

ANNUAL REPORT | ÁRSSKÝRSLA | 2008

*Saga* ) (*Capital*





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Halldor Johannsson, Chairman



Thorvaldur Ludvik Sigurjonsson, CEO

## ADDRESS OF CHAIRMAN AND CEO

The year 2008 was a memorable year, both domestically and internationally. Never have so many banks gone bankrupt in a single year in history. The collapse of all the major Icelandic commercial banks left a lasting mark on the economy and altered the image of the Icelandic banking sector and the country's economy as a whole for years to come. Few nations have ever been faced with a challenge as huge as the one Iceland will have to deal with in the near future. The economy is going through an extensive adaptation to a totally different landscape of global trading. The globalisation of the Icelandic economy during the past few years makes this adaptation very painful for the country, as witnessed by the collapse of almost the entire banking system and the difficulties experienced by households and companies in Iceland.

### THE CONSEQUENCES OF THE COLLAPSE OF THE BANKS

The collapse of the banks and the country's largest companies had a profound impact on Saga Capital's operations during the year. According to the bank's audited nine month accounts, its equity amounted to ISK 9.8 billion at the end of September and its CAD ratio stood at around 53%. Until then, the bank's operations and balance sheet had withstood all the major blows and were balanced. Then the banks collapsed one by one, and they were followed by some of Iceland's largest companies. The major problem for Saga Capital's portfolio suddenly became its lending to the large commercial banks and the uncertainty of reclaiming from the estates of the banks following the emergency legislation,

## ÁVARP FORMANNS OG FORSTJÓRA

Árið 2008 verður lengi í minnum haft. Bæði héraendis og erlendis. Þetta ár fóru fleiri bankar í gjaldþrot en nokkru sinni áður í sögunni. Fall allra stóru íslensku viðskiptabankanna setti mark sitt á efnahagslífið með afgerandi hætti og breytti í flestu þeirri ásjón sem íslenskur bankageiri og efnahagslífið allt munu hafa á komandi árum. Fáar þjóðir hafa áður staðið frammi fyrir svo mikilli áskorun sem Íslendingar standa frammi fyrir nú um stundir. Efnahagslífið er að fara í gegnum mikla aðlögun að gerbreyttu landslagi í heimsviðskiptum. Alþjóðavæðing íslensks efnahagslífs á undanförunum árum hefur gert þessa aðlögun mjög sársaukafulla fyrir land og þjóð, með hruni meirihluta bankakerfisins og miklum erfiðleikum fyrir heimili og fyrirtæki í landinu.

### AFLEIÐINGAR BANKAHRUNSINS

Hrun bankanna og stærstu fyrirtækja landsins hafði mikil áhrif á rekstur Saga Capital á árinu. Samkvæmt endurskoðuðu níu mánaða uppgjöri bankans nam eigið fé hans um 9,8 milljörðum króna í lok september og CAD eiginfjárlutfall var um 53%. Rekstur bankans og efnahagur hófðu fram að þeim tíma staðið af sér helstu áföll og voru í jafnvægi. Síðan féllu bankarnir hver af öðrum og einnig mörg stærstu fyrirtæki landsins. Helsta vandanámál í eignasafni Saga Capital varð skyndilega hversu mikið bankinn hafði lánað stóru viðskiptabönkunum og hve mikil óvissa myndaðist um heimtur til kröfuhafa úr búum þeirra í kjölfar neyðarlaganna, sem skiptu upp eignum og skuldum gömlu viðskiptabankanna. Endanlegar heimtur eiga enn eftir

resulting in the liquidation of the banks' assets and liabilities. It remains to be seen how much of the amount can be reclaimed eventually, but the process of liquidating the estates of the old banks will probably take at least two years. This greatly upset Saga Capital's asset value and during the past months its directors have put in a massive effort, safeguarding the interests of shareholders and securing the bank's basis of operation by negotiating with the Treasury. An agreement was reached in mid March whereby the Treasury granted Saga Capital a loan because of the bank bonds, allowing the bank to meet the setbacks it had experienced due to the methodology used by the government during the liquidation of the old banks.

**OPERATIONS AND MILESTONES IN 2008** | Saga Capital's operations in 2008 resulted in a loss of ISK 3,7 billion. Its equity at the end of the year amounted to ISK 6,2 billion and the CAD ratio stood at 15%. The losses are almost entirely due to the collapse of the big banks. Despite such major setbacks the bank stands on solid ground and has a strong CAD ratio. The bank's high CAD ratio at the time of the collapse of the commercial banks provided a strong foundation, enabling Saga Capital to continue its operations.

Despite the difficult circumstances and detrimental external conditions the bank reached many important milestones during the year. Midway through the year the bank became a full member of the Icelandic Banks Data Centre (RB) and around the same time it became a member of the Central Bank of

að koma í ljós, en líklegt er að það muni taka næstu tvö ár að klára uppgjör þrotabúa gömlu bankanna. Við þetta var eignavirði Saga Capital sett í mikið uppnám og undanfarna mánuði hafa stjórnendur hans unnið mikið starf við að gæta hagsmuna hluthafa og tryggja áframhaldandi grundvöll bankans með samningum við ríkissjóð. Þeir samningar náðust um miðbik marsmánaðar á þann hátt að ríkissjóður veitti Saga Capital lánaþyrirgreiðslu vegna bankabréfanna og gerði bankanum þannig kleift að mæta þeim áföllum sem hann varð fyrir vegna aðferðafræðinnar sem notuð var við uppskiptingu gömlu bankanna.

