 2009 amounted to ISK 157,592 million (2008: ISK 143,285 million), equivalent to 15.2% (2008: 13.1%) of total assets, according to the balance sheet. The capital adequacy ratio, calculated in accordance with Article 84 of Act No. 161/2002 on Financial Undertakings, was 15.0% (2008: 13.0%) at the end of the year. According to the Act, this ratio may not fall below 8.0%.

Capital base	**2009**	**2008**
Share capital	24,000	24,000
Share premium	123,898	125,898
Statutory reserve	741	0
Retained earnings (accumulated deficit)	6,791	(6,945)
Non-controlling interests	2,162	332
Tier 1 capital	**157,592**	**143,285**
Deduction from original and additional own funds	(2,329)	(1,870)
Capital base	**155,263**	**141,415**
Capital requirement		
Credit risk	59,971	59,223
Market risk	18,359	25,345
Operational risk	4,666	2,663
Capital requirement under Pillar I	**82,996**	**87,231**
Surplus of own funds	72,267	54,184
Total risk-weighted assets	**1,037,447**	**1,090,390**
Tier 1 capital ratio	15.2%	13.1%
Capital adequacy ratio	15.0%	13.0%

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Risk management

45. Material financial risks

The Group is exposed to the following material risks which arise from financial instruments:

- Credit risk
- Liquidity risk
- Market risk
    - Currency risk
    - Interest rate risk
    - Other price risk

The Group also examines other relevant risk dimensions, such as operational risk and compliance risk.

The above material risks are addressed in the notes below.

46. Risk management process

Risk is inherent in the Group's activities but is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. Risk identification involves finding the origins and structures of possible risk factors in the Group's operations and undertakings. Risk measurement entails applying relevant measures to identified risk factors in order to allow for benchmarking and comparison. Finally, risk control provides for using rules and procedures to monitor and limit any risk taken on by the Group and ensuring that it complies with the Group's risk appetite and policies.

The objective of the Group's risk policies and procedures is to ensure that the risks involved in its operations are known, measured, monitored and effectively managed. Exposure to risks is managed so as to ensure that it will remain within limits adopted by the Group and will comply with regulatory requirements. In order to ensure that the fluctuations which might affect the Group's equity as well as performance are kept limited and manageable, the Group has adopted a policy regarding the risk structure of its portfolio.

47. Risk management framework

The Group's risk management governance structure is as follows:

Supervision by the Board of Directors	**Board of Directors** Internal Audit, Remuneration Committee, Audit and Risk Committee				
Key management bodies and committees	**The CEO** Asset and Liability Committee Credit Committee Executive Management Committee Operations Committee Risk Committee				
Risk types	Compliance risk	Credit risk	Market risk	Operational risk	Liquidity risk

The Bank's Board of Directors is responsible for implementing the general risk policy of the Group. The CEO is responsible to the Board of Directors on all matters involving risk.

The Bank's CEO sits on five committees, each of which handles different aspects of risk: the Asset and Liability Committee, Credit Committee, Executive Management Committee, Operations Committee and Risk Committee. The Credit Committee deals with credit risk, while the Asset and Liability Committee (ALCO) covers market risk and liquidity risk. The Risk Committee monitors all Group risks and is responsible for enforcing the limits set out in the Group's lending and market risk rules; in addition, this committee reviews and approves all changes to risk models. The Operations Committee makes decisions in regard to pricing and interest rate changes, exposure limits and quality procedures in retail banking. Also, the CEO is a member of the Executive Management Committee, which serves as a forum for consultation and communication between the CEO and managing directors, addressing the main issues that are current in each division. This committee makes all major decisions which are not being consulted on elsewhere or being considered in other standing committees.

In order to ensure that it has procedures in place to supervise business operations, the Board has two committees of its own, the Remuneration Committee and Audit and Risk Committee.

47 Risk management framework (continued)

The Compliance Department ensures that the Group follows its rules on securities trading and insider trading and that operations comply with the Act on Securities Transactions, the Act on Actions to Combat Money Laundering and Terrorist Financing, and other relevant legislation and regulations. This department also concentrates on Group adherence to codes of ethics and on limiting market abuse, minimising conflicts of interest and ensuring best practice. Such compliance is one of the Group's support functions and is integral to its corporate culture.

Internal audit is part of the Group's risk management framework as well as being an aspect of the surveillance system. The purpose of internal audit is to confirm that risk management is functioning and is sufficient for the Group. The effectiveness of the Group's risk management and risk assessment procedures, including the ICAAP process, is evaluated by internal audit and the findings are reported to the Board of Directors. Internal audit activities extend to every operating unit, including the Bank's subsidiaries.

In preparation for granting the Bank a permanent operating licence, the FME in May 2009 started an assessment of the Bank's risk management and governance, pinpointing the principal issues that needed addressing. The Bank started the process of dealing with these issues in 2009 and will continue to do so in 2010.

48 Risk management division

The Risk Management Division has four units focused on the Group's main types of risk, as well as a research and development unit.
• The Credit Risk Unit is responsible for credit risk in the Group's loan portfolio, covering aspects such as large exposures, analysis of the portfolio and the general monitoring of credit risk.
• The Market Risk Unit is responsible for risks arising in the Group's trading book. The sources of market risk are interest rates, foreign exchange rates, equity prices and commodity prices.
• The Asset and Liability Mismatch Risk Unit is responsible for any liquidity risk, currency risk and interest rate risk appearing in the non-trading portfolios.
• The Operational Risk Unit is responsible for ensuring that Group operational risks are captured and that the Group implements, maintains and monitors an effective operational risk management framework.
• The Research and Risk Analysis Unit is responsible for developing risk management systems. It ensures that any risk is captured in its entirety by developing and maintaining risk models, forecasting risks and developing measures of risk. Finally, it is a risk architect for risk data warehousing and serves as a liaison with the IT department.

49 Risk policy and appetite

The Board of Directors of the Bank is responsible for overall policy on risk, ensuring that it conforms to the Group's strategy, its capital adequacy goals and risk appetite, and the experience of its management. The CEO is responsible to the Board for daily operations, managing Group risk through committees. Managing directors report to the CEO on the activities of their division and compliance with the risk policies of the Group. Two aspects of this involved the Board of Directors approving new lending rules as well as updated risk rules in early 2010. In 2009 the Group established a process for defining its risk appetite and setting new risk policies for any risks.

50 Effects of the financial crisis

Due to economic conditions in Iceland following the events of October 2008, the Group is experiencing rather high uncertainty about borrowers' ability to pay back their loans. The uncertainty is especially prevalent in the case of loans denominated in foreign currencies granted to borrowers with limited or no income in foreign currencies.

The Group has adopted various measures to assist individuals and corporations experiencing payment difficulties. Based on the number of customers experiencing payment difficulties and utilizing the Group's solutions, the financial impact is estimated insignificant.

Solutions for individuals experiencing payment difficulties

Situations may differ between individuals and this calls for varying solutions, customised to fit the needs of each customer. Solutions are based on an overall assessment of each customer's financial situation. The Group provides several remedies for individuals experiencing financial difficulties based on legislation or developed internally by the Group. The remedies variously consist of general measures and/or involve more extensive actions.

Individuals experiencing payment difficulties are broadly divided into two categories: "ends don't meet" and "significant loss of income". Possible solutions are listed below:

• Mortgage loans, whether denominated in ISK or a foreign currency, are written down to 110% of the market value of the underlying property. The outstanding balance of the current loan, in excess of 110% of the market value of residential housing, is cancelled.
• Foreign currency mortgage loans are lowered and re-denominated in ISK with a maturity of up to 40 years, resulting in an up to 20-27% lower outstanding loan principal. The payment burden can be lowered even further if conditions allow for a longer loan term.
• Instalments on mortgage loans can be linked to a payment netting index, published monthly by Statistics Iceland. The loan continues to be in ISK or a foreign currency but the principal changes in accordance with the payment netting index, which consists of the wage index weighted with employment development. The difference, i.e. the deferred instalments, are added to the loan principal. If the loan has not been paid off in full upon maturity, its term is extended for up to three years. At the end of that period, any outstanding amount is cancelled.
• Repayment of loans issued against mortgages in residential housing can be limited to interest payments for up to 12 months.
• The payment burden of mortgages can be lowered by limiting instalments on mortgages to a set amount.
• Instalments and interest payments on loans issued against mortgages in residential housing can be deferred for up to 3 years in the case of unemployment or significant loss of income. No payments take place during the deferral period; however, the loan principal increases equivalent to accrued interest and CPI-indexation.
• For individuals in the process of building or who have bought real estate but not managed to sell the current property interest payments and instalments on the principal on one of the assets can be postponed.
• The Group offers special debt adjustment to individuals experiencing serious payment difficulties and with a negative asset position. The debt burden is adjusted to payment capacity and asset position based on a 3-year contract specific to each individual's status. Debt exceeding 110% of the value of the underlying property and the borrower's payment capacity are cancelled after three years, provided the individual honours the contract.
• The Group offers payment netting to individuals with vehicle loans. The purpose of this type of payment netting is to return the payment burden of foreign currency vehicle loans/contracts to what they were in May 2008. Amounts outstanding following adjustment of the payment burden are added to the loan principal. The number of instalment dates increases to reflect the change but the repayment term may not exceed 3 years in excess of the period specified in the current contract. It is possible for individuals to convert foreign currency loans into ISK-denominated loans. The principal is thus lowered, in general by 10-25%.

