Landsbankinn

Consolidated Financial Statements

for the period from 7 October to 31 December 2008

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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 period ended 31 December 2008 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. At a shareholders' meeting held on 10 November 2008, a new Board of Directors was elected.

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.

Operating environment

The fact that the values of assets and liabilities were not determined during the reporting period has affected the Board and CEO's ability to make informed decisions regarding management of the Bank. It should also be noted that the Bank's asset structure was determined by the size and composition of the assets and liabilities of Landsbanki Íslands hf. Although the legal requirements regarding major exposures have been met, some individual risk exposures are larger than the Board and CEO would otherwise consider prudent. In addition, the valuation of the transferred assets and liabilities as at 9 October 2008 is subject to uncertainty in estimation, a fact which is complicated by the greater than usual instability in the domestic as well as the global economy.

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.

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.

Endorsement and Statement by the Board of Directors and the CEO

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 period 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 loss amounted to ISK 6,936 million for the period from 7 October to 31 December 2008. The Board of Directors proposes that no dividend will be paid. Consolidated total equity amounted to ISK 143,285 million at the end of the period, 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 13.0% at year-end 2008.

Soon after the foundation of NBI hf. and the transfer of loans from Landsbanki Íslands hf., the Icelandic government mandated that borrowers could be granted payment holidays for loan principal and/or interest. Many of the Bank's customers took advantage of this. While few loans had been renegotiated up to 31 December 2008, a larger portion of the loan book was restructured during 2009. 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 2008 amounted to ISK 43,372 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. The income statement recognises a net loss of ISK 38.2 billion on these bonds as change in their fair value during the reporting period, 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.

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 period ended 31 December 2008 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 Bank for the period from 7 October to 31 December 2008, its consolidated financial position as at 31 December 2008 and its consolidated cash flows for the period from 7 October to 31 December 2008.

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 Bank's operations and its position and describes the principal risks and uncertainties faced by the Bank.

The Board of Directors and the CEO have today discussed the Consolidated Financial Statements of NBI hf. for the period from 7 October to 31 December 2008 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, 22 January 2010.

Board of Directors

Haukur Halldórsson

Chairman

Eva Hrund Einarsdóttir

Stefanía K. Karlsdóttir

Salvör Jónsdóttir

Ása Richardsdóttir

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 31 December 2008, and the consolidated income statement, consolidated statement of changes in equity and consolidated cash flow statement for the period then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

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

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 the Group as at 31 December 2008, and 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, as discussed in the note, and is satisfied that the Bank has the resources to continue its operations. However, 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. The going concern assumption is dependent on a significant reduction of the foreign currency mismatch, the availability of financing facilities and the successful restructuring of the Bank's loan portfolios. We also draw attention to Note 4, which discloses how the fair value of assets acquired from Landsbanki Islands hf. was determined, and to Notes 42-75, which address the risks and uncertainties in Group operations.

Reykjavík, 22 January 2010.

KPMG hf.

Reynir Stefan Gylfason

Helgi F. Arnarson

National Audit Office

Sveinn Arason

Consolidated Balance Sheet as at 31 December 2008

Notes		31.12.2008	Pro-forma Opening Balance Sheet as at 9.10.2008*
	Assets		
7	Cash and balances with Central Bank	30,071	38,602
8	Bonds and debt instruments	39,896	24,624
8	Equities and equity instruments	39,681	36,158
9	Loans and advances to financial institutions	8,845	5,291
10	Loans and advances to customers	705,182	655,725
11	Investments in associates	2,518	2,325
12	Property and equipment	6,864	6,909
13	Intangible assets	1,220	1,206
21	Deferred tax assets	7,347	4,935
14	Unpaid capital contribution	149,225	149,225
15	Other assets	38,958	1,157
		1,029,807	926,157
16	Assets classified as held for sale	7,584	6,498
	Total assets	1,037,391	932,655
	Liabilities		
17	Due to financial institutions and Central Bank	132,219	82,517
18	Deposits from customers	431,006	418,045
19	Derivative liabilities	746	0
21	Tax liabilities	845	1,420
4, 20	Provisional liability due to Landsbanki Íslands hf.	305,057	274,800
22	Other liabilities	19,793	1,306
		889,666	778,088
16	Liabilities associated with assets classified as held for sale	4,440	4,519
	Total liabilities	894,106	782,607
23	**Equity**		
	Share capital	24,000	24,000
	Share premium	125,898	125,880
	Accumulated deficit	(6,945)	0
	Total equity attributable to owners of the Bank	142,953	149,880
	Non-controlling interests	332	168
	Total equity	143,285	150,048
	Total liabilities and equity	1,037,391	932,655

*The pro-forma balance sheet reflects the capital contribution from the Icelandic State, the fair value of the identifiable assets acquired and liabilities assumed from Landsbanki Íslands hf. on 9 October 2008 determined in accordance with IFRS 3 (revised 2008) and the related provisional liability due to Landsbanki Íslands hf. (see note 4). The pro-forma balance sheet is not comparative information as specified in IAS 1 as the Bank was founded on 7 October 2008.

The notes on pages 10 to 60 are an integral part of these consolidated financial statements.

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Consolidated Income Statement for the Period from 7 October to 31 December 2008

Notes		7.10. - 31.12.2008
	Interest income	28,021
	Interest expense	(23,730)
24	Net interest income	4,291
59	Impairment loss on loans and advances	(1,256)
	Net interest income less impairment loss on loans and advances	3,035
	Fee and commission income	1,710
	Fee and commission expense	(723)
25	Net fee and commission income	987
26	Net loss on financial assets designated as at fair value through profit or loss	(39,985)
27	Net gain on financial assets held for trading	467
28	Net foreign exchange gain	32,583
29	Other income and expenses	71
	Other net operating loss	(6,864)
	Net operating loss before operating expenses	(2,842)
30	Salaries and related expenses	1,506
31	Other administrative expenses	2,399
12	Depreciation and amortisation	294
32	Acquisition-related costs	3,072
	Operating expenses	7,271
11	Share of profit of associates, net of income tax	193
	Loss before income tax	(9,920)
33	Income tax	2,941
	Loss for the period from continuing operations	(6,979)
	Profit for the period from discontinued operations, net of income tax	43
	Loss for the period	(6,936)
	Loss for the period attributable to:	
	Owners of the Bank	
	Loss for the period from continuing operations	(6,988)
	Profit for the period from discontinued operations	43
	Loss for the period attributable to owners of the Bank	(6,945)
	Non-controlling interests	
	Profit for the period from continuing operations	0
	Profit for the period from discontinued operations	9
	Profit for the period attributable to non-controlling interests	9
	Loss for the period	(6,936)

The notes on pages 10 to 60 are an integral part of these consolidated financial statements.

NBI hf. Consolidated Financial Statements 2008 6 All amounts are in ISK million

Consolidated Statement of Changes in Equity for the Period from 7 October to 31 December 2008

Notes							7.10. - 31.12.2008
		Attributable to owners of the Bank					
		Share capital	Share premium	Accumulated deficit	Total	Non-controlling interests	Total
23	Paid-in share capital upon foundation of the Bank	775			775		775
14	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					168	168
	Capital contribution and other changes in equity in non-controlling interests					155	155
	Loss for the period			(6,945)	(6,945)	9	(6,936)
	Balance at 31 December 2008	**24,000**	**125,898**	**(6,945)**	**142,953**	**332**	**143,285**

The notes on pages 10 to 60 are an integral part of these consolidated financial statements.

NBI hf. Consolidated Financial Statements 2008 7 All amounts are in ISK million

Consolidated Statement of Cash Flows for the Period from 7 October to 31 December 2008

Notes		7.10. - 31.12.2008
	Operating activities	
	Loss for the period	(6,936)
	Adjustments for non-cash items included in loss for the period	1,552
	Changes in operating assets and liabilities	5,725
	Interest received	9,451
	Interest paid	(17,861)
	Income tax paid	(27)
	Net cash used in operating activities	(8,096)
	Investing activities	
4	Cash and cash equivalents included in the net assets acquired from Landsbanki Íslands hf.	29,829
12	Acquisition of property and equipment	(203)
12	Proceeds from sale of property and equipment	4
13	Acquisition of intangible assets	(66)
	Net cash from investing activities	29,564
	Financing activities	
23	Proceeds from issue of share capital upon foundation of the Bank	775
	Proceeds from issue of share capital in subsidiary	162
	Net cash from financing activities	937
	Net change in cash and cash equivalents	22,405
	Effect of exchange rate changes on cash and cash equivalents held	492
	Cash and cash equivalents at the beginning of the period	0
	Cash and cash equivalents at 31 December 2008	22,897
	Investing and financing activities not affecting cash flows	
14	Unpaid capital contribution	149,225
23	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

The notes on pages 10 to 60 are an integral part of these consolidated financial statements.