**REKSTUR OG ÁFANGAR Á ÁRINU** | Rekstur Saga Capital á árinu 2008 skilaði 3,7 milljörðum í tap. Eigið fé hans í árslok var 6,2 milljarðar og CAD eiginfjárlutfall hans var 15%. Tap hans má að langmestu leyti rekja til falls stóru bankanna. Þrátt fyrir slík stóráföll stendur bankinn á styrkum stoðum og er með traust CAD hlutfall. Einungis vegna þess hve hátt CAD eiginfjárlutfall Saga Capital var við fall viðskiptabankanna er honum kleift að halda áfram á styrkum grunni.

Þrátt fyrir erfiðar aðstæður og óhagfellt ytra umhverfi náðust margir markverðir áfangar á árinu. Um miðbik árs hlaut bankinn

„Saga Capital stendur á styrkum stoðum með traust CAD hlutfall. Einungis vegna þess hve hátt CAD eiginfjárlutfall Saga Capital var við fall viðskiptabankanna er honum kleift að halda áfram á styrkum grunni.“

Iceland's Real Time Gross Settlement System. This meant that the bank was assigned a bank number, and its infrastructure was reinforced. This will allow customers to open accounts and carry out their traditional banking business at Saga Capital once its application for a banking licence has been approved by the Financial Supervisory Authority.

“Saga Capital stands on solid ground and has a strong CAD ratio. The bank's high CAD ratio at the time of the collapse of the commercial banks provided a strong foundation, enabling Saga Capital to continue its operations.”

a bright future for Saga Capital, with the bank playing an important role in the resurrection of the Icelandic economy and restoration of the banking system. Saga Capital's application for a commercial banking licence is being handled by the Financial Supervisory Authority and if granted, the bank will be able to provide services to individuals and institutions on a wider platform.

Furthermore, the bank took back previously outsourced activities in relation to the settlement of securities transactions and payment intermediation. Four new employees were hired to perform these new activities, and the arrangement has already proved much more cost-effective than the outsourcing method.

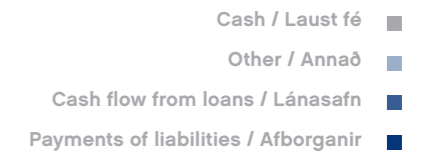
So far this year Corporate Finance has plenty of projects underway or in the pipeline, while Capital Markets activities continue to grow, as the bank has increasingly managed bond issues for municipalities and public parties, with great success. Everything points to

fulla aðild að Reiknistofu bankanna (RB) og gerðist um svipað leyti aðili að stórgreiðslukerfi Seðlabanka Íslands. Við þetta var bankanum úthlutað bankanúmeri og innviðirnir styrktir til að gera viðskiptamönnum hans kleift að opna reikninga og stunda sín venjubundnu bankaviðskipti í bankanum, að fengnu leyfi Fjármálaeftirlits.

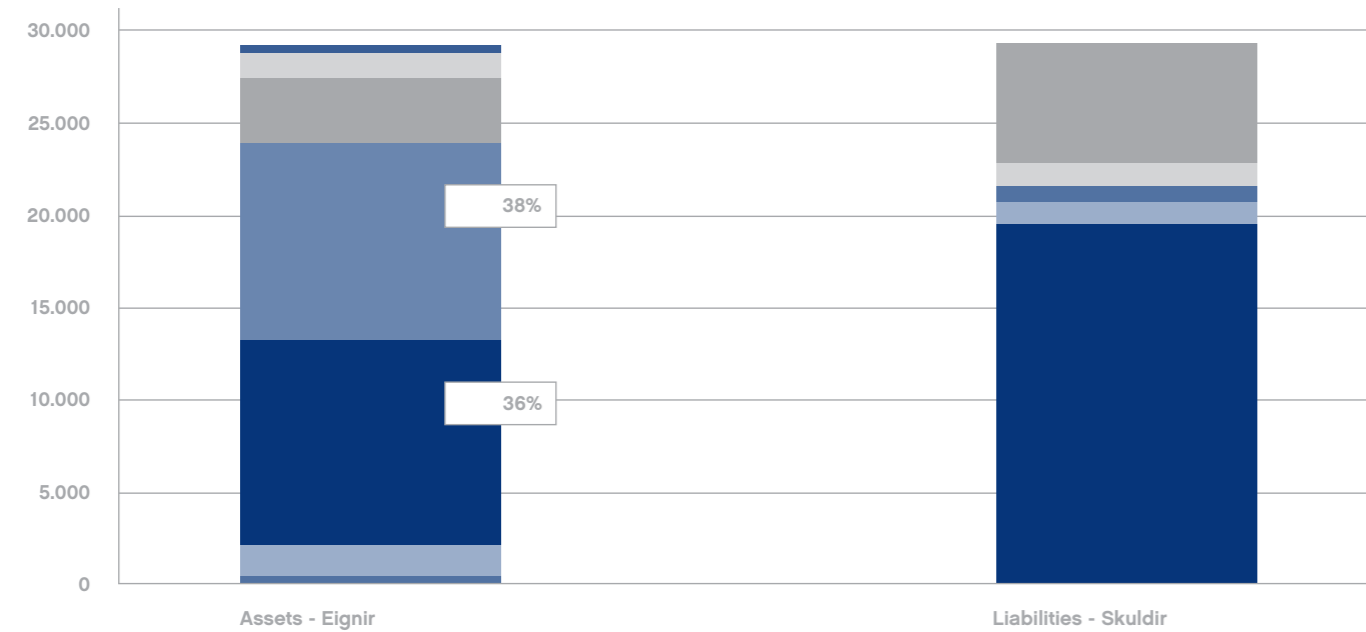
Þá tók bankinn sjálfur til sín áður útvistaða starfsemi vegna uppgjors verðbréfavíðskipta og greiðslumiðlunar. Starfsmönnum fjölgaði um fjóra við þessa nýju starfsemi, en nú þegar hefur sýnt sig að þetta fyrirkomulag er mun hagkvæmara en útivistunin sem áður var beitt.