50 Effects of the financial crisis (continued)

Solutions for companies experiencing payment difficulties

The Group has approved a framework to govern the financial restructuring of companies that have a business relation with the Group and are experiencing financial difficulties. The framework is intended to elaborate on the government's declaration, Act No. 107/2009 and Joint Rules on the Financial Restructuring of Companies by the members of the Icelandic Financial Services Association. The framework includes guidelines on sensitive points for employees but does not expose a set of hard and fast rules.

Possible solutions for companies deemed viable in the long term, i.e. where budgets anticipate a positive cash flow and that the company will be able to honour interest payments and instalments once the difficult period ends and restructuring is complete:

Debt restructuring – payment of interests and part of instalments

Companies that are only able to service interest payments and part of instalments, based on updated interest terms, can request a postponement of payment on part or all instalments for 12-24 months. Instalments should be met insofar as possible and the denomination of loans should correspond with that of companies' cash flows. In the long term, companies must be able to meet all obligations pursuant to the Group, based on normal maturity as assessed by the Group.

Write-down of company debt against equity injection by owner

When a company can no longer fulfil commitments under its repayment burden, neither in the short nor long term, it will enter into bankruptcy, normally rendering its share capital valueless. Prior to intervention by the Group, owners should attempt to increase share capital in the company, e.g. by getting new shareholders to provide added equity, attempting to negotiate a merger with other companies, selling assets or seeking composition. A company's debt cannot be cancelled unless its owners can inject new equity into its operations in accordance with the write-off. Converting debt into share capital will also be considered. In all debt restructuring efforts it must be ensured that new equity from owners and outstanding debt does, in the Group's estimation, not exceed 110% of revalued assets or the company's total enterprise value based on estimated cash flow (total value), whichever is higher, taking into consideration the value of security held by the Group. Debt should be denominated in currencies that correspond to companies' cash flows.

Write-down of debt with no equity injection by owner

For companies with interest-bearing debt under ISK 500 million it may be possible in exceptional cases for the Group to write down debt in part without new equity from owners, provided it is clear that owners are unable to provide equity. In such cases it shall be ensured that outstanding debt, in the Group's estimation, does not exceed 125% of revalued assets or the company's total enterprise value, whichever is higher taking into consideration the value of the Group's equity. This applies in particular to companies where the owners are integral to operations and the Group does not consider taking over shares in the company a viable option. Debt should be denominated in currencies that correspond to companies' cash flows. This possibility is contingent on various other criteria. The Group will, for instance, receive 50% of the sale value exceeding liabilities should the company be sold within a set period following restructuring.

The Group assumes ownership of share capital in collaboration with owners

If the above means are not sufficient to improve the situation of a company, the most favourable solution may be for the Group, either on its own or in collaboration with other large creditors, to take over the company entirely following agreement with its owners. The holdings of former owners, valueless at this point, hereby become null and void. The aim of this action is to salvage value and resources which would be lost through bankruptcy and to ensure maximum repayment of debt once the company is sold. In some cases, uncertainty surrounding other of the company's obligations may prevent the Group from converting debt into share capital.

Composition

If the actions above are not feasible, a company may enter into bankruptcy and/or seek composition with creditors. Composition agreements, both voluntary and formal ones, are usually drafted in collaboration between the company, its Board or management, and outside advisors, as well as largest creditors. Composition is often negotiated while the company is in moratorium. This allows the company to start rearranging its finances without attempts by creditors to collect on their claims.

The following points guide the Group's position on composition agreements:
- Outstanding debt and new equity shall exceed at least 10% of total enterprise value or revalued assets, whichever is higher.
- If unsecured debt is to be converted into equity, which is included in total enterprise value, such debt shall be held equal to new share capital.

Credit risk

51 Credit risk

Credit risk is defined as the risk that a party to a financial instrument will cause a financial loss for the Group by failing to discharge its obligations.

Due to the financial crisis, there is rather high uncertainty concerning the recovery of the loan portfolio. In 2009, a large part of the loan portfolio received a payment holiday or was in default due to Icelandic economic conditions. Customers' ability to service their debt deteriorated due to the depreciation of the ISK, high interest rates and a relatively high level of debt leverage among most customers. It is estimated that the corporate loan book needs to be restructured during the years 2010 and 2011. This involves agreements with borrowers on new terms and conditions, debt to equity swaps, and loans redenominated from foreign currencies to ISK for customers with limited or no foreign currency income.

Credit risk is the greatest single risk faced by the Group and arises principally from loans and advances to customers and from investments in debt securities. However, it also arises from issued guarantees and letters of credit which commit the Group to pay a third party in the event of customer inability to fulfil obligations. Guarantees and documentary credits are secured by the goods shipments they cover, thus representing a lower risk than direct loans. Unused credit lines represent commitments to increase loans or guarantees. Conceivably, the Group could suffer losses equivalent to the total of open credit lines.

52 Credit risk management

The Group manages credit risk by setting limits on acceptable risk-weighted exposures to individual borrowers or groups of related borrowers. Such limits are monitored and regularly reviewed. Credit risk is also managed by modifying authorised credit limits or acquiring preferable collateral for existing client obligations.

The Group's management and control of credit risk is centralised. The Board of Directors sets the Group lending policy, with the purpose of controlling overall Group exposure by the combined, comprehensive monitoring of indirect risk exposure through clients and direct claims of the Bank and its subsidiaries.

Credit risk is managed by the Credit Committee and its sub-committees. The Risk Management Division measures credit risk and compiles detailed reports. The lending policy approved by the Credit Committee indicates the maximum allowable exposure to individual borrowers and groups of related borrowers.

The Group's Credit Committee sets detailed lending rules based on the policy approved by the Board of Directors. Lending authorisation levels are well-defined and incremental. Lending authorisations within the branch network vary according to branch size and the lending experience of credit officers, with higher lending authorisations being granted to branch managers and corporate relationship managers. The highest lending authorisation in the Group is in the hands of its Corporate Banking Division. Loans exceeding authorisations set by the lending rules require approval by the Credit Committee, which may approve loans falling outside the authorisations stipulated in Group lending rules. The Credit Committee delegates and reviews employee authorisation levels and is responsible for reviewing lending rules. Comprised of the Bank's CEO and the managing directors of Corporate Banking and Financial Operations, the Credit Committee meets regularly to discuss all credit decisions which exceed the authorisation levels of branches and the Corporate Banking Division.

53 Credit risk mitigation

Securing loans with collateral is the traditional method of mitigating credit risk. The Group applies the various instruments available towards reducing credit risk by obtaining collateral to secure client obligations where this is considered appropriate, normally in the form of a lien on client assets which gives the Group a claim on these assets for both existing and future client obligations.

The amount and type of collateral required depends on an assessment of the credit risk associated with the counterparty. Guidelines are clarified by the Group regarding valuation parameters and the acceptability of different types of collateral. Credit extended by the Group may be secured on residential or commercial properties, land, securities, transport vessels, fishing vessels together with their non-transferable fishing quotas, aircraft, etc. The Group also secures its loans by means of receivables and operating assets, such as machinery, equipment, raw materials, and inventories. Residential mortgages involve the underlying residential property. Less stringent requirements are set for securing short-term personal loans, such as overdrafts and credit card borrowings.

Where possible, management monitors the market value of collateral and may require additional collateral in accordance with the underlying loan agreement.

The current discussion and political debate on possible changes to the fishing quota system in Iceland which may include a gradual decrease in the quota awarded to current quota owners may have an adverse effect on the value of the fishing vessels placed as security for a part of the corporate loan porftfolio of the Bank. This could therefore have an adverse effect on the value of the Bank's loan book. At the moment any such effect is impossible to determine.

In 2010 the Group plans to implement a new collateral system for the Bank. The new collateral system is developed internally and allows the Bank to analyse the quality and value of the collateral held to secure the loan portfolio. The collateral system is a part of the Bank's customer relations management system.

In order to limit further the credit risk arising from financial instruments, the Group enters into netting agreements, which in cases of default arrange for the Group to be able to set off all contracts covered by the netting agreement against the debt. The arrangements generally include all market transactions between the Group and the client.

Generally, collateral is not held over loans and advances to financial institutions, nor is it usually held against bonds and debt instruments.

54 Credit risk measurement

The Group monitors exposures to identify signs of weakness in customer earnings and liquidity as soon as possible. On the basis of customer data, the Group has developed internally a number of statistical models to predict the probability of customers defaulting on their obligations to the Group, or the probability of default. The probability of default is the likelihood of a loan falling into 90 days default within the next 12 months, as defined in the Basel II regulatory framework. The Group's PD's are based on point-in-time calculations. Clients of the Group are segmented into credit quality classes. The rating scale reflects the range of default probabilities defined for each risk classification. This means that exposures migrate between classes as the assessment of their probability of default changes. Work to review and upgrade the Group's rating tools due to the developments in the Icelandic economy since October 2008 started in 2009 and will continue in 2010.