NBI hf. Consolidated Financial Statements 2008 8 All amounts are in ISK million

Consolidated Statement of Cash Flows for the Period from 7 October to 31 December 2008 (continued)

Notes		7.10. - 31.12.2008
	Adjustments for non-cash items included in loss for the period	
59	Impairment loss on loans and advances	1,256
12	Depreciation and amortisation	294
24	Net interest income	(4,291)
	Income tax	(2,941)
11	Share of profit of associates, net of income tax	(193)
26	Net loss on financial assets designated as at fair value through profit or loss	39,985
27	Net gain on financial assets held for trading	(467)
	Net foreign exchange gain	(32,091)
		1,552
	Changes in operating assets and liabilities	
	Change in reserve requirement with Central Bank	(918)
	Change in loans and advances to financial institutions	3,934
	Change in loans and advances to customers	12,299
	Change in bonds and equities	(45,447)
	Change in other assets	(25,636)
	Change in due to financial institutions and Central Bank	47,566
	Change in deposits from customers	9,544
	Change in other liabilities	4,383
		5,725
	Cash and cash equivalents at 31 December 2008	
7	Cash and unrestricted balances with Central Bank	21,154
9	Bank accounts with financial institutions	1,743
	Cash and cash equivalents at 31 December 2008	**22,897**

The notes on pages 10 to 60 are an integral part of these consolidated financial statements.

NBI hf. Consolidated Financial Statements 2008 9 All amounts are in ISK million

Notes to the Consolidated Financial Statements

Notes to the Consolidated Financial Statements

1. Reporting entity

NBI hf. (formerly named Nýi Landsbanki Íslands hf. and hereinafter referred to as the "Bank") is a limited liability company incorporated and domiciled in Iceland. The registered address of the Bank's office is Austurstræti 11, 155 Reykjavík. The consolidated financial statements of the Bank for the period from 7 October to 31 December 2008 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 and had 1,182 employees at year-end 2008.

NBI hf. was founded on 7 October 2008 by the Ministry of Finance on behalf of the State Treasury with an initial capital of ISK 775 million, paid in cash. Unpaid capital contribution from the State Treasury amounting to ISK 149,225 million was recognised as an asset in the consolidated balance sheet (see Note 23).

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, to transfer specific operations together with assets and liabilities from Landsbanki Íslands hf. to NBI hf. The guiding principle was to transfer most of the domestic operations of Landsbanki Íslands hf. along with related assets and liabilities to NBI hf. 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 22 January 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 2008, except that the Group has early adopted some standards (see Note 3).

Going concern

The Bank's management has assessed the Bank's ability to continue as a going concern and is satisfied that the Bank 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 Bank's assets and liabilities that may hinder the Bank's ability 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 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.

Based on the results of the Bank's management stress tests, the Bank is sufficiently capitalised to continue as a going concern. Significant market shocks during the realignment period of the Bank's risk profile pose some uncertainty. Of critical importance is the Bank's access to funding to fullfil the maturity of existing short-term liabilities and to continue financing the Bank'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 42-75.

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.

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 of which could result in material adjustments to the carrying amounts of assets and liabilities during the next financial year.

3. Significant accounting policies, estimates and judgements

The principal accounting policies applied in these consolidated financial statements are set out below. The consolidated financial statements have been prepared using uniform accounting policies for like transactions and other events in similar circumstances.

Consolidation

(a) Subsidiaries

Subsidiaries are all 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 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 the 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. 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. Accounting policies of subsidiaries have been changed where this is necessary to ensure consistency with 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 holders 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 Bank'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 Bank'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 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. Where necessary, associates' accounting policies have been changed to ensure consistency with 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 profit or loss in the item listed as "Net foreign exchange gain".

Due to differences in customer financial strength, the Bank needs to assess the increase of risk due to foreign exchange fluctuation in its foreign-currency-denominated loan portfolio. Some of the Bank's customers have income in foreign currency partially or in full, while other customers have limited or no income in foreign currency. This means that the latter group of customers will in many instances encounter difficulties in meeting their obligations in the event of ISK depreciation. Therefore, 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.

Segment reporting

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 hf.

• 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 inception 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 8 October to 31 December 2008.

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 held for trading or as designated as at fair value through profit or loss or as loans and receivables. The Group classifies all financial liabilities either as held for trading 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 and equity instruments. Financial liabilities held for trading consist of derivative liabilities.

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

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

Financial assets and liabilities (continued)

(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.

(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 Bank 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.

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

Financial assets and liabilities (continued)

(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:

(i) significant financial difficulties of the borrower;

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

(iii) 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;

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

(v) 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 the asset's 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 income statement item listed as "Impairment loss on loans and advances". 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.

In order to conduct a collective evaluation of impairment, loans are grouped on the basis of similar credit risk characteristics (i.e. 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, included in the 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 "Impairment loss on loans and advances".

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

Financial assets and liabilities (continued)

(g) Impairment of financial assets (continued)

Impairment of loans and advances acquired at deep discount

The following accounting treatment is applied to loans and advances acquired from Landsbanki Íslands hf. on 9 October 2008:
• If the estimated cash flows for acquired loans and advances decreases, a new loan impairment is accounted for.
• If the estimated cash flows of acquired loans and advances increase, additional interest revenues are recognised in the income statement.

See more detailed discussion below regarding loans and advances acquired from Landsbanki Íslands hf.

Renegotiated loans

Soon after the Bank was founded and loans were transferred to it from Landsbanki Íslands hf., the Icelandic government mandated that borrowers would be granted payment holidays for principal and/or interest. Many of our customers took advantage of this.

As of 31 December 2008, only a few loans had been renegotiated; however, a larger portion of the loan book was restructured in the course of 2009. In regard to corporations, the Group put remedies in place for those experiencing financial difficulties and also presented transparent procedures for corporate 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.

A loan which was impaired and for which new terms have already been negotiated is no longer considered past due or impaired. It is not considered to be a new loan so the original effective interest rate is left unchanged.

Loans that have not been impaired, but were renegotiated because of borrower financial difficulties, are treated as new loans since expectations are that the original cash flow from the loan will be collected. The original loans are derecognised and the renegotiated loans are recognised, with new terms and amendments to the loan contracts. The same applies to renegotiated loans in instances where the borrower has no financial difficulties.

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

Both initially and also subsequently to initial recognition, bonds and equities are recognised at fair value in the balance sheet. Transaction costs are recognised directly in the consolidated income statement. Gains and losses arising from changes in fair value are recognised directly in the consolidated income statement in the items "Net gain on financial assets held for trading" and "Net loss on financial assets designated as at fair value through profit or loss", respectively. Interest income on bonds is included in the item "Interest income". Foreign exchange gains and losses are included in the item "Net foreign exchange gain".

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, except for accrued interest on unpaid capital contribution, which is included in the item "Other assets" in the consolidated balance sheet. Interest income on loans and advances is recognised in the consolidated income statement in the item "Interest income" and foreign exchange differences in the item "Net foreign exchange gain".

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

Loans and advances acquired from Landsbanki Íslands hf.

The Bank acquired loans from Landsbanki Íslands hf. variously with or without evidence of credit quality deterioration since their origination. Evidence of credit quality deterioration on the transfer date might include statistics such as past due status, refreshed borrower credit scores and refreshed loan-to-value ratios, some of which were not yet available on the day of transfer. The Bank continues to evaluate this and other credit-related information as it becomes available.

The initial fair value of the loans acquired at deep discount was determined by using valuation approaches. Transferred loans were grouped in portfolios based on risk categories. Corporate loans were separated into significant loans and other loans. Significant loans were examined on a loan by loan basis, while other loans were categorised based on industries, collateral and customer size. Loans to individuals were categorised based on products, collateral and loan denomination. For corporate loans, the main valuation variables were EBITDA multiples, collateral and average investment period.

Due to varying customer financial strength, the Bank must assess the increase in risk due to exchange fluctuations in the foreign currency denominated loan portfolio. While some Bank 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 difference related to loans and advances is presented in the income statement net of the amount of foreign exchange difference deemed to be uncollectible.

During the valuation process, the Bank analysed its largest corporate customers in great detail. The valuation process included estimating the FX-delta on the FX loan book.

FX-delta was estimated by analysing major customers which have loans dominated 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 exchange dominated loans.

Concerning loans to individuals, the main valuation variables were collateral value and the individual's ability to pay back ISK and foreign exchange loans (see the FX-delta discussion above).

The expected cash flows were estimated at the acquisition date by using internal credit risk, interest rate and prepayment risk models that incorporated management's best estimate of such current key assumptions as default rates, loss severity and payment speed.

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.

At each balance sheet date, 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 recorded 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 expected cash flow increase and the expected future increase in cash flows is discounted by using the effective interest rate of the loan, which is established according to the acquisition date and recorded immediately as interest income.