Reksturinn það sem af er ári 2009 hefur einkennst af góðri verkefnastöðu í Fyrirtækjaráðgjöf og verulega auknum umsvifum Markaðsviðskipta, en bankinn hefur í vaxandi mæli tekið að sér að fjármagna sveitarfélög og opinbera aðila með skuldaþréfaútböðum sem gengið hafa vel. Allar forsendur eru til þess að framtíð Saga Capital sé björt og að bankinn muni skipa stóran sess við endurreisn íslensks atvinnulífs og uppbyggingu bankakerfisins. Viðskiptabankaleyfisumsókn Saga Capital er í meðörum Fjármálaeftirlitsins en að því fengnu mun bankinn geta þjónustað einstaklinga og stofnanir á breiðari grunni. Einstaklingar og fyrirtæki geta þá opnað eigin bankareikninga hjá Saga Capital og bankanum verður kleift að þjónusta viðskiptavini sína í allri hefðbundinni bankastarfsemi.

**NÝTT UPPHAF** | Í öllum umbreytingum og áföllum felast tækifæri. Það er okkar bjargfasta trú að Saga Capital muni



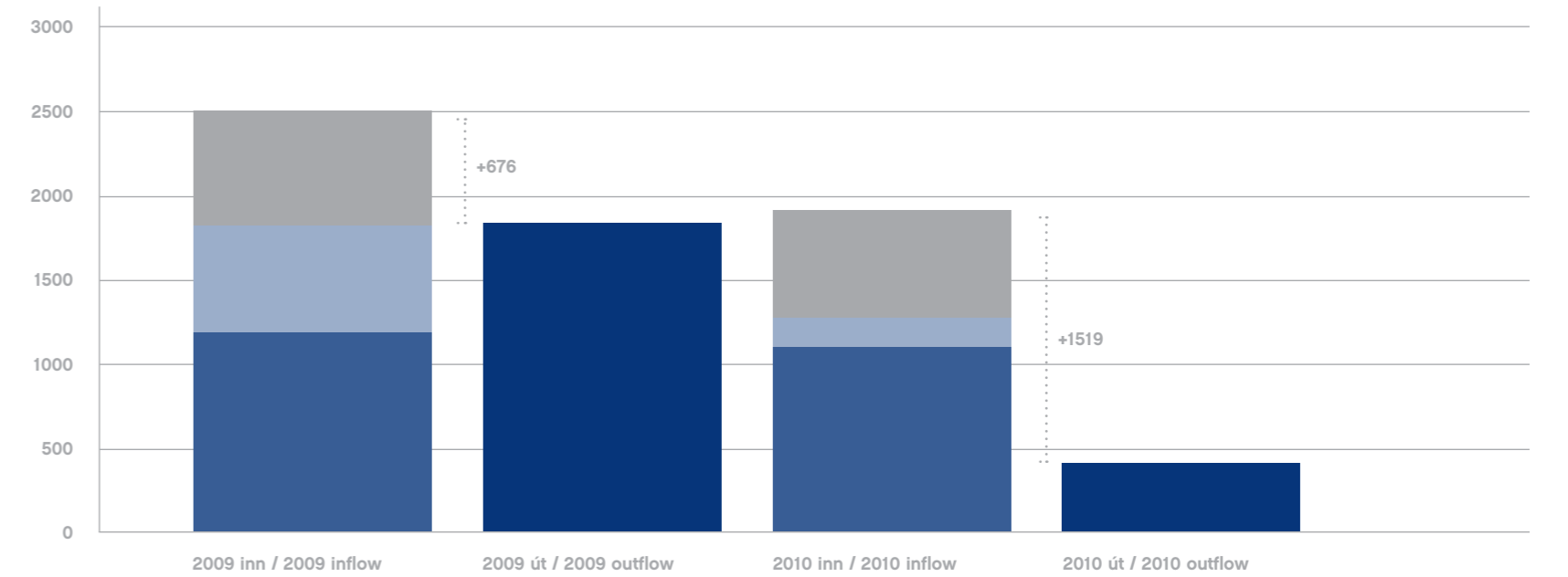
BALANCE SHEET - ASSETS /  
EFNAHAGUR - EIGNIR