Rather than a rating scale of 1 to 13, the Group used another classification for customers involved in loans and advances transferred to the Bank from Landsbanki Íslands hf. A simple means of classification was devised, creating three credit risk groups: green, amber and red. In the green group, client difficulties could be considered temporary and likely to improve once the economy recovered and/or the ISK appreciated. In the contrasting group, the business model was considered to have failed and bankruptcy was anticipated. Loans to customers classified as red were evaluated according to collateral value.

Customer groups with loan exposure above ISK 500 million are grouped, on the basis of similar credit risk characteristics, into red, green, and amber credit risk groups, according to the Group's current rating process.

Credit risk groups	Definition	Likely action
Green	Company can meet payment obligations.	No impairment assumed for this class.
Amber	Company cannot meet all of its payment obligations. Needs financial reorganisation.	Loan impairment recognition. Loan restructuring; instalments postponed in part or in whole. Loans converted into subordinated debt. Loans converted into equity.
Red	Company cannot meet its repayment obligations and/or its business model is not viable.	Guarantees collected and the company sold, or else its management temporarily assumed by the Group.

The following table presents the classification of loans and advances to customers by credit risk groups:

Carrying amount at 31 December	2009	2008
Customer groups with loan exposures above ISK 500 million		
Green	107,407	125,522
Amber	220,150	248,930
Red	40,027	47,247
Customer groups with loan exposures below ISK 500 million	299,538	283,483
Total	**667,122**	**705,182**

Moody's or similar external ratings were used where applicable to assist in managing the credit risk exposure of bonds. Otherwise the Group used fair value estimates based on available information and the Group's own estimates.

55 Loan impairment

Group policy requires that individual financial assets above materiality thresholds be reviewed at least quarterly, and more frequently when circumstances so demand. Impairment allowances on individually assessed accounts are determined case-by-case by evaluating incurred losses at the reporting date. Collectively assessed impairment allowances are permitted in the following cases: (i) portfolios of homogenous loans that are individually below materiality thresholds, and (ii) losses that have been incurred but not yet identified, using the available historical experience along with experienced judgement and statistical techniques.

Should the expected cash flows be re-examined and the present value of the cash flows (calculated using the effective interest rate) be revised, the difference is then recognised in profit or loss (as either impairment or interest income). Impairment is calculated using the effective interest rate, before any revision of the expected cash flows. Any adjustments to the carrying amount which result from revising the expected cash flows are recognised in profit or loss. The impact of financial restructuring of the Group's customers in 2009 is reflected in loan impairment as the expected cash flow of customers has changed.

The Group measures and estimates the impact of foreign exchange rate changes on the financial strength of each borrower or group of borrowers. While some customers receive income partially or fully in foreign currency, other customers have very limited or no income in foreign currency. Customers with limited income in foreign currency will suffer more than others, should the ISK depreciate.

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56. Maximum exposure to credit risk and concentration by industry sectors

The following tables represent the Group's maximum credit risk exposure at year-end 2009 and 2008, without taking into account any collateral held or other credit enhancements attached. For on-balance sheet assets, the exposures set out below are based on net carrying amounts as reported in the balance sheet. Off-balance sheet amounts in the tables below are the maximum amounts the Group might have to pay for guarantees, loan commitments in their full amount, and undrawn overdraft and credit card facilities. The loans to individuals are residential mortgages and consumer lending. Consumer lending consists of current account loans, ISK term loans and loans dominated in foreign currencies, to name a few of the lending forms.

The Group uses the ISAT 08 industry classification for corporate customers. This classification is based on the NACE Rev. 2 industry classification used by EEA countries.

				Corporations									
At 31 December 2009	Financial institutions	Public entities*	Individuals	Fisheries	Construction and real estate companies	Holding companies	Retail	Services	Manufacturing	ITC**	Agriculture	Other	Carrying amount
Cash and balances with Central Bank	-	26,174	-	-	-	-	-	-	-	-	-	-	26,17 4
Bonds and debt instruments	19,985	129,571	-	-	1,343	6,759	-	-	1,251	-	-	6,812	165,721
Derivative instruments	962	-	-	-	-	-	-	-	-	-	-	9	971
Loans and advances to financial institutions	83,129	-	-	-	-	-	-	-	-	-	-	-	83,129
Loans and advances to customers	-	10,388	175,986	162,490	110,404	53,401	46,161	49,589	26,933	17,659	13,208	903	667,122
Other financial assets	5,424	50	7	40	1	594	3	779	2	1	0	89	6,99 0
Total on-balance sheet exposure	109,500	166,183	175,993	162,530	111,748	60,75 4	46,16 4	50,368	28,186	17,660	13,208	7,813	950,107
Off-balance sheet exposure	-	7,000	34,008	10,219	7,852	1,124	11,701	4,719	3,481	2,588	1,796	141	84,629
Financial guarantees	-	412	378	598	3,521	215	423	1,313	581	493	6	95	8,035
Undrawn loan commitments	-	0	73	7,000	2,715	166	7,598	628	1,665	1,100	1,409	0	22,354
Undrawn overdraft/credit card facilities	-	6,588	33,557	2,621	1,616	743	3,680	2,778	1,235	995	381	46	54,240
Maximum exposure to credit risk	109,500	173,183	210,001	172,749	119,600	61,878	57,865	55,087	31,667	20,248	15,004	7,95 4	1,034,736

* Public entities consist of central government, state-owned enterprises, Central Bank and municipalities.

** ITC consists of corporations in the information, technology and communication industry sectors.

All amounts are in ISK million

56. Maximum exposure to credit risk and concentration by industry sectors (continued)

At 31 December 2008	Financial institutions	Public entities*	Individuals	Corporations: Fisheries	Corporations: Construction and real estate companies	Corporations: Retail	Corporations: Holding companies	Corporations: Services	Corporations: Manufacturing	Corporations: ITC**	Corporations: Agriculture	Corporations: Other	Carrying amount
Cash and balances with Central Bank	-	30,071	-	-	-	-	-	-	-	-	-	-	30,071
Bonds and debt instruments	19,590	6,009	0	0	0	0	6,988	417	4,561	0	0	2,331	39,89 6
Loans and advances to financial institutions	8,845	-	-	-	-	-	-	-	-	-	-	-	8,845
Loans and advances to customers	-	11,453	170,033	171,827	107,479	58,226	63,165	48,625	25,414	27,845	16,287	4,828	705,182
Unpaid capital contribution***	-	149,225	-	-	-	-	-	-	-	-	-	-	149,22 5
Other financial assets	21,980	6,091	139	63	0	5,662	62	104	282	8	0	188	34,579
Total on-balance sheet exposure	50,415	202,849	170,172	171,890	107,479	63,888	70,215	49,146	30,257	27,853	16,287	7,347	967,798
Off-balance sheet exposure	-	4,602	38,064	12,569	2,911	13,957	2,400	901	1,222	11,205	6,592	454	94,877
Financial guarantees	0	811	366	5,347	439	599	470	0	519	412	1,229	92	10,284
Undrawn loan commitments	0	0	53	4,379	1,771	10,022	297	648	0	5,599	1,696	32	24,497
Undrawn overdraft/credit card facilities	0	3,791	37,645	2,843	701	3,336	1,633	253	703	5,194	3,667	330	60,096
Maximum exposure to credit risk	50,415	207,451	208,23 6	184,459	110,390	77,845	72,615	50,047	31,479	39,058	22,879	7,801	1,062,67 5

* Public entities consist of central government, state-owned enterprises, Central Bank and municipalities.

** ITC consists of corporations in the information, technology and communication industry sectors.

*** The unpaid capital contribution is not a financial asset but it is included in the table because it was an integral part of the information used by the Bank's management to manage financial risk, as the contribution was to be made in government bonds.