If the increase in expected cash flows is due to foreign exchange differences in foreign currency denominated loans and advances acquired, this increase is recognised in the income statement under "Net foreign exchange gain".

Subsequent increases in expected cash flows will result in recovering, if applicable, any previously recorded allowance for loan losses recognised subsequent to acquisition. In such cases, the remaining increase in expected cash flow is recorded as interest income. The book value of the loan is as well as increased correspondingly as of the date of revision (a reclassification from non-accretable difference to accretable yield).

The excess of the contractually required payments receivable over the investor initial investment, 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, i.e. decreasing ability of the borrower to repay debt, the decrease in expected cash flow is discounted by the effective interest rate of the loan and immediately recorded as impairment. If the decrease in expected cash flow is due to foreign exchange differences on foreign currency denominated loans and advances acquired, the decrease is recognised in the income statement under "Net foreign exchange gain".

Subsequent decreases in expected cash flows will result in an increase under impairment losses and a corresponding increase of the allowance for loan losses.

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 other than land 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 and other intangible assets

Acquired computer software licenses are capitalised on the basis of the costs incurred to acquire and bring them into service. Computer software recognised as an intangible asset is amortised over its useful life, which is set at 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.

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. Temporary differences also include tax losses carried forward and the difference between the fair values of acquired assets and their tax base.

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

Assets and liabilities classified as held for sale

The Group classifies non-current assets (or a group 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 as security for loans and advances and also with the assets and liabilities of subsidiaries which are acquired with a view to resale.

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 either their carrying amount or their fair value less costs to sell, whichever is the lower. This measurement provision does not apply to deferred tax assets and liabilities, financial assets within the scope of IAS 39 or investment properties that are accounted for in accordance with the fair value model in IAS 40.

Gains and losses on sale of repossessed collateral are recognised in the item "Other income and expenses" in the consolidated income statement.

Deposits and borrowings

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

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 borrowed amounts are initially measured at fair value plus 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.

Derivative financial 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 fair value changes recognised in the item "Net foreign exchange gain", since the Group has only entered into foreign currency derivatives during the reporting period. In the consolidated 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.

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 given 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 are initially recognised in the financial statement at fair value on the date the guarantee was given. Subsequent to initial recognition, the Group's liabilities under such a guarantee are 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 the 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

In the balance sheet, the Group does not recognise contingent liabilities as liabilities, 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.

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

Employee benefits

All Group entities have defined contribution plans, with these 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.

Interest income and expense

Interest income and expense on financial assets and liabilities recognised 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 but not 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.

The interest income and expense presented in the income statement include:
- Interest on financial assets and liabilities at amortised cost, calculated on an effective interest rate basis;
- Interest on financial assets and liabilities held for trading on an accrual basis;
- Interest on financial assets designated as at fair value through profit or loss, on an accrual basis.

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 "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 after the service has been provided. 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-apportionate 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 loss on financial assets designated as at fair value through profit or loss

The net loss from financial instruments designated as at fair value through profit or loss includes all gains and losses from changes in the fair value of financial assets designated by the Group as at fair value through profit or loss. Dividend income arising from these financial assets is also included in this item and is recognised when the Group's right to receive payment becomes established. Interest income on these financial assets is included under the item "Interest income". Foreign exchange gains and losses are included under the item "Net foreign exchange gain".

Net gain on financial assets held for trading

The net loss from financial assets held for trading includes all gains and losses from changes in the fair value of such financial assets. Any dividend income arising on these financial assets is also included in this item and is recognised when the Group's right to receive payment becomes established. Interest income on these financial assets is included under the item "Interest income". Foreign exchange gains and losses are included under the item "Net foreign exchange gain".

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

Net foreign exchange gain

oreign exchange gains and losses resulting from the settlement of foreign currency transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the consolidated income statement. Foreign exchange gains and losses are presented net in the consolidated income statement.

Other income and expenses

Other income and expenses relate to derecognising certain financial assets and liabilities and comprise net realised gain on financial liabilities, measured at amortised cost, as well as other net realised gain. Furthermore, gains and losses on repossessed collateral are included.

Leases

(a) Where the 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, under the 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 the 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 post-tax profit or loss from discontinued operations and 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 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 acquired 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 was computed for these loans by estimating their cash flows and comparing it with their acquisition prices. Estimating the cash flows involved 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.

(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 homogenus portfolios. The methodology and assumptions for estimating both the amount and timing of future cash flows are reviewed regularly, with an eye to reducing any discrepancies between loss estimates and actual loss experience.

(c) 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.

(d) Valuation of financial instruments

The Group measured fair value using the following hierarchy of methods:

- Quoted market price, where an active market is present for identical instruments.
- Valuation techniques based on observable inputs. This approach includes instruments valued according to quoted market prices in active markets for similar instruments, according to quoted prices for similar instruments in markets considered less than active, or on some other basis where all significant inputs are directly or indirectly observable market data.
- Valuation techniques using significant unobservable inputs. This approach includes all instruments where the valuation technique includes inputs not based on observable data and where the unobservable inputs could have a significant effect on the instrument's valuation. Instruments may be included here that are valued according to quoted prices for similar instruments where significant unobservable adjustments or assumptions are required to reflect the differences between instruments.

The fair value of financial instruments not quoted in active markets is determined by using valuation techniques. 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)

(e) Financial asset and liability classification

The Group´s accounting policies provide scope for assets and liabilities to be designated at inception into different categories in certain circumstances:
• Where financial assets or liabilities have been classifed 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.

(f) 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.

Due to illiquid markets for the assets and disposal groups classified by the Group as held for sale, the Group may prove unable to dispose of all these assets within 12 months of the balance sheet date.

(g) 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.

(h) 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 Note 65, 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 Interpretation 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 2008 except that the Group has early adopted the following standards as permitted:

IFRS 3 (revised 2008) and amended IAS 27: 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.

IFRS 8 Operating Segments: IFRS 8 introduces the "management approach" to segment reporting. IFRS 8 requires the presentation and disclosure of segment information based on the internal reports regularly reviewed by the Group's "chief operating decision-maker" in order to assess each segment's performance and to allocate resources to them. Since the Group was esablished, financial information available for management to evaluate and decide how to allocate resources and assess performance has covered the business as a whole. For this reason, the Group has a single reportable segment during the period from 8 October to 31 December 2008.

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 2008, and have not been applied in preparing these consolidated financial statements. Relevant to the Group´s reporting are:

IAS 1 (revised 2007), Presentation of Financial Statements: A revised version of IAS 1 was issued in September 2007 and will become mandatory for the Group's 2009 consolidated financial statements. This version prohibits the presentation of items of income and expenses (i.e. "non-owner changes in equity") in the statement of changes in equity, but instead requires non-owner changes in equity to be presented separately from owner changes in equity in a statement of comprehensive income. As a result, the Group will present all owner changes in equity in the consolidated statement of changes in equity, whereas all non-owner changes in equity will be presented in the consolidated statement of comprehensive income. Comparative information will ber re-presented so as to conform to the revised standard. Since the change in accounting policy only impacts presentation aspects, it will have no impact on retained earnings.

IFRS 7, Improving Disclosures about Financial Instruments: The IASB published amendments to IFRS 7 in March 2009. The amendment requires enhanced disclosures about fair value measurements and liquidity risk. In particular, the amendment requires disclosure of fair value measurements by levels of a fair value measurement hierarchy. The adoption of the amendment results in additional disclosures but does not have an impact on the financial position or the comprehensive income of the Group.

Improvements to IFRS were issued in May 2008 and April 2009 (not yet endorsed by the EU). These improvements contain numerous amendments to IFRS that the IASB considers non-urgent but necessary. "Improvements to IFRS" comprise amendments that result in accounting changes for presentation, recognition or measurement purposes, as well as terminology or editorial amendments related to a variety of individual IFRS standards. Most of the amendments are effective for annual periods beginning on or after 1 January 2009 and 1 January 2010 respectively, with earlier application permitted.

IFRIC 9 and IAS 39, Embedded Derivatives: These amendments apply to embedded derivatives within the scope of IFRIC 9 and IAS 39, clarifying the requirement that upon reclassifying a financial asset in the "at fair value through profit or loss" category, all embedded derivatives must be assessed and, if necessary, separately accounted for in financial statements.

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.

IFRIC 19, Extinguishing Financial Liabilities with Equity Instruments: This new interpretation affects an entity's accounting when the terms of a financial liability are renegotiated so that the entity issues equity instruments to one of its creditors that extinguish all or part of the liability. The amended interpretation does not affect the creditor's accounting.
IFRIC 19 determines that an entity's issue of equity instruments to a creditor to extinguish all or part of the creditor's financial liability is a consideration that is paid in accordance with Paragraph 41 of IAS 39. IFRIC 19 will become mandatory for 2011 financial statements, if endorsed by the EU.