Amounts are in ISK millions

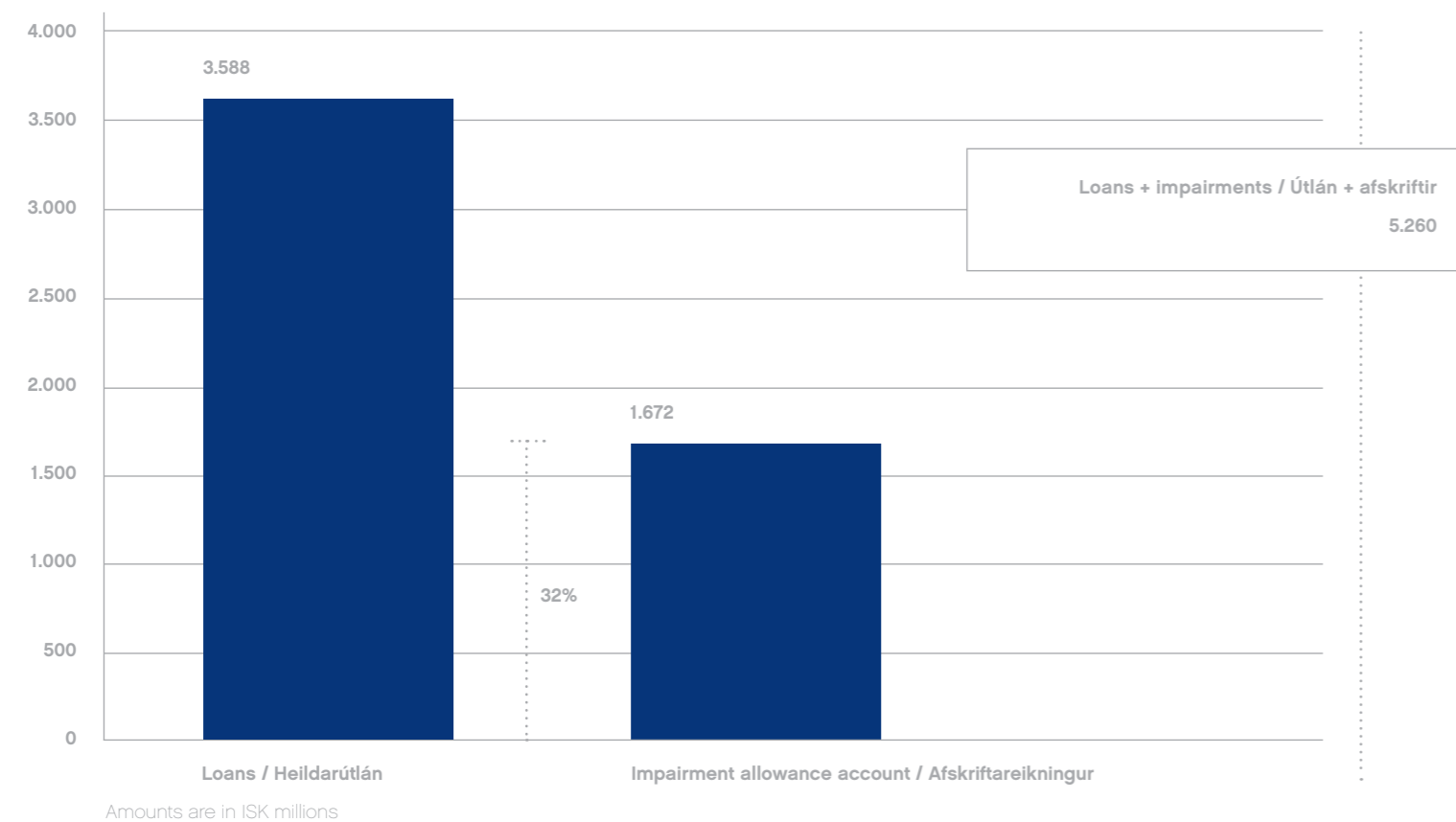
BALANCE SHEET - LIABILITIES /  
EFNAHAGUR - SKULDIR

CASH FLOW 2009 AND 2010 / ENDURGREIÐSLUPRÓFÍLL 2009 OG 2010



Amounts are in ISK millions

LOANS AND IMPAIRMENTS / ÚTLÁN OG AFSKRIFTAREIKNINGUR



“We have weathered the storm so far and now it is time to roll up one’s sleeves and deal with new circumstances armed with diligence, honesty, experience and professionalism.”

The licence will enable individuals and companies to open their personal bank accounts with Saga Capital and the bank can provide any traditional banking services to its customers.

**A NEW BEGINNING** | Every transformation and set-back brings opportunities. We believe that Saga Capital will, in the year 2009, be able to expand its activities and manage an increasing customer base professionally and honestly. In many ways this can be seen as a new beginning since Saga Capital became operational only a month before the global financial crisis hit. We have weathered the storm so far and now it is time to role up one’s sleeves and deal with new circumstances armed with diligence, honesty, experience and professionalism.

At this junction in time and in light of the challenging project ahead, we would like to thank our staff for their selfless and unique work in the interest of the bank’s shareholders and customers under unprecedented circumstances; while we also thank the shareholders for the support they have given the bank during this difficult time. Saga Capital’s future is bright and we will take the plunge, pushing hard from our solid ground.

„Við höfum synt í gegnum brimrótið hingað til og nú er tími til að bretta upp ermar og takast á við breytt landslag með vinnusemi, heiðarleika, reynslu og fagmennsku að vopni.“

á árinu 2009 getað breikkað starfsemi sína til muna og sinnt stækkandi viðskiptamannagrunni með fagmennsku og heiðarleika að leiðarljósi. Að mörgu leyti er um nýtt upphaf að ræða þar sem Saga Capital varð starfhæft einungis einum mánuði áður en alþjóðlega fjármálakreppan skall á. Við höfum synt í gegnum brimrótið hingað til og nú er tími til að bretta upp ermar og takast á við breytt landslag með vinnusemi, heiðarleika, reynslu og fagmennsku að vopni.

Á þessum tímamótum og í ljósi þess ógrandi verkefnis sem framundan er viljum við þakka starfsfólki mikið og einstakt starf í þágu hluthafa og viðskiptamanna bankans við afar sérstakar aðstæður og jafnframt þakka hluthöfum þann stuðning sem þeir hafa veitt bankanum á þessum óvenjulegu tímum. Framtíð Saga Capital er björt og frá styrkum grunni verður spyrnt fast.

**Haldór Jóhannsson**, Chairman of the Board / stjórnarformaður

**Porvaldur Lúðvík Sigurjónsson**, CEO / forstjóri



Board of Directors: **Robert Melax**, Thorvaldur Ludvík Sigurjónsson, CEO, **Johann Antonsson**, Halldor Johannsson, Chairman, **Gunnar Thor Gislason**, and **Sindri Sindrason**.

“Saga Capital emphasises the transparent flow of information to its shareholders and adheres to the Instructions for Corporate Governance...”

„Saga Capital leggur mikla áherslu á gegnsætt upplýsingaflæði til hluthafa sinna og fylgir þar Leiðbeiningum um stjórnarhætti fyrirtækja...”