All amounts are in ISK million

57 Loans and advances by industry sectors

	2009			2008		
Industry sectors	**Gross carrying amount**	**Allowance for impairment**	**Carrying amount**	**Gross carrying amount**	**Allowance for impairment**	**Carrying amount**
Financial institutions	83,129	-	83,129	8,845	-	8,845
Public entities	10,582	(194)	10,388	11,529	(76)	11,453
Individuals	177,110	(1,124)	175,986	170,052	(20)	170,033
Corporations						
Fisheries	162,677	(187)	162,490	171,859	(32)	171,827
Construction and real estate companies	111,791	(1,387)	110,404	107,771	(292)	107,479
Holding companies	56,985	(3,584)	53,401	63,703	(538)	63,165
Retail	46,866	(705)	46,161	58,287	(60)	58,226
Services	49,799	(210)	49,589	48,653	(29)	48,625
Information, technology and communication	17,719	(60)	17,659	27,855	(10)	27,845
Manufacturing	27,211	(278)	26,933	25,530	(116)	25,414
Agriculture	13,226	(18)	13,208	16,297	(10)	16,287
Other	916	(13)	903	4,828	-	4,828
Total	**758,011**	**(7,760)**	**750,251**	**715,209**	**(1,183)**	**714,027**

58 Credit quality of financial assets

	Gross carrying amount					
At 31 December 2009	**Neither past due nor individually impaired**	**Past due but not individually impaired**	**Individually impaired**	**Total**	**Allowance for impairment**	**Carrying amount**
Cash and balances with Central Bank	26,174	-	-	26,174	-	26,174
Bonds and debt instruments	148,111	17,610	-	165,721	-	165,721
Derivative instruments	971	-	-	971	-	971
Loans and advances to financial institutions	83,115	14	-	83,129	-	83,129
Loans and advances to customers	493,941	178,484	2,457	674,882	(7,760)	667,122
Other financial assets	6,990	-	-	6,990	-	6,990
Total	**759,302**	**196,108**	**2,457**	**957,867**	**(7,760)**	**950,107**
At 31 December 2008						
Cash and balances with Central Bank	30,071	-	-	30,071	-	30,071
Bonds and debt instruments	22,009	17,887	-	39,896	-	39,896
Loans and advances to financial institutions	8,845	-	-	8,845	-	8,845
Loans and advances to customers	523,191	182,258	916	706,365	(1,183)	705,182
Other financial assets	34,579	-	-	34,579	-	34,579
Total	**618,695**	**200,145**	**916**	**819,756**	**(1,183)**	**818,573**

The impairment allowances above include both the allowance for financial assets that are individually impaired as well as the allowance for financial assets that are subject to collective impairment. Assets covered by collective impairment allowance are not included under financial assets that are past due or impaired.

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59 Loans and advances neither past due nor individually impaired

At 31 December 2009	Green	Amber	Red	Exposures below ISK 500 million	Gross carrying amount
	Credit risk groups				
Financial institutions	-	-	-	83,115	83,115
Public entities	4,706	576	-	3,676	8,958
Individuals	33	148	89	140,029	140,299
Corporations					
Fisheries	55,185	68,338	382	10,534	134,439
Construction and real estate companies	4,283	28,684	2,151	21,788	56,906
Holding companies	8,935	8,226	1,186	18,708	37,055
Retail	5,718	16,078	6,685	6,940	35,421
Services	6,522	7,574	694	16,223	31,013
Information, technology and communication	12,454	2,777	-	1,553	16,784
Manufacturing	4,862	4,387	230	2,929	12,408
Agriculture	895	13,338	-	5,580	19,813
Other	-	221	588	36	845
Total	**103,593**	**150,347**	**12,005**	**311,111**	**577,056**
At 31 December 2008					
Financial institutions	55	-	11	8,779	8,845
Public entities	3,998	1,350	-	3,728	9,076
Individuals	43	555	258	143,248	144,104
Corporations					
Fisheries	57,817	66,024	1,162	8,097	133,100
Construction and real estate companies	3,813	28,190	2,806	18,683	53,492
Holding companies	12,761	17,497	2,589	13,153	46,000
Retail	5,524	21,885	10,217	4,669	42,295
Services	7,877	10,226	1,164	15,139	34,406
Information, technology and communication	12,473	10,411	2,528	1,694	27,106
Manufacturing	6,028	6,675	225	2,242	15,170
Agriculture	1,114	6,966	138	5,800	14,018
Other	-	3,232	942	250	4,424
Total	**111,503**	**173,011**	**22,040**	**225,482**	**532,036**

60 Loans and advances past due but not individually impaired

The following table shows the gross carrying amount of loans to customers that have failed to make payments which had become contractually due by one or more days.

At 31 December 2009	Past due up to 30 days	Past due up to 31 - 60 days	Past due up to 61 - 90 days	Past due over 90 days	Gross carrying amount
Loans and advances to customers	26,929	16,075	14,056	121,424	178,484
At 31 December 2008					
Loans and advances to customers	82,642	44,455	23,816	31,345	182,258

The gross carrying amount of loans and advances to financial institutions that were past due but not individually impaired amounted to ISK 14.4 million at year-end 2009 (2008: ISK 0.3 million) and they were past due by up to 30 days (2008: up to 30 days).

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61 Individually impaired loans and advances to customers

At 31 December 2009	Gross carrying amount	Allowance for impairment	Carrying amount
Loans and advances to customers	2,457	(1,450)	1,007
At 31 December 2008			
Loans and advances to customers	916	(864)	52

62 Allowance for impairment on loans and advances to customers

	2009	2008
Balance at beginning of period	1,183	-
Net impairment loss on loans and advances	6,577	1,256
Collected previously written-off loans	0	8
Loans written-off	0	(81)
Balance at 31 December	**7,760**	**1,183**
Specific allowance	1,450	864
Collective allowance	6,310	319
Total	**7,760**	**1,183**

63 Renegotiated loans

Financial restructuring and renegotiation of loans to the Group's customers acquired from Landsbanki Íslands hf. started in 2009. In regard to financial restructuring of customers, the Group put remedies in place for those experiencing financial difficulties and also presented procedures for financial restructuring. These restructuring approaches include extended and modified repayment arrangements and approved external management plans. Restructuring may be suitable for borrowers in financial difficulties as well as those who are not, and is available whether loans have become past due or not. In 2009 many of the Group's customers took advantage of payment holidays for principal and/or interest, which was not indicative on the borrower demonstrating an inability to service the loan.

The following table shows the status of restructuring of loans and advances to customers of the Group as at 31 December 2009 based on classification of the customers:

Status of loans to corporations	% of carrying amount	% of number of customers
Performing without restructuring	45%	63%
Performing after restructuring	15%	10%
Non-performing (90 days in arrears or unlikely to pay in full)	40%	27%
Total	**100%**	**100%**
Status of loans to individuals		
Performing without restructuring	36%	77%
Performing after restructuring	39%	15%
Non-performing (90 days in arrears or unlikely to pay in full)	25%	8%
Total	**100%**	**100%**

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64 Large exposures

At year-end 2009, three Group clients were rated as large exposures (2008: six clients). Clients are rated as large exposures if their total obligations, or those of financially or administratively connected parties, exceed 10% of the Group's equity after taking account of collateral held, in accordance with the Financial Supervisory Authority's Rules on Large Exposures Incurred by Financial Undertakings No. 216/2007. According to these rules, no exposure may attain the equivalent of 25% of equity, as defined by the Basel II regulatory framework. All of the Group's large exposures were within these limits at the end of 2009.

At year-end 2009, the Group's internal rules on large exposures stated that clients could comprise up to 20% (2008: 25%) of the Group's equity as defined by the Basel II regulatory framework ("capital base"). At year-end 2009, no exposure exceeded 20% (2008: one exposure). According to the Group's risk appetite, the total utilisation percentage of a large exposure ought to remain below 200% (2008: 150%) of the Group's capital base.

At 31 December 2009	Number of large exposures	Large exposures
Large exposures above 20% of the Group's capital base	0	0
Large exposures between 10% and 20% of the Group's capital base	3	67,189
Total	**3**	**67,189**
Utilisation of 800% limit (%)		43%

At 31 December 2008		
Large exposures above 20% of the Group's capital base	1	32,538
Large exposures between 10% and 20% of the Group's capital base	5	93,663
Total	**6**	**126,201**
Utilisation of 800% limit (%)		89%

65 Bonds and debt instruments

A breakdown of the Group's bond portfolio, by Moody's rating, is as follows:

Carrying amount at 31 December	2009	2008
Aaa	-	1,709
Aa1	377	214
Aa3	274	-
A3 to A1	1,188	-
Baa1 to Baa3	130,355	6,317
Lower than Baa3	15,349	9,849
Unrated	18,178	21,807
Total	**165,721**	**39,896**

Unrated bonds and bonds with ratings lower than Baa3 are primarily bonds issued by domestic corporations, some of which developed into liquidating estates, such as Baugur Group hf., Kaupthing Bank hf. and Eimskipafélag Íslands hf.

The following table shows the carrying amounts of bonds for which the issuers have failed, by one or more days, to make a payment when it was contractually due:

At 31 December 2009	Past due up to 30 days	Past due up to 31 - 60 days	Past due up to 61 - 90 days	Past due over 90 days	Carrying amount
Financial institutions	-	-	-	10,536	10,536
Holding companies	105	111	-	5,200	5,416
Other	-	-	-	1,658	1,658
Total	**105**	**111**	**0**	**15,736**	**17,610**

At 31 December 2008					
Financial institutions	5,298	4,259	-	-	9,557
Holding companies	5,024	620	411	-	6,055
Other	2,089	0	186	-	2,275
Total	**12,411**	**4,879**	**597**	**0**	**17,887**

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Liquidity Risk

66 Liquidity risk

Liquidity risk is the risk that the Group will encounter difficulty in meeting its obligations associated with financial liabilities that are settled by delivering cash or another financial asset, or of having to do so at excessive cost. This risk arises from possible mismatches in the timing of cash flows.