IFRIC 17, Distributions of Non-Cash Assets to Owners: This IFRIC interpretation applies to the following types of non-reciprocal distributions of assets by an entity to its owners, acting in their capacity as owners: (a) distributions of non-cash assets (e.g. items of property, plant and equipment; businesses as defined in IFRS 3; ownership interests in another entity; or disposal groups as defined in IFRS 5); and (b) distributions that give owners a choice between receiving non-cash assets or a cash alternative. IFRIC 17 becomes mandatory for the Group's 2010 financial statements.

4. Business combination

On 9 October 2008, the Financial Supervisory Authority in Iceland (FME) issued its decision on transferring the domestic assets, liabilities and operations of Landsbanki Íslands hf. to NBI hf. 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 and e) obligations to the Depositor's and Investor's 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 (continued)

	As 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 period disclosed in the consolidated income statement.

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4. Business combination (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 73).

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 a 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 (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, 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 (continued)

Consideration transferred by the Bank (continued)

Contingent bond

According to provisions of the settlement agreement signed on 15 December 2009, NBI hf. might have to issue a contingent bond on 31 March 2013 as a supplement to the acquisition price. This contingent bond might have a nominal amount of up to ISK 92 billion, with the amount being contingent on whether the value of certain pools of assets on 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 supplement 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 contingent bond would bear floating interest rate and it would mature in October 2018 with quarterly instalments starting in 2014.

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 32).

Performance-based employee incentive scheme

According to the agreements entered into on 15 December 2009 between the Bank, the Ministry of Finance and Landsbanki Íslands hf. regarding the settlement of the assets, liabilities and operations transferred from Landsbanki Íslands hf. to the Bank, the Bank committed itself to establishing a performance-based employee incentive scheme for all staff of NBI hf. These incentives directly or indirectly comprise shares in NBI hf. that Landsbanki Íslands hf. will 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 this purpose is 500 million, the final number of shares will depend on the increase in value of the asset pools.

This 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 employee incentive scheme. Nevertheless, the Bank's management concluded that the vesting period of the scheme commenced on 16 December 2009, when the Bank's employees were first informed about the planned incentive scheme. Accordingly, the scheme will be accounted for in the consolidated financial statements of the Group in accordance with IFRS 2 starting from 16 December 2009, based on provisional values until grant date will be reached. When grant date will be reached, the Group will finalise its estimates and recognise any adjustments as changes in estimates.

5 Operating segments

The management plans to organise the Bank'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-fármögnun hf.
• Corporate banking, which includes the services provided to large and medium-size corporate clients by the corporate division of NBI hf., Reykjavík.
• Asset management and private banking, which includes fund and wealth management services provided by divisions of NBI hf. in Reykjavík and by the NBI subsidiary Landsvaki hf.
• Investment banking, which includes the Group's trading and corporate finance activities.
• Treasury operations, which undertake 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 and corporate and government debt securities.

Ever since the formation of the Group, the financial information available for management to evaluate in deciding how to allocate resources and assess performance has covered the business as a whole. For this reason, the Group has comprised a single reportable segment during the current reporting period. All of the Group's assets and liabilities are managed from Iceland.

6. Financial assets and liabilities

According to IAS 39, financial assets and liabilities are classified into specific categories which affect how they are measured. Each category's basis of measurement is specified below:

• 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;
• Loans and receivables, measured at amortised cost;
• Other financial liabilities, measured at amortised cost.

The following table shows how the Group's financial assets and liabilities were classified as at 31 December 2008:

Financial assets	Loans and receivables	Held for trading	Designated as at fair value	Liabilities at amortised cost	Total carrying amount
Cash and balances with Central Bank	30,071	-	-	-	30,071
Bonds and debt instruments	-	3,523	36,373	-	39,896
Equities and equity instruments	-	2,582	37,099	-	39,681
Loans and advances to financial institutions	8,845	-	-	-	8,845
Loans and advances to customers	705,182	-	-	-	705,182
Other financial assets	34,579	-	-	-	34,579
Financial assets included in disposal groups held for sale	3,169	-	-	-	3,169
Total	781,846	6,105	73,472	0	861,423
Financial liabilities					
Due to financial institutions and Central Bank	-	-	-	132,219	132,219
Deposits from customers	-	-	-	431,006	431,006
Derivative liabilities	-	746	-	-	746
Other financial liabilities	-	-	-	15,319	15,319
Financial liabilities included in disposal groups held for sale	-	-	-	194	194
Total	0	746	0	578,738	579,484

The carrying amount of financial assets and liabilities carried at amortised cost in the consolidated balance sheet is a reasonable approximation of their fair value as at 31 December 2008.

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6. Financial assets and liabilities (continued)

The fair value of financial assets and liabilities carried at fair value in the consolidated balance sheet has been estimated as follows:

Financial assets	Quoted prices in active markets	Valuation techniques- observable inputs	Valuation techniques- significant unobservable inputs	31.12.2008 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 liabilities	0	746	0	746

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

The fair value of financial instruments that were not quoted in active markets was determined by using valuation techniques. Where valuation techniques (for example, models) were used to determine fair values, these techniques were validated and periodically reviewed by qualified personnel who were independent of the area creating the techniques. To the extent practical, models included only observable data; however, areas such as credit risk (whether own or counterparty), volatility and correlation require management to make estimates. Changes in assumptions on these factors could affect the reported fair value of financial instruments. Although the Group believes that its estimates of fair value are appropriate, the application of different methodologies or assumptions might lead to other figures for fair value.

7. Cash and balances with Central Bank

	31.12.2008
Cash on hand	1,916
Unrestricted balances with Central Bank	19,238
Total cash and unrestricted balances with Central Bank	**21,154**
Reserve requirement with Central Bank	8,917
Total cash and balances with Central Bank	**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.

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8. Bonds and equities

Bonds and debt instruments	Held for trading	Designated as at fair value	31.12.2008 Total
Domestic			
Listed	3,523	8,909	12,432
Unlisted	-	12,013	12,013
	3,523	20,922	24,445
Foreign			
Listed	-	5,787	5,787
Unlisted	-	9,664	9,664
	0	15,451	15,451
Total bonds and debt instruments	3,523	36,373	39,896
Equities and equity instruments			
Domestic			
Listed	586	5,843	6,429
Unlisted	108	601	709
	694	6,444	7,138
Foreign			
Listed	1,557	22,733	24,290
Unlisted	331	7,922	8,253
	1,888	30,655	32,543
Total equities and equity instruments	2,582	37,099	39,681
Total bonds and equities	6,105	73,472	79,577

Listed bonds and equities are classified as "domestic" if they are listed on the OMX stock exchange in Iceland, otherwise they are classified as "foreign". Unlisted bonds and equities which were previously listed have been classified in the same way as listed bonds and equities. Other unlisted bonds and equities are classified on the basis of the country where the issuer is incorporated.

9. Loans and advances to financial institutions

	31.12.2008
Bank accounts with financial institutions	1,743
Money market loans	1,447
Overdrafts	4,774
Other loans	881
Total	8,845

10. Loans and advances to customers

	31.12.2008
Public entities	11,529
Corporations	524,784
Individuals	170,052
Less: Allowance for impairment	(1,183)
Total	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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11. Investments in associates

	7.10. - 31.12.2008
Acquisitions through business combination	2,325
Share of profit of associates, net of income tax	193
Total	**2,518**

Company	Total assets	Total liabilities	Total revenue	Ownership interest	Share of profit of associates	Carrying amount 31.12.2008
Valitor 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					**193**	**2,518**

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

12. Property and equipment

	Buildings	Fixtures, equipment and vehicles	Total
Acquisitions through business combination	3,418	3,491	6,909
Additions during the period	25	178	203
Sold during the period	-	(4)	(4)
Depreciation charges	(21)	(223)	(244)
Carrying amount at 31 December 2008	**3,422**	**3,442**	**6,864**
Cost	3,443	3,665	7,108
Accumulated depreciation	(21)	(223)	(244)
Carrying amount at 31 December 2008	**3,422**	**3,442**	**6,864**
Depreciation rates	2-4%	10-33%	

Official assessment value of buildings	31.12.2008
Official assessment value used for tax purposes	4,163
Replacement value used for insurance purposes	7,049

Depreciation and amortisation	7.10. - 31.12.2008
Property and equipment	244
Intangible assets	50
Total	**294**

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13. Intangible assets

	Computer software licenses
Acquisitions through business combination	1,206
Additions	66
Disposals	(2)
Amortisation	(50)
Carrying amount at 31 December 2008	1,220
Amortisation rates	20%
Cost	1,270
Accumulated amortisation	(50)
Carrying amount at 31 December 2008	1,220

14. Unpaid capital contribution

In 2008, the Icelandic State committed itself to funding NBI hf. 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. The interest accrued during the period from 9 October to 31 December 2008 amounted to ISK 5,699 million and is included under "Other assets" in the consolidated balance sheet.