## SAGA CAPITAL'S BOARD OF DIRECTORS

The key to the reconstruction of the Icelandic economy lies first and foremost in renewing the trust between the public and the country's financial institutions. This trust will only be achieved by stressing honesty, respect and transparency of communication. Saga Capital emphasises the transparent flow of information to its shareholders and adheres to the Instructions for Corporate Governance issued by The Iceland Chamber of Commerce, The Iceland Stock Exchange and the Confederation of Icelandic Employers; these instructions are key documents in laying down the law on this issue.

The Instructions urge companies to publish detailed information about their board members in their annual accounts or statements and to accurately evaluate whether board members are truly independent of the company; the majority of the board should be independent and at least two board members should be independent of large shareholders in the company. According to these guidelines a board member of Saga Capital is not considered independent of the bank:

- If the board member is or has been an employee of the bank or companies within the bank's group for the previous three years.
- If the board member accepts payments from the bank or its senior directors, e.g. as an adviser or contractor, apart from wages for being on the board.

## STJÓRN SAGA CAPITAL

Lykillinn að enduruppbyggingu íslensks atvinnulífs liggur ekki síst í endurnýjuðu trausti á milli almennings og fjármálafyrirtækja landsins. Þetta traust næst aðeins með því að leggja áherslu á heiðarleika, virðingu og gegnsæi í öllum samskiptum. Saga Capital leggur mikla áherslu á gegnsætt upplýsingaflæði til hluthafa sinna og fylgir þar Leiðbeiningum um stjórnarhætti fyrirtækja sem unnar voru í samstarfi Viðskiptaráðs Íslands, Kauphallar Íslands og Samtaka atvinnulífsins og leggja línurnar um þetta efni.

Í þessum leiðbeiningum er meðal annars talið æskilegt að fyrirtæki birti í ársreikningi eða ársskýrslu ítarlegar upplýsingar um stjórnarmenn sína og meti eftir nákvæmum viðmiðum hvort stjórnarmenn séu óháðir félaginu, en talið er æskilegt að meirihluti stjórnarinnar sé óháður og að minnsta kosti tveir stjórnarmanna séu óháðir stórum hluthöfum í félaginu. Samkvæmt þessum viðmiðum telst stjórnarmaður í Saga Capital ekki óháður bankanum:

- Ef hann er eða hefur verið starfsmaður bankans eða félaga í samstæðu bankans undanfarandi þrjú ár.
- Ef hann þiggur greiðslur frá bankanum eða æðstu stjórnendum hans, t.d. sem ráðgjafi eða verktaki, að frátöldum launum sem hann fær sem stjórnarmaður.

- If the board member is closely related to any of the bank's advisers, auditors, board members or senior directors.
- If the board member serves as senior director for another company with considerable dealings with the bank.
- If the board member serves as senior director for a company where one of the bank's senior directors serves as board member.
- If the board member has significant dealings or business interests with the bank.
- If the board member is party to a performance-related reward system with the bank.
- If the board is aware of any other issues on which the interests of board members and the bank may clash significantly.

- Ef hann er tengdur nánum fjölskylduböndum einhverjum af ráðgjöfum, endurskoðendum, stjórnarmönnum eða æðstu stjórnendum bankans.
- Ef hann er einn af æðstu stjórnendum í öðru fyrirtæki sem er í umtalsverðum viðskiptum við bankann.
- Ef hann er einn af æðstu stjórnendum fyrirtækis þar sem einn af æðstu stjórnendum bankans situr sem stjórnarmaður.
- Ef hann er í miklum viðskiptum eða hefur mikilla viðskiptahagsmuna að gæta í bankanum.
- Ef hann er aðili að árangurstengdu umbunarkerfi hjá bankanum.
- Ef stjórn er kunnugt um einhver þau önnur atriði þar sem hagsmunir stjórnarmanna og bankans geta skarast verulega.

**Saga Capital's Board of Directors fulfils the above criteria on board members' independence and forthwith publishes information on its board members, which serves as the basis of this assessment.**

**Stjórn Saga Capital uppfyllir ofangreind skilyrði um sjálfstæði stjórnarmanna og birtir hér þær upplýsingar um stjórnarmenn sína sem liggja til grundvallar því mati.**



Name, Date of Birth: **Gunnar Thor Gislason, 18 November, 1965.**

Education: **Business graduate, University of Iceland; MBA, London Business School.**

Main job: **Managing Director of Sundagardar hf. from 1994.**

Career: **Various administrative positions in relation to financial markets and the food industry. Chairman of the Board at Stoke City Football Club Ltd. from 1999 until 2006.**

First elected on Saga Capital's Board of Directors: **2008.**

Other commissions of trust, incl. board memberships for other companies: **Sundagardar hf., Langisjor ehf., Sild og Fiskur ehf., Matfugl ehf., Brimgardar ehf., Mata hf. and Salathusid ehf.**

Direct or indirect shareholding in Saga Capital: **Gislason and related parties hold a share of 11.3% in Saga Capital; Gislason holds 1% personally and Sundagardar hf., of which Gislason is Managing Director and shareholder, holds 10.3%.**

Purchase or sales option contracts with Saga Capital: **None.**

Spouse: **Solveig Ingólfssdóttir.**

Nafn, fæðingardagur og ár: **Gunnar Þór Gíslason, 18. nóvember 1965.**

Menntun: **Viðskiptafræðingur frá HÍ, MBA frá London Business School.**

Aðalstarf: **Framkvæmdastjóri Sundagarða hf. frá 1994.**

Starfsferill: **Ýmis stjórnunarstörf er tengjast fjármálamörkuðum og matariðnaðinum. Stjórnarformaður Stoke City Football Club Ltd. á árunum 1999-2006.**