67 Liquidity risk management

The Group has instituted a liquidity management policy for the Bank and its subsidiaries. The Asset and Liability Committee (ALCO) sees to formulating this policy, while the Treasury Department implements it in co-operation with the Asset and Liability Mismatch Risk Unit, which is part of the Risk Management Division. The objective of the liquidity management policy is to ensure, even in times of stress, that sufficient liquid assets and funding capacity are available to meet financial obligations in a timely manner and at reasonable cost. Enforcing this policy has the further objective of minimising fluctuations in liquidity.

The Group follows liquidity rules set by the Central Bank of Iceland to govern the ratio of weighted liquid assets and liabilities. These rules require the ratio of weighted assets to weighted liabilities to stay above 1 for the next three months, and involve a stress test, weighting assets and liabilities with specific coefficients and reflecting how accessible each asset would be in a liquidity crisis and how great the need would be to repay the liability in question when due. The Group submits monthly reports on its liquidity position to the Central Bank of Iceland.

Group liquidity risk is managed centrally by the Treasury Department and is monitored by the Asset and Liability Mismatch Risk Unit, both of which are located at the head office. This allows management to monitor and manage liquidity risk throughout the Group. ALCO monitors the Group's liquidity risk, while the Group's internal audit assesses whether the liquidity management process is designed properly and operating effectively.

The Group monitors intraday liquidity risk, short-term liquidity risk, and risk arising from mismatches of longer term assets and liabilities. Short-term liquidity risk is defined as under 12 months. The Group has neither defaulted on any principal or interest nor breached any covenants in respect of liabilities up to the date of these consolidated financial statements being authorised for issue.

The Group's liquidity management process includes projecting expected cash flows in a maturity profile rather than relying merely on contractual maturities, monitoring balance sheet liquidity, monitoring and managing the maturity profile of liabilities and off-balance sheet commitments, monitoring the concentration of liquidity risk in order to avoid undue reliance on large individual depositors, projecting cash flows arising from future business, and maintaining liquidity and contingency plans which outline measures to take in the event of difficulties arising from liquidity crises.

The Asset and Liability Mismatch Risk Unit conducts stress tests by applying various hypothetical scenarios on the Group's liquidity position to ensure that it has adequate liquidity to withstand stressed conditions. Different assumptions are drawn for each stress test to estimate the impact of a variety of market conditions, in particular the lifting of capital controls in Iceland and how that would impact the Group's deposit base.

The key measure used by the Group for monitoring liquidity risk is the ratio of core liquid assets to deposits, which shows the ratio of deposits that the Group could deliver on demand without incurring any significant losses due to forced asset sales or other costly actions. Core liquid assets are comprised of cash at hand, balances with Central Bank and assets eligible for repo transactions with Central Bank (such as government bonds). The core liquidity ratio at year-end 2009 was 36% (2008: 26%). On 30 December 2009, the Bank received a capital contribution from the Icelandic government in the notional amount of ISK 121,225 million and accrued interest in the amount of ISK 18,588 million therefore strengthening the Bank's core liquidity ratio significantly at year-end 2009.

68 Maturity analysis of financial assets and liabilities

The following table shows a maturity analysis of the Group's financial instruments as at 31 December 2009:

Non-derivative financial assets	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total	Carrying amount
Cash and balances with Central Bank	26,174	-	-	-	-	-	26,174	26,174
Bonds and debt instruments	-	10,291	10,387	73,767	190,467	-	284,912	165,721
Equities and equity instruments	-	-	-	-	-	23,411	23,411	23,411
Loans and advances to financial institutions	-	78,570	4,349	77	213	-	83,209	83,129
Loans and advances to customers	37,692	64,769	99,336	340,412	468,381	-	1,010,590	667,122
Other financial assets	-	1,826	5,164	-	-	-	6,990	6,990
Total	**63,866**	**155,456**	**119,236**	**414,256**	**659,061**	**23,411**	**1,435,286**	**972,547**
Derivative financial assets								
Gross settled derivatives								
Inflow	-	9,411	9,739	-	-	-	19,150	
Outflow	-	(8,900)	(9,989)	-	-	-	(18,889)	
Total	**0**	**511**	**(250)**	**0**	**0**	**0**	**261**	**962**
Net settled derivatives	-	9	-	-	-	-	9	9
Total	**0**	**520**	**(250)**	**0**	**0**	**0**	**270**	**971**
Non-derivative financial liabilities								
Due to financial institutions and Central Bank	(89,657)	(8,177)	-	(441)	-	-	(98,275)	(98,228)
Deposits from customers	(317,330)	(83,068)	(13,147)	(39,932)	-	-	(453,477)	(452,655)
Short positions	-	(2,064)	(325)	(3,690)	(2,657)	-	(8,736)	(5,268)
Borrowings	-	-	(19,769)	(91,266)	(260,449)	-	(371,484)	(306,493)
Contingent bond	-	-	-	(3,922)	(10,163)	-	(14,085)	(10,241)
Other financial liabilities	-	(2,138)	-	-	-	-	(2,138)	(2,138)
Total	**(406,987)**	**(95,447)**	**(33,241)**	**(139,251)**	**(273,269)**	**0**	**(948,195)**	**(875,023)**
Off-balance sheet items								
Financial guarantees	-	(4,576)	(335)	(3,124)	-	-	(8,035)	
Undrawn loan commitments	(22,354)	-	-	-	-	-	(22,354)	
Undrawn overdraft/credit card commitments	(54,240)	-	-	-	-	-	(54,240)	
Total	**(76,594)**	**(4,576)**	**(335)**	**(3,124)**	**0**	**0**	**(84,629)**	
Total non-derivative financial liabilities and off-balance sheet items	**(483,581)**	**(100,023)**	**(33,576)**	**(142,375)**	**(273,269)**	**0**	**(1,032,824)**	
Derivative financial liabilities								
Gross settled derivatives								
Inflow	-	168	297	1,278	904	-	2,647	
Outflow	-	(167)	(412)	(1,668)	(1,182)	-	(3,429)	
Total	**0**	**1**	**(115)**	**(390)**	**(278)**	**0**	**(782)**	**(673)**
Net settled derivatives	-	(2)	-	-	-	-	(2)	(2)
Total	**0**	**(1)**	**(115)**	**(390)**	**(278)**	**0**	**(784)**	**(675)**
Net liquidity position	**(419,715)**	**55,952**	**85,295**	**271,491**	**385,514**	**23,411**	**401,948**	

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68 Maturity analysis of financial assets and liabilities (continued)

The following table shows a maturity analysis of the Group's financial assets and liabilities as at 31 December 2008:

Non-derivative financial assets	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total	Carrying amount
Cash and balances with Central Bank	30,071	-	-	-	-	-	30,071	30,071
Bonds and debt instruments	-	1,817	3,667	33,843	10,035	-	49,362	39,896
Equities and equity instruments	-	-	-	-	-	39,681	39,681	39,681
Loans and advances to financial institutions	1,633	3,428	3,082	871	-	-	9,014	8,845
Loans and advances to customers	101,770	134,469	146,908	443,572	235,236	-	1,061,955	705,182
Unpaid capital contribution	-	-	51,597	73,796	208,810	-		149,225
Other financial assets	-	10,228	24,351	-	-	-	34,579	34,579
Total	**133,474**	**149,942**	**229,605**	**552,082**	**454,081**	**39,681**	**1,224,662**	**1,007,479**
Non-derivative financial liabilities								
Due to financial institutions and Central Bank	(119,262)	(12,619)	(378)	-	-	-	(132,259)	(132,219)
Deposits from customers	(320,837)	(44,238)	(14,790)	(51,441)	-	-	(431,306)	(431,006)
Provisional liability due to Landsbanki Íslands hf.	-	-	(29,070)	(61,319)	(324,983)	-	(415,372)	(305,057)
Other financial liabilities	-	(13,808)	(1,511)	-	-	-	(15,319)	(15,319)
Total	**(440,099)**	**(70,665)**	**(45,749)**	**(112,760)**	**(324,983)**	**0**	**(994,256)**	**(883,601)**
Off-balance sheet items								
Financial guarantees	-	(6,097)	(1,745)	(2,442)	-	-	(10,284)	
Undrawn loan commitments	(24,497)	-	-	-	-	-	(24,497)	
Undrawn overdraft/credit card commitments	(60,096)	-	-	-	-	-	(60,096)	
Total	**(84,593)**	**(6,097)**	**(1,745)**	**(2,442)**	**0**	**0**	**(94,877)**	
Total non-derivative financial liabilities and off-balance sheet items	**(524,692)**	**(76,762)**	**(47,494)**	**(115,202)**	**(324,983)**	**0**	**(1,089,133)**	**(883,601)**
Derivative financial liabilities								
Gross settled derivatives								
Inflow	-	1,076	542	1,237	1,168	-	4,023	
Outflow	-	(1,084)	(737)	(1,689)	(1,599)	-	(5,109)	
Total	**0**	**(8)**	**(195)**	**(452)**	**(431)**	**0**	**(1,086)**	**(746)**
Net liquidity position	**(391,218)**	**73,172**	**181,916**	**436,428**	**128,667**	**39,681**	**134,443**	

The amounts in the maturity analyses as at 31 December 2009 and 2008 are allocated to maturity buckets in respect of remaining contractual maturity (i.e. based on the timing of future cash flows according to contractual terms). Exceptions to this are loans and advances to customers and bonds issued by companies in moratorium or in the process of liquidation. For loans and advances to larger customers the Group estimates both the timing and amounts of cash flows by taking into consideration the expected financial restructuring of the customer. For loans and advances to smaller customers the Group estimates the timing of the cash flows based on the contractual terms but the amounts are based on the historical recovery rate. For bonds issued by companies in moratorium or in the process of liquidation the amounts presented are future cash flows estimated as their fair value at balance sheet date.