15. Other assets

	31.12.2008
Claims on Landsbanki Íslands hf.	18,652
Unsettled securities trading	9,323
Accrued interest on unpaid capital contribution	5,699
Accounts receivable and prepayments	905
Other	4,379
Total	38,958

The securities trades which remained unsettled at the reporting date were settled within three days. The claim on Landsbanki Íslands hf. consisted of (i) non-executed customer transfers, (ii) netting arrangements with customers, (iii) a legal claim of NBI hf. on Landsbanki Íslands hf. due to the netting of a claim between Landsbanki Íslands hf. and Landsvaki, one of the NBI hf. subsidiaries, and (iv) other payments of NBI hf. to Landsbanki Íslands hf. These claims were settled in the year 2009.

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16. Assets and liabilities classified as held for sale

Assets classified as held for sale	31.12.2008
Repossessed collateral	2,150
Assets of disposal groups classified as held for sale	5,434
Total	7,584

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

Repossessed collateral	31.12.2008
Acquisitions through business combination	1,433
Repossessed during the period	869
Impairment	(25)
Disposed of during the period	(127)
Total	2,150

The Group classified the assets and liabilities of its subsidiaries Vörður tryggingar hf. and Vörður líftryggingar hf. as assets and liabilities of disposal groups held for sale, because the subsidiaries had been acquired by the Group with a view to resale. Because these subsidiaries met 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. These subsidiaries were sold in October 2009.

Assets of disposal groups classified as held for sale	31.12.2008
Cash at hand	1,701
Investments	611
Reinsurance assets	565
Receivables	725
Other assets	747
Intangible assets	1,085
Total	5,434

Liabilities associated with assets classified as held for sale	
Insurance liability	4,246
Other liabilities	194
Total	4,440

17. Due to financial institutions and Central Bank

	31.12.2008
Loans and repurchase agreements with Central Bank	18,655
Loans and deposits from financial institutions	113,564
Total	132,219

18. Deposits from customers

	31.12.2008
Demand deposits	320,837
Time deposits	110,169
Total	431,006

19. Derivative liabilities

	Notional	Fair value 31.12.2008	
Foreign exchange derivatives	amount	Assets	Liabilities
Cross currency interest rate swaps	2,923	-	746

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
Provisional liability due to Landsbanki Íslands hf. at 31 December 2008	305,057

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

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21. Tax assets and liabilities

Tax assets and liabilities are specified as follows:

Tax assets	31.12.2008
Deferred tax assets	7,347

Tax liabilities	
Current tax liabilities	762
Deferred tax liabilities	83
Total	845

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

	Assets	Liabilities	Net
Property and equipment	-	(173)	(173)
Equities and equity instruments	-	(45)	(45)
Investments in associates	-	(57)	(57)
Other assets	441	-	441
Derivative liabilities	112	-	112
Deferred foreign exchange differences	-	(83)	(83)
Other items	-	(102)	(102)
Tax losses carried forward	7,171	-	7,171
	7,724	(460)	7,264
Set-off of deferred tax assets together with liabilities of the same taxable entities	(377)	377	0
Total	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 2008, according to which the domestic corporate income tax rate was 15.0%. However, on 29 December 2009 the President of Iceland endorsed a legislative bill passed by the Parliament of Iceland according to which the corporate income tax rate was increase from 15.0% to 18.0%. This change is effective for the fiscal year starting on 1 January 2010. The deferred tax asset recognised in these consolidated financial statements would be higher by ISK 1,400 million if it were calculated in accordance with the new corporate income tax rate.

The amount of tax losses carried forward at year-end 2008 was ISK 47,807 million which was incurred in the fiscal year 2008 and it expires on 1 January 2019. The recognised deferred tax asset arising from these tax losses carried forward amounts to ISK 7,171 million, of which ISK 2,148 million is attributable to the Bank and ISK 4,930 million to its subsidiary SP-fjarmögnun 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 where as follows:

	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	(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 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 was ISK 993 million at year-end 2008. 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.

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22. Other liabilities

	31.12.2008
Unsettled securities trading	10,368
Withholding tax	3,511
Accounts payable	775
Unpaid contribution to the Depositors' and Investors' Guarantee Fund*	665
Other	4,474
Total	**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 excist indipendent of the Bank's future actions and therfor do not represent a present obligation of the Bank at the balance sheet date. Accordingly, they are not recognised as part of the liabilty towards the Fund. Therefor, the amount recognised as liability at 31 December 2008 is the ISK 665 million which the Bank paid to the Fund on 29 September 2009.

In respect of the declaration of liability of the Bank, the management of the Bank has concluded that a liabilty 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 these consolidated financial statements. The Bank issued its first declaration of liability to the Fund on 12 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 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.

23. Equity

Share capital

The total number of ordinary shares authorised and issued by NBI hf. 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 a part of the acquisition price for the Icelandic operations of Landsbanki Íslands hf., NBI hf. issued senior secured bonds amounting to ISK 260 billion. If NBI hf. 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).

Share premium

A 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.

Accumulated deficit

Accumulated deficit consists of losses accumulated since the Bank's foundation.

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24. Net interest income

Interest income	7.10. - 31.12.2008
Cash and balances with Central Bank	782
Bonds and debt instruments	945
Loans and advances to financial institutions	808
Loans and advances to customers	19,779
Unpaid capital contribution	5,699
Other interest income	8
Total	28,021
Interest expense	
Due to financial institutions and Central Bank	(1,882)
Deposits from customers	(15,186)
Provisional liability due to Landsbanki Íslands hf.	(6,611)
Other liabilities	(51)
Total	(23,730)
Net interest income	4,291

Interest spread is calculated as the ratio of net interest income to the average carrying amount of total assets during the period.	1.9%

In relation to financial assets or liabilities not carried at fair value through profit or loss, the total interest income and expense calculated using the effective interest method reported above amount to ISK 22,377 million and ISK (17,119) million, respectively.

25. Net fee and commission income

Fee and commission income	7.10. - 31.12.2008
Asset management	437
Cards	360
Lending	282
Interbank clearing	148
Collection and payment services	104
Foreign trade	103
Investment banking	180
Other commissions and fees	96
Fee and commission income	1,710
Interbank clearing	(142)
Other fees	(581)
Fee and commission expense	(723)
Net fee and commission income	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.

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26. Net loss on financial assets designated as at fair value through profit or loss

	7.10. - 31.12.2008
Bonds and debt instruments	(43,154)
Equities and equity instruments	3,169
Total	(39,985)

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. The income statement recognises a net loss of ISK 38.2 billion on these bonds as change in their fair value during the reporting period, 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.

27. Net gain on financial assets held for trading

	7.10. - 31.12.2008
Bonds and debt instruments	82
Equities and equity instruments	385
Total	467

28. Net foreign exchange gain

	7.10. - 31.12.2008
Assets:	
Cash and balances with Central Bank	(21)
Bonds and debt instruments	2,875
Equities and equity instruments	2,049
Loans and advances to financial institutions	1,260
Loans and advances to customers	59,099
Other assets	728
Total	65,990
Liabilities:	
Due to financial institutions and Central Bank	13
Deposits from customers	(9,447)
Derivative liabilities	(286)
Provisional liability due to Landsbanki Íslands hf.	(23,646)
Other liabilities	(41)
Total	(33,407)
Net foreign exchange gain	32,583

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 60,167 million gain for financial assets and loss of ISK 32,984 million for financial liabilities. 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 2008, which is deemed to be uncollectible and is therefore offset by the FX-delta ratio, amounted to a gain of ISK 43,372 million.

29. Other income and expenses

	7.10. - 31.12.2008
Gain on sale of repossessed collateral	54
Other	17
Total	71

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30. Salaries and related expenses

	7.10. - 31.12.2008
Wages and salaries	1,151
Contributions to defined contribution pension plans	232
Other personnel expenses	123
Total	1,506
Number of full-time employment positions at year-end 2008	1,182

31. Other administrative expenses

	7.10. - 31.12.2008
Contribution to the Depositors' and Investors' Guarantee Fund	665
Software licensing and other information technology costs	326
Audit and related services*	8
Other professional services	89
Operating lease rentals	126
Other administrative expenses	1,185
Total	2,399

* The amount of audit and related services includes fees to others than the Bank's auditors to the amount of ISK 5 million.

32. Acquisition-related costs

	7.10. - 31.12.2008
Cost of acquisition of assets and liabilities from Landsbanki Íslands hf.	1,072
Claims on Landsbanki Íslands hf. which were written off due to a settlement agreement with Landsbanki Íslands hf.	2,000
Total	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.