Fyrst kosinn í stjórn Saga Capital: **2008.**

Önnur trúnaðarstörf, þ.á.m. stjórnarseta í öðrum: **Sundagarðar hf., Langisjór ehf., Sild og Fiskur ehf., Matfugl ehf., Brimgarðar ehf., Mata hf. og Salat-húsið ehf.**

Beinir og óbeinir eignarhlutir í Saga Capital: **Gunnar Þór og tengdir aðilar eiga 11,3% eignarhlut í Saga Capital, þar af á Gunnar Þór 1% og Sundagarðar hf., þar sem Gunnar Þór er framkvæmdastjóri og hluthafi, eiga 10,3%.**

Kaup- eða söluréttarsamningar við Saga Capital: **Engir.**

Maki: **Sólveig Ingólfssdóttir.**



Name, Date of Birth: **Halldor Johannsson, 4 August, 1972.**

Education: **Business graduate (Accounting & Audit) from the University of Iceland.**

Main job: **Managing Director of KEA svf.**

Career: **Financing, investments, merger consulting, administrative positions, board memberships and chairmanship for many companies.**

First elected on Saga Capital's Board of Directors: **2007.**

Other commissions of trust, incl. board memberships for other companies:

**Fjarfestingafelagid Urdir ehf., Eignarhaldsfelagid Fludir ehf., Nordurvegur ehf., Thekkingarvordur ehf., KEA eignir ehf., Islandsbref ehf. and Fasteignafelagid Klappir ehf.**

Direct or indirect shareholding in Saga Capital: **Johannsson is not a shareholder of Saga Capital but he is Chairman of the Board for KEA eignir ehf., which holds a share of 9.4% in Saga Capital. KEA eignir ehf. is fully owned by KEA svf.**

Purchase or sales option contracts with Saga Capital: **None.**

Spouse: **Erla Arnadottir.**

Nafn, fæðingardagur og ár: **Halldór Jóhannsson, 4. ágúst 1972.**

Menntun: **Viðskiptafræðingur af endurskoðunar- og reikningshaldssviði frá HÍ.**

Aðalstarf: **Framkvæmdastjóri KEA svf.**

Starfsferill: **Fjármögnun, fjárfestingar, samrunaráðgjöf, stjórnunarstörf, stjórnarsetur og formennska í fjölmörgum fyrirtækjum.**

Fyrst kosinn í stjórn Saga Capital: **2007.**

Önnur trúnaðarstörf, þ.á.m. stjórnarseta í öðrum félögum: **Fjárfestingarfélagið**

**Urðir ehf., Eignarhaldsfélagið Flúðir ehf., Norðurvegur ehf.,**

**Þekkingarvörður ehf., KEA eignir ehf., Íslandsbréf ehf. og**

**Fasteignafélagið Klappir ehf.**

Beinir og óbeinir eignarhlutir í Saga Capital: **Halldór á ekki hlut í Saga**

**Capital en hann er stjórnarformaður KEA eigna ehf. sem á 9,4% hlut í**

**Saga Capital. KEA eignir ehf. er í 100% eigu KEA svf.**

Kaup- eða söluréttarsamningar við Saga Capital: **Engir.**

Maki: **Erla Árnadóttir.**



Name, Date of Birth: **Johann Antonsson, 31 May, 1946.**

Education: **Business graduate from the University of Iceland.**

Main job: **Chairman of the Board for Sparisjodur Svarfdaela savings bank.**

Career: **Various marketing, administrative and consulting positions in relation to financial institutions and the fishing industry.**

First elected on Saga Capital's Board of Directors: **2007.**

Other commissions of trust, incl. board memberships for other companies:

**Rodull ehf., Kaktus software ehf., Eignarhaldsfelagid Fludir ehf. and Rimar ehf.**

Direct or indirect shareholding in Saga Capital: **Antonsson and related parties hold a 3.8% share in Saga Capital, of which Antonsson owns 0.7% and Sparisjodur Svarfdaela savings bank holds 3.1%.**

Purchase or sales option contracts with Saga Capital: **None.**

Spouse: **Svanfrídur Jonasdóttir.**

Nafn, fæðingardagur og ár: **Jóhann Antonsson, 31. maí 1946.**

Menntun **Viðskiptafræðingur frá Háskóla Íslands.**

Aðalstarf: **Stjórnarformaður Sparisjóðs Svarfðæla.**

Starfsferill: **Ýmis markaðs-, stjórnunar- og ráðgjafastörf tengd starfsemi fjármálafyrirtækja og sjávarútvegi.**

Fyrst kosinn í stjórn Saga Capital: **2007.**

Önnur trúnaðarstörf, þ.á.m. stjórnarseta í öðrum félögum: **Röðull ehf., Kaktus**

**Software ehf., Eignarhaldsfélagið Flúðir ehf. og Rimar ehf.**

Beinir og óbeinir eignarhlutir í Saga Capital: **Jóhann og tengdir aðilar eiga 3,8% hlut í Saga Capital, þar af á Jóhann 0,7% og Sparisjóður Svarfðæla 3,1%.**

Kaup- eða söluréttarsamningar við Saga Capital: **Engir.**

Maki: **Svanfríður Jónasdóttir.**



Name, Date of Birth: **Robert Melax, 24 January, 1960.**

Education: **Pharmacist M.Sc., MBA.**

Main job: **Investor.**

Career: **Founder of Lyfja Pharmacy chain. Board memberships for various companies, including Islandsbanki hf. and a privat investor for years.**

First elected on Saga Capital's Board of Directors: **2007.**

Other commissions of trust, incl. board memberships for other companies:

**Eignarhaldsfélagid Nidjaland ehf., Tammuz ehf., Vatnsvirkinn hf., City Center Properties AS and Istarh SARL.**

Direct or indirect shareholding in Saga Capital: **Melax is the owner of Tammuz ehf., which holds a 7.2% share in Saga Capital.**