Amounts presented in the maturity analyses are the undiscounted future cash flows receivable and payable by the Group, including both principal and interest cash flows. These amounts differ from the carrying amounts presented in the balance sheet, which are based on discounted rather than undiscounted future cash flows. If an amount receivable or payable is not fixed, the amount presented in the maturity analyses has been determined by reference to the conditions existing at the balance sheet date. When there is a choice of when an amount shall be paid, future cash flows are calculated on the basis of the earliest date at which the Group can be required to pay, which is the worst case scenario from Group perspectives. An example of this is that demand deposits are figured in the earliest time band. Where the Group is committed to have amounts available in instalments, each instalment is allocated to the earliest period in which the Group might be required to pay. Thus undrawn loan commitments are included in the time band together with the earliest date at which such loans may be drawn. For financial guarantee contracts issued by the Group, the amount included in the maturity analysis is the guarantee's maximum amount, allocated to the earliest period in which the guarantee might be called.

Nonetheless, the Group's expected cash flows on demand deposits vary significantly from the amounts presented in the maturity analyses. Demand deposits from customers have short contractual maturities but are considered a relatively stable financing source with expected maturity exceeding one year, and it is not expected that every committed loan will be drawn down immediately. As mentioned above in relation to liquidity management, the Group also conducts a weekly stress test to estimate the impact of fluctuating market conditions and deposit withdrawals.

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69 Maturity analysis of financial assets and liabilities by currency

The following table shows a maturity analysis of the Group's financial instruments by currency of denomination as at 31 December 2009:

Non-derivative financial assets	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total	Carrying amount
Total in foreign currencies	14,963	102,579	65,337	243,968	232,525	11,116	670,488	522,757
ISK	48,903	52,877	53,899	170,288	426,536	12,295	764,798	449,790
Total	**63,866**	**155,456**	**119,236**	**414,256**	**659,061**	**23,411**	**1,435,286**	**972,547**
Derivative financial assets								
Total in foreign currencies	-	511	(250)	-	-	-	261	962
ISK	-	9	-	-	-	-	9	9
Total	**0**	**520**	**(250)**	**0**	**0**	**0**	**270**	**971**
Non-derivative financial liabilities								
Total in foreign currencies	(88,534)	(1,153)	(23,005)	(91,266)	(260,449)	-	(464,407)	(399,418)
ISK	(318,453)	(94,294)	(10,236)	(47,985)	(12,820)	-	(483,788)	(475,605)
Total	**(406,987)**	**(95,447)**	**(33,241)**	**(139,251)**	**(273,269)**	**0**	**(948,195)**	**(875,023)**
Off-balance sheet items								
Total in foreign currencies	(15,474)	(10)	(1)	(58)	-	-	(15,543)	
ISK	(61,120)	(4,566)	(334)	(3,066)	-	-	(69,086)	
Total	**(76,594)**	**(4,576)**	**(335)**	**(3,124)**	**0**	**0**	**(84,629)**	
Derivative financial liabilities								
Total in foreign currencies	-	163	89	408	296	-	956	(673)
ISK	-	(164)	(204)	(798)	(574)	-	(1,740)	(2)
Total	**0**	**(1)**	**(115)**	**(390)**	**(278)**	**0**	**(784)**	**(675)**
Net liquidity position in foreign currencies	**(89,045)**	**102,090**	**42,170**	**153,052**	**(27,628)**	**11,116**	**191,755**	
Net liquidity position in ISK	**(330,670)**	**(46,138)**	**43,125**	**118,439**	**413,142**	**12,295**	**210,193**	
Net liquidity position	**(419,715)**	**55,952**	**85,295**	**271,491**	**385,514**	**23,411**	**401,948**	

The amounts in the maturity analysis as at 31 December 2009 are allocated to maturity buckets in respect of remaining contractual maturity (i.e. based on the timing of future cash flows according to contractual terms). Exceptions to this are loans and advances to customers and bonds issued by companies in moratorium or in the process of liquidation as disclosed in Note 68.

The expected cash flows of loans are based on the currency of denomination. However, cash inflows of loans granted in foreign currency to customers with limited or no foreign income may not be in the denominated foreign currency (see Note 78).

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Market risk

70 Market risk

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate because of changes in market prices. Market risk arises from open positions regarding currency, equity and interest rate products, all of which are exposed to general and specific market movements and changing volatility levels in market rates and prices, for instance in interest rates, credit spreads, foreign exchange rates and equity prices.

71 Market risk management

The Group separates its exposure to market risk into trading and non-trading portfolios, managing each of them separately. Trading portfolios include all of the positions arising from investment banking operations of the Finance Division, such as positions arising from market-making and proprietary position-taking (i.e. bonds classified as held for trading, equities, unsettled securities trading, derivatives and short positions). Non-trading portfolios include positions arising from the Group's retail and commercial banking operations (i.e. loans and advances, deposits and bonds designated as at fair value through profit or loss or classified as loans and receivables). The overall authority for market risk management has been vested by the Board of Directors in the CEO and Asset and Liability Committee (ALCO). The Market Risk Management Unit is responsible for developing detailed risk management policies (which are subject to review and approval by the Risk Committee and ALCO) and for reviewing their implementation from day to day. The objective of market risk management is to control market risk exposures and keep them within acceptable parameters, while still optimising

Market risks arising from trading and non-trading activities are monitored and managed by two separate teams within the Risk Management Department, which submit daily and monthly reports to ALCO and the head of each business unit. The Group's market risk is thereby measured on a daily basis, and the detailed limits set by ALCO are monitored by the Market Risk Management Unit within the Risk Management Division. Several indicators are used, including daily profits and losses as well as net positions across different attributes such as the currency and issuer.

The Board of Directors has set a ceiling on the Group's exposure to market risk, so that it may not exceed 15% of the total risk-weighted asset base. Risk-weighted assets are determined by applying specific risk weights to Group assets, following methodology developed by the Basel Committee on Banking Supervision. In compliance with this limit, exposure to equity price risk may not exceed 12%; exposure to foreign exchange risk may not rise above 2%, neither for long nor short positions; and the maximum exposure to interest rate risk must not go over 6%. The Group's exposure to market risk at year-end 2009 was 22.1% (2008: 29.1%) of its total risk-weighted asset base, with the exposure to equity price risk measuring 3.4% (2008: 5.5%), the exposure to interest rate risk measuring 5.1% (2008: 5.0%) and the exposure to foreign exchange risk measuring 13.7% (2008: 18.6%). Due to the circumstances described in Note 76, the Group surpassed these limits to foreign exchange risk at year-end 2009. In February 2010 the Board set a new risk appetite altering the ceiling for market risk so as the regulatory capital requirements for market risk cannot exceed 15% of the Group´s equity according to the most recently published consolidated financial statements.

The currency risk in the Group's trading portfolios is disclosed together with that in its non-trading portfolios in Notes 76-79, along with the related sensitivity analysis.

72 Sensitivity analysis for trading portfolios

The management of market risk in the trading book is supplemented by monitoring sensitivity of the trading portfolios to various scenarios in equity prices and interest rates.

The following table shows how the Group's profit (loss) before income tax would have been affected by parallel shifts in interest yield curves through changes in the fair value of its bond trading portfolios at year-end 2009 and 2008 and cash flows for the next 12 months after that, assuming a constant financial position.

	2009			2008		
Currency (ISK million)	Parallel shift in yield curve (in basis points)	Effect of downward shift on profit	Effect of upward shift on profit	Parallel shift in yield curve (in basis points)	Effect of downward shift on profit	Effect of upward shift on profit
ISK, non-CPI indexed	100	370	(360)	100	52	(50)
ISK, CPI indexed	50	(42)	40	50	67	(63)
USD	10	0	0	10	1	(1)
GBP	20	0	0	20	0	0
Total		**328**	**(320)**		**120**	**(114)**

The Group's equity would have been affected to the same extent as the income statement, but net of income tax. This is because the increase (decrease) in profit before income tax would have affected retained earnings (accumulated deficit).

The following table shows how the Group's profit before income tax would have been affected by a change of +/-10% in the price of equity and equity instruments held by the Group at year-end which are classified into Level 1 and 2 (as defined in Note 6):

	2009		2008	
Currency (ISK million)	Increase	Decrease	Increase	Decrease
ISK	100	(100)	661	(661)
EUR	10	(10)	417	(417)
SEK	53	(53)	2,013	(2,013)
NOK	36	(36)	331	(331)
Other	0	0	45	(45)
Total	**199**	**(199)**	**3,467**	**(3,467)**

The Group's equity would have been affected to the same extent as the income statement, but net of income tax. This is because the increase (decrease) in profit before income tax would have affected retained earnings (accumulated deficit).