33. Income tax

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

	7.10. - 31.12.2008
Current tax expense	(252)
Deferred tax income	3,193
Total	2,941

Further information on deferred income tax is presented in Note 21. The tax on Group losses differs to the following extent from the amount that would theoretically arise by the domestic corporate income tax rate:

		7.10. - 31.12.2008
Loss before income tax		(9,920)
Income tax calculated using the domestic corporate income tax rate	15.0%	1,488
Effect of different tax rates in other countries	(7.4%)	(737)
Income not subject to tax	20.5%	2,032
Non-deductable expenses	(0.4%)	(37)
Other	2.0%	195
Effective income tax	29.7%	2,941

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34. 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 Bank 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 NBI hf., 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 NBI hf., submitting claims to the District Court of Reykjavík. Aresbank demanded that NBI hf. 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. NBI hf. believes that the claim against the bank 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 NBI hf., 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., NBI hf. is now obliged to pay according to this guarantee. NBI hf. 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 NBI hf. 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 Reykjavík reached a decision in a case between SP-fjármögnun hf., a subsidiary of NBI hf., and one of its clients. What is important about this decision is the court's establishing that loans granted by SP-fjármögnun hf. in foreign currency were lawful. This decision could have a wider impact, since similar loans granted in foreign currency by other financial institutions have been challenged.

5) In December 2009 documents were served on NBI hf. by Basler Kantonalbank (BKB), a bank of the Swiss canton Basel City, as the initial step in starting ordinary proceedings against NBI hf. 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, NBI hf. 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 NBI hf., 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. NBI hf. 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 NBI hf. to have a claim recognised for ISK 1,223 million. The City of Reykjavík maintains that NBI hf. 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., NBI hf. intends to defend itself vigorously. However, the final resolution of this matter cannot yet be determined.

35. 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 liability that might be issued 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 appropriate adjustment period.

36. 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 2008:

	2008
No later than 1 year	54
Later than 1 year and no later than 5 years	207
Later than 5 years	273
Total	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 Group financial statements.

The future minimum lease payments expected to be received under non-cancellable operating leases were as follows on 31 December 2008:

	2008
Less than 1 year	6,401
More than 1 year and less than 5 years	11,621
More than 5 years	1,377
Total	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 on 31 December 2008:

	Gross investment in finance lease	Future finance income	Present value of minimum lease payments	Unguaran-teed residual value
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	0

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37. 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 do not comprise Bank assets. 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 2008, financial assets managed by the Group amounted to ISK 238 billion. Custody accounts amounted to ISK 1,403 billion.

38. Related-party transactions

The Group's parent company was, at 31 December 2008, NBI hf., domiciled and incorporated in Iceland. The Government of Iceland holds 100% of the shares in NBI hf. at year-end 2008. 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, NBI hf. and Group companies 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 2008. 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 2008 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
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

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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38. Related-party transactions (continued)

Key management personnel

(a) Compensation to directors of the board, CEOs and managing directors of the Bank

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 NBI hf.	540
Haukur Halldórsson, vice-chairman of the board of NBI hf.	405
Stefanía K. Karlsdóttir, member of the board of NBI hf.	270
Salvör Jónsdóttir, member of the board of NBI hf.	270
Erlendur Magnússon, member of the board of NBI hf.	270
Reserve directors of the board of NBI hf.	344
Elín Sigfúsdóttir, CEO	4,107
Seven managing directors of the Bank's divisions	18,838
	25,044

No termination or post-employment benefits were paid during the period 7 October to 31 December 2008. Elín Sigfúsdóttir resigned as Bank CEO on 28 February 2009, and Ásmundur Stefánsson was hired as the new CEO. At the same time, Haukur Halldórsson became chairman of the Bank's board of directors and Ása Richardsdóttir became board member. Erlendur Magnússon resigned as board member on 7 January 2010. At the same time, Eva Hrund Einarsdóttir became board member.

(b) Loans

The following table presents the total amounts of loans to board directors, CEO and managing directors during the period from 7 October 2008 to 31 December 2008:

Loans in ISK million	
Loans outstanding on 9 October 2008	64
Loans outstanding on 31 December 2008	71

No specific allowance for impairment was recognised in respect of loans to board directors and managing directors. The main collateral types for these loans were residential properties and vehicles. No new loans were granted to directors or other key management personnel during the accounting period.

All of the loans referred to here were acquired from Landsbanki Íslands hf. and are on normal commercial terms.

39. Events after balance sheet date

On 10 October 2009 Landsbanki Íslands hf. signed a "Head of Terms" agreement with the Icelandic Ministry of Finance regarding the capitalisation and future ownership of NBI hf. where the Ministry of Finance retains majority shareholding of 81.3% in NBI hf. and Landsbanki Íslands hf. 18.7%. The Icelandic Ministry of Finance funded NBI hf. to the amount of ISK 121,225 million, which was paid in on 30 December 2009 with an equivalent amount in Government bonds. Landsbanki Íslands hf. capitalised NBI hf. to the amount of ISK 28,000 million with an equivalent amount in assets.

On 5 October 2009 the Group sold to Føroya Bank a 51.0% shareholding in the subsidiary Vörður tryggingar hf. and a 21.0% shareholding in the subsidiary Vörður líftryggingar hf. The Group's shareholding after the sale is 24.0% in Vörður tryggingar hf. and 49.0% in Vörður líftryggingar hf.

As a result of foreclosing collaterals set by customers as security for the Group's loans and advances, the largest possessions taken by the Group during the year 2009 were majority shareholdings in the following companies:

Company	Activity	Ownership interest acquired through foreclosure	Ownership interest held at the date when these financial statements were authorised for issue
Teymi hf.	Holding company	60%	62%
Húsasmiðjan hf.	Retail company	100%	100%
Fasteignafélag Íslands hf.	Real estate holding company	100%	100%

The Group's objective in respect of the shares in these companies is to maximise the Group's return on these assets within a reasonable time period.

Capital management

40. Capital management

(a) BASEL II

The Bank 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 the FME. Furthermore, NBI hf. must maintain a capital adequacy ratio (CAD ratio) above 16% unless the FME approves a lower CAD ratio on the basis of additional capital resourses available for the Group.

(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.

41. Capital base and capital adequacy ratio

Bank equity at year-end 2008 amounted to ISK 143,285 million, equivalent to 13.8% 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 13.0% at the end of the year. According to the Act, this ratio may not fall below 8.0%.

Capital base	31.12.2008
Share capital	24,000
Share premium	125,898
Accumulated deficit	(6,945)
Non-controlling interests	332
Tier 1 capital	143,285
Deduction from original and additional own funds	(1,870)
Capital base	141,415
Capital requirement	
Credit risk	59,223
Market risk	25,345
Operational risk	2,663
Capital requirement under Pillar I	87,231
Surplus of own funds	54,184
Total risk-weighted assets	1,090,390
Tier 1 capital ratio	13.1%
Capital adequacy ratio	13.0%

For year-end 2008, the Tier 1 capital ratio was calculated in accordance with the Capital Requirements Directive (CRD).

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Risk management

42. 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.

43. 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 Group 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.

44. 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.

44. 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 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 scheme 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, whereupon 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 is in the process of dealing with these issues and will continue to do so. Moreover, the FME assessment is an ongoing process that will take Bank responses into consideration.

45. 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, i.e. in its investment activities. 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.

46. 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 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 its compliance with risk policies of the Group. Since the Group was formed on 9 October 2008, it has concentrated on maximising the value of the loans transferred to it from Landsbanki Íslands hf. Two aspects of this were putting new lending rules in place and updating risk rules which had been approved by the Board of Directors. Since 31 December 2008, the Group has established a formal process for defining its risk appetite and setting new risk policies for any risks.

47. Effects of the financial crisis

Due to developments in Iceland during October 2008 and based on Act No. 161/2002 on Financial Undertakings, the FME issued a decision regarding disposal of certain assets and liabilities of Landsbanki Íslands hf. to the Bank. Following this decision, settling the transfer of assets and liabilities involved a valuation of the disposed assets and liabilities. The largest transferred asset class was loans to customers, for which the Group's most significant risk was that the valuation of the transferred assets was too high. The uncertainty about borrowers' ability to pay back their loans was also rather high due to Iceland's economic conditions, especially in the case of loans denominated in foreign currencies granted to borrowers with limited or no income in foreign currencies. In addition, the transfer of assets and liabilities resulted in a mismatch risk for the Bank. This mismatch in currency, liquidity and interest rate risks will be discussed in the following sections.

Credit risk

48. 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. Between 9 October and 31 December 2008, as well as 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 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.

49. 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.

50. 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.

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.

51. 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 thirteen 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.

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 green 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.

The Group divided customer groups with loan exposure above ISK 500 million into red, green, and amber credit risk groups.

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:

At 31 December 2008	Carrying amount
Customer groups with loan exposures above ISK 500 million	
Green	125,522
Amber	248,930
Red	47,247
Customer groups with loan exposures below ISK 500 million	283,483
Total	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. The bond portfolio is composed of bonds with a wide range of credit quality.