Purchase or sales option contracts with Saga Capital: **None.**

Spouse: **Aslaug Jonsdottir.**

Nafn, fæðingardagur og ár: **Róbert Melax, 24. janúar 1960.**

Menntun: **Lyfjafræðingur M.Sc., MBA.**

Aðalstarf: **Fjárfestir.**

Starfsferill: **Stofnandi Lyfju. Stjórnarsetur í ýmsum fyrirtækjum, m.a. Íslandsbanka hf. og hefur starfað sem fjárfestir um árabíl.**

Fyrst kosinn í stjórn Saga Capital: **2007.**

Önnur trúnaðarstörf, þ.á.m. stjórnarseta í öðrum félögum:

**Eignarhaldsfélagið Nidjaland ehf., Tammuz ehf., Vatnsvirkinn hf., City Center Properties AS og Istarh SARL.**

Beinir og óbeinir eignarhlutir í Saga Capital: **Róbert er eigandi Tammuz ehf. sem á 7,2% í Saga Capital.**

Kaup- eða söluréttarsamningar við Saga Capital: **Engir.**

Maki: **Áslaug Jónsdóttir.**



Name, Date of Birth: **Sindri Sindrason, 20 August, 1952.**

Education: **Business graduate from the University of Iceland.**

Main job: **Chairman of the Board for HF Eimskipafélag Íslands.**

Career: **Served as Managing Director for Pharmaco hf. (now Actavis) from 1981 to 2003.**

First elected on Saga Capital's Board of Directors: **2008.**

Other commissions of trust, incl. board memberships for other companies:

**Eignarhaldsfélagid Nidjaland ehf., Larsen Group hf., Cave Japan ehf., CRI ehf., B. Magnusson hf., Reykjavik Records ehf.**

Direct or indirect shareholding in Saga Capital: **None.**

Purchase or sales option contracts with Saga Capital: **None.**

Spouse: **Kristbjorg Sigurdardottir.**

Nafn, fæðingardagur og ár: **Sindri Sindrason, 20. ágúst 1952.**

Menntun: **Viðskiptafræðingur frá Háskóla Íslands.**

Aðalstarf: **Stjórnarformaður HF Eimskipafélags Íslands.**

Starfsferill: **Starfaði sem framkvæmdastjóri Pharmaco hf. (nú Actavis) á árunum 1981-2003.**

Fyrst kosinn í stjórn Saga Capital: **2008.**

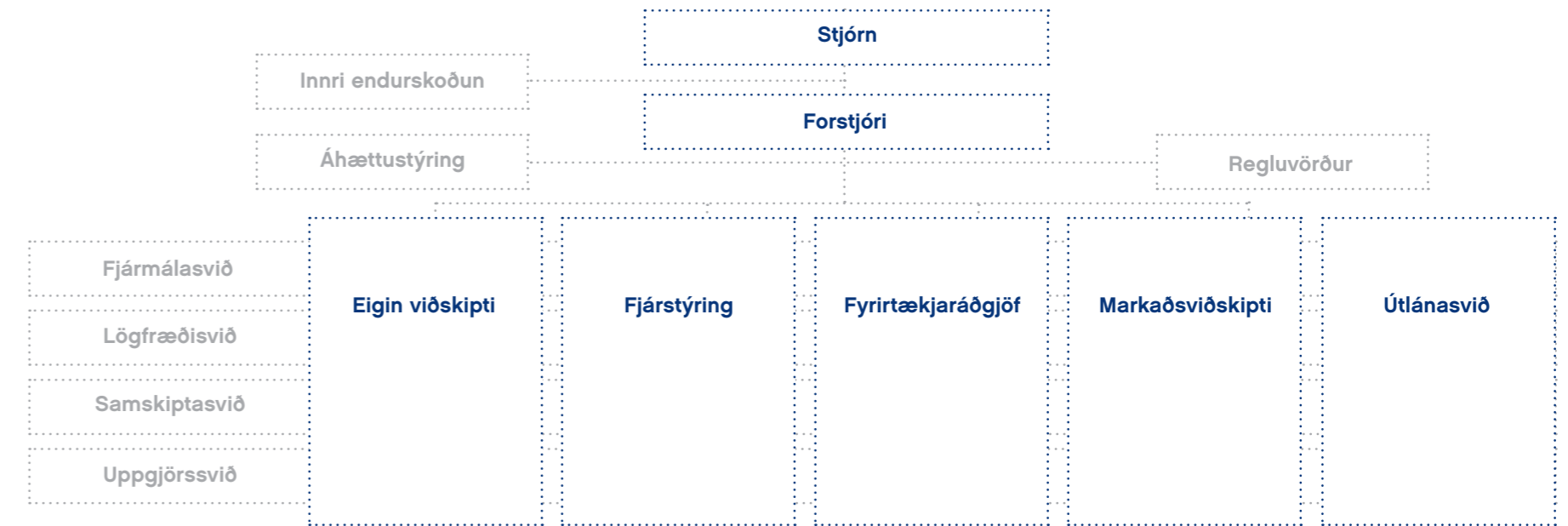
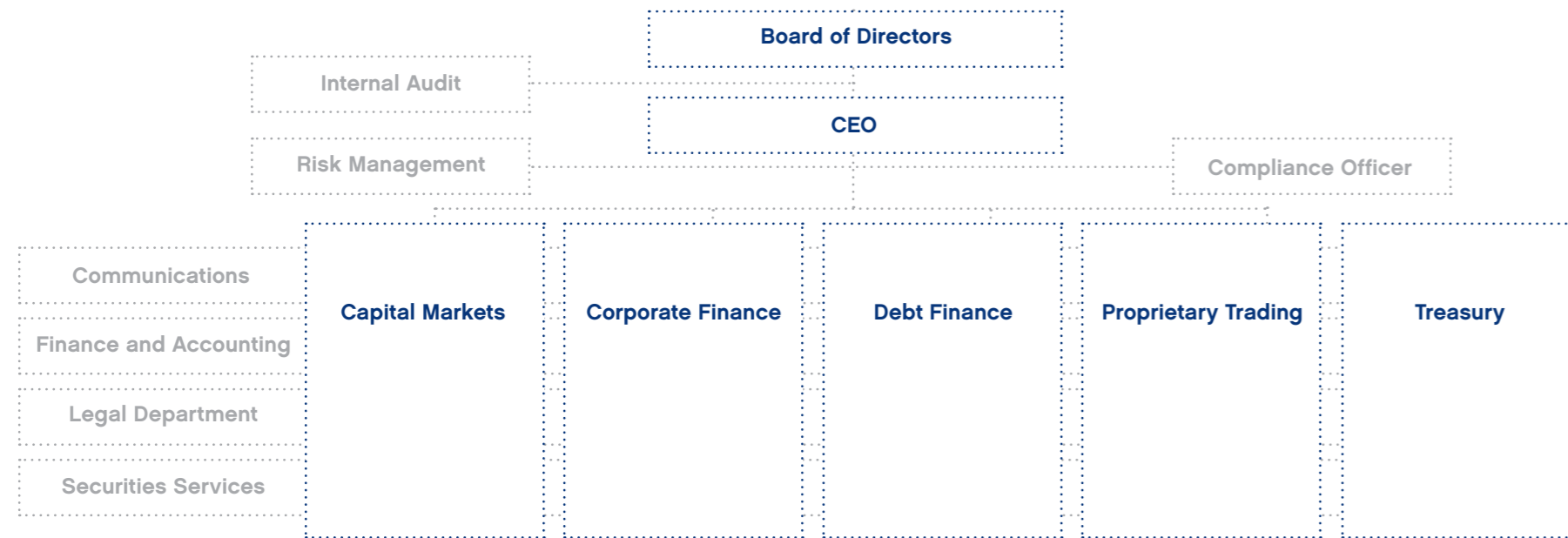
Önnur trúnaðarstörf, þ.á.m. stjórnarseta í öðrum félögum: **Eignarhaldsfélagið**