The following table shows how the Group's profit before income tax would have been affected by changes in significant inputs into fair value measurement of equity and equity instruments held by the Group at year-end which are classified into Level 3 (as defined in Note 6). For equities valued using discounted cash flow the yield was shifted by +/-300 basis points and when comparables or recent transactions are used the price was changed by +/-10%.

	2009		2008	
Currency (ISK million)	Increase	Decrease	Increase	Decrease
ISK	414	(414)	132	(132)
USD	18	(18)	43	(43)
EUR	19	(19)	320	(320)
NOK	23	(23)	6	(6)
Total	**474**	**(474)**	**501**	**(501)**

The Group's equity would have been affected to the same extent as the income statement, but net of income tax. This is because the increase (decrease) in profit before income tax would have affected retained earnings (accumulated deficit).

73 Interest rate risk (non-trading portfolios)

The interest rate risk in non-trading portfolios is the risk that the fair value or future cash flow of financial instruments will fluctuate due to changes in market interest rates.

Changes in interest rate for the Group's assets and liabilities, other than those in its trading portfolios, have an impact on its interest rate margin. This risk results primarily from duration mismatch between assets and liabilities.

Interest rate risk is managed principally by monitoring interest rate gaps. Interest rate risk is managed centrally within the Group by the Treasury Department, and is monitored by the Asset and Liability Mismatch Risk Unit of the Risk Management Division. In the current economic environment, the Group has no access to derivative instruments and other tools for managing interest rate risk.

The following tables summarise the Group's exposure to interest rate risk in its non-trading portfolios. The tables include interest-bearing financial assets and liabilities at their carrying amounts, while off-balance sheet amounts are the notional amounts of the derivative instruments (see Note 9). The amounts presented are categorised by the earlier of either the contractual repricing or the maturity date.

At 31 December 2009	Up to 3 months	3-12 months	1-5 years	Over 5 years	Carrying amount
Financial assets					
Cash and balances with Central Bank	26,174	-	-	-	26,174
Bonds and debt instruments	150,635	5,151	4,236	5,699	165,721
Derivative instruments	282	689	-	-	971
Loans and advances to financial institutions	81,904	1,002	26	197	83,129
Loans and advances to customers	518,539	57,383	39,910	51,290	667,122
Other financial assets	6,990	-	-	-	6,990
Total	**784,524**	**64,225**	**44,172**	**57,186**	**950,107**
Financial liabilities					
Due to financial institutions and Central Bank	(98,228)	-	-	-	(98,228)
Deposits from customers	(452,655)	-	-	-	(452,655)
Derivative instruments and short positions	(2,030)	(798)	(2,044)	(1,071)	(5,943)
Borrowings	(306,493)	-	-	-	(306,493)
Contingent bond	(10,241)	-	-	-	(10,241)
Other financial liabilities	(2,138)	-	-	-	(2,138)
Total	**(871,785)**	**(798)**	**(2,044)**	**(1,071)**	**(875,698)**
Net on-balance sheet position	(87,261)	63,427	42,128	56,115	74,409
Net off-balance sheet position	(1,101)	2,013	(502)	(410)	
Total interest repricing gap	**(88,362)**	**65,440**	**41,626**	**55,705**	

At 31 December 2008	Up to 3 months	3-12 months	1-5 years	Over 5 years	Carrying amount
Financial assets					
Cash and balances with Central Bank	30,071	-	-	-	30,071
Bonds and debt instruments	8,592	13,048	13,610	4,646	39,896
Loans and advances to financial institutions	8,212	633	-	-	8,845
Loans and advances to customers	552,816	67,384	41,699	43,283	705,182
Unpaid capital contribution*	149,225	-	-	-	149,225
Other financial assets	34,579	-	-	-	34,579
Total	**783,495**	**81,065**	**55,309**	**47,929**	**967,798**
Financial liabilities					
Due to financial institutions and Central Bank	(131,872)	(347)	-	-	(132,219)
Deposits from customers	(426,042)	(4,964)	-	-	(431,006)
Derivative liabilities	(746)	-	-	-	(746)
Provisional liability due to Landsbanki Íslands hf.*	(305,057)	-	-	-	(305,057)
Other financial liabilities	(15,319)	-	-	-	(15,319)
Total	**(879,036)**	**(5,311)**	**0**	**0**	**(884,347)**
Net on-balance sheet position	(95,541)	75,754	55,309	47,929	83,451
Net off-balance sheet position	1,000	(24)	(451)	(525)	
Total interest repricing gap	**(94,541)**	**75,730**	**54,858**	**47,404**	

*The unpaid capital contribution is not a financial asset but it is included in the table because it was an integral part of the information used by the Bank's management to manage financial risk, as the contribution was to be made in government bonds. Similarly, the provisional liability due to Landsbanki Íslands hf. is not a financial liability but it is included in the table on the basis of the information used by the Bank's management for the purpose of managing interest rate risk.

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74 Sensitivity analysis for non-trading portfolios

The management of interest rate risk against interest rate gap limits is supplemented by monitoring the sensitivity of financial assets and liabilities to various interest rate scenarios. The Group employs a monthly stress test of the interest rate risk in the Group's overall non-trading net on-balance sheet position. In this test, the interest rate curve is shifted for every currency. The following table shows how the Group's profit (loss) before income tax would have been affected by a parallel shift in all yield curves, with all other variables kept constant, as related to risk exposure at year-end 2009 and 2008 and cash flows for the next 12 months after that, assuming a constant financial position.

	2009			2008		
Currency (ISK million)	**Parallel shift in yield curve (in basis points)**	**Effect of downward shift on profit**	**Effect of upward shift on profit**	**Parallel shift in yield curve (in basis points)**	**Effect of downward shift on profit**	**Effect of upward shift on profit**
ISK, non-CPI indexed	100	44	(44)	100	59	(59)
ISK, CPI indexed	50	(28)	28	50	(59)	59
EUR	20	(10)	10	20	(7)	7
USD	10	(7)	7	10	(5)	5
GBP	20	2	(2)	20	10	(10)
CAD	10	(1)	1	10	(1)	1
JPY	5	(4)	4	5	(10)	10
CHF	5	(5)	5	5	(7)	7
Other	10	(3)	3	10	(3)	3
Total		**(12)**	**12**		**(23)**	**23**

The Group's equity would have been affected to the same extent as the income statement, but net of income tax. This is because the increase (decrease) in profit before income tax would have affected retained earnings (accumulated deficit).

75 CPI indexation risk (all portfolios)

The consumer price index (CPI) indexation risk is the risk that the fair value or future cash flows of CPI-indexed financial instruments may fluctuate due to changes in the Icelandic CPI index. The Group has a considerable imbalance in its CPI-indexed assets and liabilities. The majority of the Group's mortgage loans and consumer loans are indexed to the CPI. Going forward, however, the asset side will increase, since it is expected that loans in foreign currency will be converted to CPI-linked loans and that overall lending will increase.

CPI indexation risk is managed centrally within the Group by the Treasury department and is monitored by the Asset and Liability Mismatch Risk Unit of the Risk Management Division. At year-end 2009 the CPI imbalance, calculated as the difference between CPI-indexed financial assets and liabilities, was ISK 71,812 million (2008: 53,812 million).

Carrying amount	**2009**	**2008**
Assets		
Bonds and debt instruments	5,438	10,117
Loans and advances to customers	154,823	130,048
Total	**160,261**	**140,165**
Liabilities		
Due to financial institutions and Central Bank	(441)	(9)
Deposits from customers	(84,725)	(85,127)
Short positions	(1,917)	0
Total	**(87,083)**	**(85,136)**
Total on-balance sheet position	73,178	55,029
Total off-balance sheet position	(1,366)	(1,217)
Total CPI indexation balance	**71,812**	**53,812**

Management of the Group's CPI indexation risk is supplemented by monitoring the sensitivity of the Group's overall position in CPI-indexed financial assets and liabilities net on-balance sheet to various inflation/deflation scenarios. As an example, experiencing 10% inflation with no change in other variables would have resulted in an increase of ISK 7,318 million (2008: 5,503 million) in net interest income. Group equity would have been affected by the same amount as the income statement, but net of income tax. This is because the increase/decrease in net interest income would have affected retained earnings (accumulated deficit).

Currency risk

76 Currency risk (all portfolios)

Currency risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in foreign exchange rates. The Group maintains significant open currency positions, because many of the loans acquired from Landsbanki Islands hf. were denominated in foreign currencies. The Group expects that this imbalance will smoothen out mostly because many loans denominated in foreign currencies will probably be converted to ISK and because liabilities are likely to remain relatively constant in the foreseeable future. As explained in Note 37 on Litigation there is a possibility that the Supreme Court of Iceland will rule that foreign currency linkage of loans are not in accordance with Icelandic law. It is the view of the Bank's management that the Group's foreign currency loans are in accordance with Icelandic law.