52. 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 balance sheet 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 Group measures the impact of foreign exchange rate fluctuations on the loan book and its performance in relation to fluctuations. The valuation process

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

The following table represents the Group's maximum credit risk exposure at 31 December 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 table 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 2008	Financial institutions	Public entities*	Individuals	Fisheries	Construction and real estate companies	Retail	Holding companies	Services	Manufacturing	ITC**	Agriculture	Other	Carrying amount
Cash and balances with Central Bank	-	30,071	-	-	-	-	-	-	-	-	-	-	30,071
Bonds and debt instruments	19,590	6,009	-	-	-	-	6,988	417	4,561	-	-	2,331	39,896
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	-	-	-	-	-	-	-	-	-	-	149,225
Other financial assets	25,149	6,091	139	63	-	5,662	62	104	282	8	-	188	37,748
Total on-balance sheet exposure	53,584	202,849	170,172	171,890	107,479	63,888	70,215	49,146	30,257	27,853	16,287	7,347	970,967
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	-	811	366	5,347	439	599	470	-	519	412	1,229	92	10,284
Undrawn loan commitments	-	-	53	4,379	1,771	10,022	297	648	-	5,599	1,696	32	24,497
Undrawn overdraft/credit card facilities	-	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	53,584	207,451	208,236	184,459	110,390	77,845	72,615	50,047	31,479	39,058	22,879	7,801	1,065,844

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

** ITC consists of corperations 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.

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54. Loans and advances by industry sectors

At 31 December 2008	Financial institutions	Public entities	Individuals	Corporations	Carrying amount
Financial institutions	8,845				8,845
Public entities		11,529			11,529
Individuals			170,052		170,052
Corporations					
Fisheries				171,860	171,860
Construction and real estate companies				107,771	107,771
Holding companies				63,703	63,703
Retail				58,287	58,287
Services				48,653	48,653
Information, technology and communication				27,855	27,855
Manufacturing				25,530	25,530
Agriculture				16,297	16,297
Other				4,828	4,828
Less: Allowance for impairment		(76)	(19)	(1,088)	(1,183)
Total	8,845	11,453	170,033	523,696	714,027

55. Credit quality of financial assets

The credit quality of financial assets was analysed as follows:

At 31 December 2008	Neither past due nor individually impaired	Past due but not individually impaired	Individually impaired	Total	Impairment allowance	Carrying amount
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
Financial assets classified as held for sale	3,169	-	-	3,169	-	3,169
Total	621,864	200,145	916	822,925	(1,183)	821,742

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 allowances are not included under financial assets that are past due or impaired.

56. Loans and advances neither past due nor individually impaired

	Credit risk groups				
At 31 December 2008	Green	Amber	Red	Exposures below ISK 500 million	Carrying amount
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

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57. Loans and advances past due but not individually impaired

The following table shows the carrying amount of loans to customers that have failed to make payments which had become contractually due by one or more days. The table shows loans transferred from Landsbanki Íslands hf. at deep discounts, together with loans that were granted by the Group and are not impaired from its perspective.

At 31 December 2008	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
Loans and advances to customers	82,642	44,455	23,816	31,345	182,258

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

58. Individually impaired loans and advances to customers

At 31 December 2008	Gross amount	Allowance for impairment	Carrying amount
Loans and advances to customers	916	(864)	52

59. Allowance for impairment on loans and advances to customers

	Total
Balance 9 October 2008	-
Impairment loss on loans and advances	1,256
Collected previously written-off loans	8
Loans written-off	(81)
Balance 31 December 2008	1,183
Specific allowance	864
Collective allowance	319
Balance 31 December 2008	1,183

60. Renegotiated loans

Soon after the Bank was founded and loans were transferred to it from Landsbanki Íslands hf., the Icelandic government mandated that borrowers would be granted payment holidays for principal and/or interest. Many of the Group's customers took advantage of this.

As of 31 December 2008, only a few loans had been renegotiated; however, a larger portion of the loan book was restructured in the course of 2009. In regard to corporations, the Group put remedies in place for those experiencing financial difficulties and also presented transparent procedures for corporate 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.

A loan which was impaired and for which new terms have already been negotiated is no longer considered past due or impaired. It is not considered to be a new loan, however, so the original effective interest rate is left unchanged.

Loans that have not been impaired, but were renegotiated because of borrower financial difficulties, are treated as new loans since expectations are that the original cash flow from the loan will be collected. The original loans are derecognised and the renegotiated loans are recognised, with new terms and amendments to the loan contracts. The same applies to renegotiated loans in instances where the borrower has no financial difficulties.

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61. Large exposures

At year-end 2008, six Group clients were rated as large exposures. 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 2008.

At year-end 2008, the Group's internal rules on large exposures stated that clients could comprise up to 25% of the Group's equity as defined by the Basel II regulatory framework ("capital base"). However, these rules were changed in April 2009 by lowering the exposure limit from 25% to 20%. At year-end 2008, one exposure did exceed 20%, but the Group intends to reduce that exposure below the 20% limit. The rules in effect since April 2009 stipulate that executives must submit any lending above 15% of the Group's capital base to the Board for review. According to the Group's risk appetite, the total utilisation percentage of a large exposure ought to remain below 150% of the Group's capital base.

At 31 December 2008	Number of large exposures	Large exposures
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%

62. Bonds and debt instruments

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

At 31 December 2008	Carrying amount
Aaa	1,709
Aa1	214
Baa1 to Baa3	6,317
Lower than Baa3	9,849
Unrated	21,807
Total	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 2008	Past due up to 60 days	to 61-90 days	Past due up to 91 - 180 days	Past due over 180 days	Carrying amount
Financial institutions	6,947	-	-	-	6,947
Holding companies	108	448	-	-	556
Other	2,127	-	-	-	2,127
Total	9,182	448	0	0	9,630

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Liquidity Risk

63. Liquidity risk

The Group's liquidity risk is its risk of encountering difficulty in meeting obligations associated with its financial liabilities as they fall due, or of having to do so at excessive cost. This risk arises from possible mismatches in the timing of cash flows.

64. Liquidity risk management

The Group has instituted a liquidity management policy for the Bank and its subsidiaries. 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 kind of 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 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. The core liquidity ratio at year-end 2008 was 26%.

65. Maturity analysis of financial assets and liabilities

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

At 31 December 2008	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total	Carrying amount
Assets								
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	-	334,203	149,225
Other financial assets	-	10,228	24,351	-	-	-	34,579	34,579
Financial assets classified as held for	-	-	3,169	-	-	-	3,169	3,169
Total financial assets	133,474	149,942	232,774	552,082	454,081	39,681	1,562,034	1,010,648
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)
Financial liabilities associated with assets classified as held for sale	-	-	(194)	-	-	-	(194)	(194)
Total financial liabilities	(440,099)	(70,665)	(45,943)	(112,760)	(324,983)	0	(994,450)	(883,795)
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 off-balance sheet items	84,593	6,097	1,745	2,442	0	0	94,877	
Gross settled derivatives								(746)
Inflow	-	1,076	542	1,237	1,168	-	4,023	
Outflow	-	(1,084)	(737)	(1,689)	(1,599)	-	(5,109)	
Total gross settled derivatives inflow/(outflow)	0	(8)	(195)	(452)	(431)	0	(1,086)	
Net liquidity position	(222,032)	85,366	188,381	441,312	128,667	39,681	661,375	

The amounts in the maturity analysis 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 acquired from Landsbanki Íslands hf. (for which future cash flows presented in the table are estimated as disclosed in Note 51 on Credit Risk Measurement) and bonds issued by companies in moratorium or in the process of liquidation (for which future cash flows presented in the table are estimated as their fair value at balance sheet date). 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 liquidity risk.

Amounts presented in the maturity analysis 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 analysis has been determined in reference to 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 maturity analysis, since it is set forth as detailed above. Demand deposits from customers are instead expected to demonstrate a stable or increasing balance, 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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Market risk

66. Market risk

Market risk is the risk of fluctuations in the fair value or future cash flow of financial instruments, due to changing 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.

67. 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, equities and unsettled securities). Non-trading portfolios include positions arising from the Group's retail and commercial banking operations (i.e. loans and advances and deposits). 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 the return on risk.

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 Group 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%. At year-end 2008, the Group's exposure to market risk was 29.1% of its total risk-weighted asset base, with the exposure to equity price risk measuring 5.5%, the exposure to interest rate risk measuring 5.5% and the exposure to foreign exchange risk measuring 18.6%. Due to the circumstances described in Note 71, the Group surpassed these limits to foreign exchange risk at year-end 2008.

The foreign exchange risk in the Group's trading portfolios is disclosed together with that in its non-trading portfolios in Notes 71-74, along with the related sensitivity analysis.

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 net interest income would have been affected by 1% and 2% parallel shifts in interest yield curves through changes in the fair value of its bond trading portfolios at year-end 2008.

Currency (ISK million)	-2% shift	-1% shift	+1% shift	+2% shift
ISK, non-CPI indexed	449	219	(210)	(412)
ISK, CPI indexed	1,025	488	(445)	(852)
USD	144	71	(68)	(133)
EUR	1,115	534	(494)	(953)
GBP	10	5	(5)	(9)
CAD	6	3	(3)	(6)
Total	2,749	1,320	(1,225)	(2,365)

Group 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 net interest income would have affected the accumulated deficit.

A 10% change in the price of equities held by the Group at year-end 2008, with all other variables remaining constant, would have resulted in an ISK 3,968 million increase/decrease in other net operating income. The Group's 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 other net operating income would have affected the accumulated deficit.

68. 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 table summarises Group exposure to interest rate risk in its non-trading portfolios. The table includes interest-bearing financial assets and liabilities at their carrying amounts, while off-balance sheet amounts are the notional amounts of currency swaps (see Note 19). The amounts presented are categorised by the earlier of either the contractual repricing or the maturity date.

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
Financial assets classified as held for sale	3,169	-	-	-	3,169
Total	786,664	81,065	55,309	47,929	970,967
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)
Financial liabilities associated with assets classified as held for sale	(194)	-	-	-	(194)
Total	(879,230)	(5,311)	0	0	(884,541)
Net on-balance sheet position	(92,566)	75,754	55,309	47,929	86,426
Net off-balance sheet position	1,000	(24)	(451)	(525)	0
Total interest repricing gap	(91,566)	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.

69. Sensitivity to interest rate risk (non-trading portfolios)

The management of interest rate risk against interest rate gap limits is supplemented by monitoring the sensitivity of Group financial assets and liabilities to various interest rate scenarios. The Group employs a monthly stress test of the interest rate risk in its non-trading portfolios. In this test, the interest rate curve is shifted by +/- 1% and +/- 2% for every currency. The following table shows how the Group's net interest income would have been affected by a 1% and 2% parallel shift in all yield curves, with all other variables kept constant, as relates to risk exposure at year-end 2008.

Currency (ISK million)	-2% shift	-1% shift	+1% shift	+2% shift
ISK, non-CPI indexed	(119)	(59)	59	119
ISK, CPI indexed	235	117	(117)	(235)
EUR	70	35	(35)	(70)
USD	99	50	(50)	(99)
GBP	(101)	(50)	50	101
CAD	14	7	(7)	(14)
JPY	262	131	(131)	(262)
CHF	383	192	(192)	(383)
Other	53	27	(27)	(53)
Total	896	450	(450)	(896)

Group equity would have been affected by the same amounts as the income statement, but net of income tax. This is because the increase/decrease in net interest income would have affected accumulated deficit.

70. 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 Icelandic consumer price index (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 2008 the CPI imbalance, calculated as the difference between CPI-indexed financial assets and liabilities, was ISK 53,812 million.

The following table shows carrying amounts of the Group's major classes of CPI-indexed financial assets and liabilities as of year-end 2008. The off-balance sheet amounts are CPI-indexed fair values in the ISK leg of currency swaps.

At 31 December 2008	Carrying amount
Assets	
Loans and advances to customers	130,048
Bonds and debt instruments	10,117
Total	**140,165**
Liabilities	
Due to financial institutions and Central Bank	(9)
Deposits from customers	(85,127)
Total	**(85,136)**
Total on-balance sheet	55,029
Total off-balance sheet	(1,217)
Total CPI indexation balance	**53,812**

Management of the Group's CPI indexation risk is supplemented by monitoring the sensitivity of CPI-indexed financial assets and liabilities 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 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 the accumulated deficit.

Currency risk

71. 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. Also, this imbalance has been substantially reduced by issuing bonds denominated in foreign currencies to Landsbanki Islands hf., which is reflected in the currencies in which the provisional liability recognised by the Bank is denominated (see Note 4). Nevertheless, a significant risk factor in the Group's opening balance sheet is the exposure to currency risk.

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 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 year-end 2009, raising the required limits.

72. FX-delta

The inherent risk in the considerable foreign exchange imbalance is limited by the FX-delta, as described in Note 3. 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.

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73. Concentration of currency risk

The following table summarises the Group's exposure to currency risk at year-end 2008, showing the carrying amount of all Group assets and liabilities by currency of denomination. The off-balance sheet amounts shown are the notional amounts of currency swaps (see Note 19). 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 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 affect Group results. The functional currency of all Group entities is ISK.

At 31 December 2008	ISK	EUR	GBP	USD	JPY	CHF	Other	Carrying amount
Assets								
Cash and balances with Central Bank	19,046	3,599	1,370	4,356	195	150	1,355	30,071
Bonds and debt instruments	22,695	13,152	174	3,782	-	-	93	39,896
Equities and equity instruments	7,147	7,907	-	434	-	-	24,193	39,681
Loans and advances to financial institutions	4,579	460	1,558	533	223	190	1,302	8,845
Loans and advances to customers	216,918	100,228	15,154	89,536	125,732	129,759	27,855	705,182
Investments in associates	2,518	-	-	-	-	-	-	2,518
Property and equipment	6,864	-	-	-	-	-	-	6,864
Intangible assets	1,220	-	-	-	-	-	-	1,220
Deferred tax assets	7,347	-	-	-	-	-	-	7,347
Unpaid capital contribution	149,225	-	-	-	-	-	-	149,225
Other assets	24,621	11,592	327	2,353	3	5	57	38,958
Assets classified as held for sale	7,584	-	-	-	-	-	-	7,584
Total	469,764	136,938	18,583	100,994	126,153	130,104	54,855	1,037,391
Liabilities and equity								
Due to financial institutions and Central Bank	(130,871)	(151)	(48)	(1,071)	(55)	(2)	(21)	(132,219)
Deposits from customers	(363,906)	(25,969)	(16,627)	(21,178)	(243)	(444)	(2,639)	(431,006)
Derivative liabilities	-	(365)	-	(381)	-	-	-	(746)
Tax liabilities	(621)	-	(224)	-	-	-	-	(845)
Provisional liability due to Landsbanki Íslands hf.	(29,286)	(142,490)	(47,331)	(85,950)	-	-	-	(305,057)
Other liabilities	(17,996)	(584)	-	(861)	-	-	(352)	(19,793)
Liabilities associated with assets classified as held for sale	(4,440)	-	-	-	-	-	-	(4,440)
Equity	(143,285)	-	-	-	-	-	-	(143,285)
Total	(690,405)	(169,559)	(64,230)	(109,441)	(298)	(446)	(3,012)	(1,037,391)
Net on-balance sheet position	(220,641)	(32,621)	(45,647)	(8,447)	125,855	129,658	51,843	0
Net off-balance sheet position	(357)	(1,341)	-	861	-	-	837	0
Net currency position	(220,998)	(33,962)	(45,647)	(7,586)	125,855	129,658	52,680	0
FX-delta (%)		65%	65%	66%	62%	62%	71%	
FX-delta adjustments to currency imbalance	175,719	(34,679)	(5,365)	(30,353)	(47,778)	(49,438)	(8,106)	0
Net effective currency position	(45,279)	(68,641)	(51,012)	(37,939)	78,077	80,220	44,574	0

The following foreign exchange rates were used by the Group:

	At 30 September 2008	At 31 December 2008	% Change	Average for the period
EUR/ISK	149.29	169.00	13.2%	163.56
GBP/ISK	189.09	177.00	(6.4%)	195.42
USD/ISK	106.23	121.20	14.1%	122.90
JPY/ISK	1.00	1.33	33.0%	1.27
CHF/ISK	94.69	113.54	19.9%	107.51
CAD/ISK	100.21	98.70	(1.5%)	103.67
DKK/ISK	20.00	22.69	13.5%	21.95
NOK/ISK	17.99	17.39	(3.3%)	18.46
SEK/ISK	15.30	15.40	0.7%	15.98

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74. Sensitivity to currency risk

The domestic currency, ISK, depreciated by 9.8% from 9 October 2008 to year-end 2008. 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 that is 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 loss would have been affected by a 10% depreciation/appreciation of each currency, with all other variables held constant.

Currency (ISK million)	-10%	+10%
EUR	(6,864)	6,864
GBP	(5,101)	5,101
USD	(3,794)	3,794
JPY	7,808	(7,808)
CHF	8,022	(8,022)
Other	4,457	(4,457)
Total	4,528	(4,528)

Group equity would have been affected by the same amounts as the income statement, but net of income tax. This is because the increase/decrease in other net operating loss would have affected the accumulated deficit.

Operational risk

75. 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. The Bank has opted to follow the basic indicator approach for calculating its regulatory capital.

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