Currency risk is managed centrally within the Group by the Treasury Department, and monitored by the Asset and Liability Mismatch Risk Unit of the Risk Management Division. Group limits for foreign exchange risk are reviewed and monitored by the Asset and Liability Committee (ALCO).

The Group follows Rules No. 707/2009 on Foreign Exchange Balances, as set by the Central Bank of Iceland. The rules stipulate that an institution's foreign exchange balance (whether long or short) must always be within certain limits in each currency. The Group submits daily reports to the Central Bank with information on its foreign exchange balance. Due to circumstances discussed above, the Central Bank has granted the Group a temporary dispensation from these rules until the end of March 2010, raising the required limits. The Bank has already requested an extension to the temporary dispensation.

77 FX-delta

The inherent risk in the considerable foreign exchange imbalance is limited by the FX-delta. The FX-delta is calculated as the average elasticity of loans in foreign currency towards foreign exchange movements. This is because some of the Bank's customers have pledged collateral or have full or partial income in foreign currency, while others have limited or no income in foreign currency. As a result, depreciation of the ISK impacts customers with limited or no income in foreign currency more than those with full or partial income in foreign currency, and vice versa when ISK appreciates.

78 Concentration of currency risk

The following tables summarise the Group's exposure to currency risk at year-end 2009 and 2008. The off-balance sheet amounts shown are the notional amounts of the Group´s derivative instruments (see Note 9). The amounts presented as FX-delta adjustment to currency imbalance represent the amounts of foreign currency loans granted to customers with limited or no foreign currency income. Such loans are deducted from the net currency position, as changes in foreign exchange rates in regard to the ISK do not affect the carrying amounts of these loans and therefore do not

At 31 December 2009	EUR	GBP	USD	JPY	CHF	Other	Total
Assets							
Cash and balances with Central Bank	517	265	197	12	32	282	1,305
Bonds and debt instruments	4,105	241	24,534	-	-	-	28,880
Equities and equity instruments	1,780	-	175	-	-	9,161	11,116
Derivative instruments	185	224	553	-	-	-	962
Loans and advances to financial institutions	14,669	17,067	24,536	5,471	5,817	2,204	69,764
Loans and advances to customers	86,662	15,528	74,392	103,116	102,750	28,227	410,675
Other assets	1,154	184	450	-	2	200	1,990
Total	**109,072**	**33,509**	**124,837**	**108,599**	**108,601**	**40,074**	**524,692**
Liabilities							
Due to financial institutions and Central Bank	(4,952)	(1,163)	(3,927)	(313)	(97)	(257)	(10,709)
Deposits from customers	(30,478)	(17,106)	(24,714)	(1,198)	(1,727)	(6,708)	(81,931)
Derivative instruments and short positions	(222)	-	(451)	-	-	-	(673)
Borrowings	(158,573)	(56,086)	(91,834)	-	-	-	(306,493)
Other liabilities	(216)	(11)	(99)	-	-	(164)	(490)
Total	**(194,441)**	**(74,366)**	**(121,025)**	**(1,511)**	**(1,824)**	**(7,129)**	**(400,296)**
Net on-balance sheet position	(85,369)	(40,857)	3,812	107,088	106,777	32,945	**124,396**
Net off-balance sheet position	5,298	2,390	10,183	(12,834)	(3,905)	-	**1,132**
Net currency position	**(80,071)**	**(38,467)**	**13,995**	**94,254**	**102,872**	**32,945**	**125,528**
FX-delta on Loans and advances to customers	**75%**	**90%**	**82%**	**57%**	**60%**	**87%**	
FX-delta adjustments to currency imbalance	**(21,917)**	**(1,494)**	**(13,056)**	**(44,288)**	**(40,823)**	**(3,644)**	**(125,222)**
Net effective currency position	**(101,988)**	**(39,961)**	**939**	**49,966**	**62,049**	**29,301**	**306**

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78 Concentration of currency risk (continued)

At 31 December 2008	EUR	GBP	USD	JPY	CHF	Other	Total
Assets							
Cash and balances with Central Bank	3,599	1,370	4,356	195	150	1,355	11,025
Bonds and debt instruments	13,152	174	3,782	-	-	93	17,201
Equities and equity instruments	7,907	-	434	-	-	24,193	32,534
Loans and advances to financial institutions	460	1,558	533	223	190	1,302	4,266
Loans and advances to customers	100,228	15,154	89,536	125,732	129,759	27,855	488,264
Other assets	11,592	327	2,353	3	5	57	14,337
Total	**136,938**	**18,583**	**100,994**	**126,153**	**130,104**	**54,855**	**567,627**
Liabilities							
Due to financial institutions and Central Bank	(151)	(48)	(1,071)	(55)	(2)	(21)	(1,348)
Deposits from customers	(25,969)	(16,627)	(21,178)	(243)	(444)	(2,639)	(67,100)
Derivative liabilities	(365)	-	(381)	-	-	-	(746)
Tax liabilities	-	(224)	-	-	-	-	(224)
Provisional liability due to Landsbanki Íslands hf.	(142,490)	(47,331)	(85,950)	-	-	-	(275,771)
Other liabilities	(584)	-	(861)	-	-	(352)	(1,797)
Total	**(169,559)**	**(64,230)**	**(109,441)**	**(298)**	**(446)**	**(3,012)**	**(346,986)**
Net on-balance sheet position	(32,621)	(45,647)	(8,447)	125,855	129,658	51,843	**220,641**
Net off-balance sheet position	(1,341)	-	861	-	-	837	**357**
Net currency position	**(33,962)**	**(45,647)**	**(7,586)**	**125,855**	**129,658**	**52,680**	**220,998**
FX-delta on Loans and advances to customers	**65%**	**65%**	**66%**	**62%**	**62%**	**71%**	
FX-delta adjustments to currency imbalance	**(34,679)**	**(5,365)**	**(30,353)**	**(47,778)**	**(49,438)**	**(8,106)**	**(175,719)**
Net effective currency position	**(68,641)**	**(51,012)**	**(37,939)**	**78,077**	**80,220**	**44,574**	**45,279**

The following foreign exchange rates were used by the Group:

	At 31 December 2009	At 31 December 2008	% Change	Average for 2009	At 30 September 2008	Average for the period 2008
EUR/ISK	179.70	169.00	6.3%	171.80	149.29	163.56
GBP/ISK	201.15	177.00	13.6%	192.28	189.09	195.42
USD/ISK	124.60	121.20	2.8%	122.96	106.23	122.90
JPY/ISK	1.35	1.33	1.5%	1.32	1.00	1.27
CHF/ISK	121.01	113.54	6.6%	114.08	94.69	107.51
CAD/ISK	118.78	98.70	20.3%	108.12	100.21	103.67
DKK/ISK	24.15	22.69	6.4%	23.07	20.00	21.95
NOK/ISK	21.64	17.39	24.4%	19.62	17.99	18.46
SEK/ISK	17.49	15.40	13.6%	16.22	15.30	15.98

79. Sensitivity to currency risk

In regard to FX loans, the Group accounts for the effects on foreign exchange rate changes to ISK as differences in loan value. The portion of a foreign exchange rate fluctuation which results in a change to loan value depends on how the borrower's ability to repay the loan changes due to the foreign currency fluctuation in question. Thus depreciations provide less gain in FX loan value for customers having ISK income compared to customers having FX income.

The following table shows how other net operating income would have been affected by a 10% depreciation/appreciation of each foreign currency against ISK, with all other variables held constant. The sensitivity analysis is applied to the Group's overall position in foreign currency on-balance sheet as disclosed in Note 78.

	2009		2008	
Currency (ISK million)	**-10%**	**+10%**	**-10%**	**+10%**
EUR	(10,199)	10,199	(6,864)	6,864
GBP	(3,996)	3,996	(5,101)	5,101
USD	94	(94)	(3,794)	3,794
JPY	4,997	(4,997)	7,808	(7,808)
CHF	6,205	(6,205)	8,022	(8,022)
Other	2,930	(2,930)	4,457	(4,457)
Total	**31**	**(31)**	**4,528**	**(4,528)**

The Group's equity would have been affected to the same extent as the income statement, but net of income tax. This is because the increase (decrease) in other net operating income would have affected retained earnings (accumulated deficit).

Operational risk

80. Operational risk

Operational risk is the risk of financial losses resulting from the failure or inadequacy of internal processes or systems, from employee error or from external events. Operational risk includes legal risks, but excludes reputational risks. It is therefore inherent in all areas of business activities.

Whereas the managing director of each division is responsible for that division's operational risk, the daily management of operational risk is in the hands of department heads. The Bank establishes, maintains and co-ordinates its operational risk management framework on a group level. This framework complies with the Basel Committee's 2003 publication "Sound Practice for the Management and Supervision of Operational Risk" and meets the new regulatory requirements which concern the solvency ratio. The Bank ensures that operational risk management stays consistent throughout the Bank by upholding a system of prevention and control that entails detailed procedures, permanent supervision and insurance policies, together with active monitoring by the Internal Audit Department. By managing operational risk in this manner, the Bank intends to ensure that all of the Bank's business units are kept aware of any operational risks, that a robust monitoring system remains in place and that controls are implemented efficiently and effectively.