**Nidjaland ehf., Larsen Group hf., Cave Japan ehf., CRI ehf., B. Magnusson hf., Reykjavík Records ehf.**

Beinir og óbeinir eignarhlutir í Saga Capital: **Engir.**

Kaup- eða söluréttarsamningar við Saga Capital: **Engir.**

Maki: **Kristbjörg Sigurðardóttir.**



**The largest shareholders in Saga Capital are as follows: | Stærstu hluthafar í Saga Capital eru eftirtaldir aðilar:**

1.....	Thorvaldur Ludvik Sigurjonsson.....	12.07%.....	1,170,455,000
2.....	Sundagardar hf.....	10.31%.....	1,000,000,000
3.....	KEA eignir ehf.....	9.41%.....	913,043,487
4.....	Tammuz ehf.....	7.22%.....	700,000,000
5.....	AB-fjarfestingafelag.....	5.15%.....	500,000,000
6.....	Byr sparisjodur.....	4.74%.....	460,000,000
7.....	Gnupverjar ehf.....	4.10%.....	400,000,000
8.....	AB 150 ehf.....	3.09%.....	300,000,000
9.....	Sparisjodur Svarfdaela.....	3.09%.....	300,000,000
10.....	Gift fjarfestingarfelag ehf.....	2.69%.....	260,869,565
11.....	Sparisjodurinn in Keflavik.....	2.69%.....	260,869,565
<b>Total   Samtals.....</b>		<b>64.56%.....</b>	<b>6,265,237,617</b>

April 2009



## MILESTONES OF OPERATIONS IN 2008

**CAPITAL MARKETS** | Saga Capital's Capital Markets department continued where it left off in the previous years with an ongoing emphasis on bond trading. A special emphasis was on strong product development and professional services to the parties of the bond market. Capital Markets added commodities and commodity-related instruments to the bank's product base through cooperation with Commerzbank.

As prices on international stock markets dropped, the turnover decreased and investors became increasingly risk averse, paving the way for an increased demand for non-traditional products. Capital Markets responded to this demand by increasing product development, for instance option contracts

## ÁFANGAR Í REKSTRI ÁRIÐ 2008

**MARKAÐSVIÐSKIPTI** | Markaðsviðskipti Saga Capital tóku upp þráðinn frá fyrra ári með áframhaldandi áherslu á skuldabréfviðskipti. Sérstök áhersla var lögð á öfluga vörupróun og faglega þjónustu við aðila skuldabréfamarkaðarins. Þá bættu Markaðsviðskipti hrávörum og hrávörutengdum fjármálagerningum við vöruframboð bankans með samstarfi við Commerzbank.

Með lækkandi verðum á alþjóðlegum hlutabréfamörkuðum minnkaði velta og áhættufælni fjárfesta jókst og í kjölfarið jókst eftirspurn eftir óhefðbundnum vörum. Markaðsviðskipti brugðust við þessari eftirspurn með aukinni vörupróun, meðal annars með því að bjóða valréttarsamninga á íslenska hlutabréfa-

for the Icelandic stock market. As winter approached the proportion of bond turnover kept increasing but the wake of the collapse of Icelandic banks saw the securities market come to an almost complete halt. Once markets were reopened turnover figures were much lower than before, on stock markets and bond markets alike.

The collapse of the banks also meant that Icelandic municipalities needed to seek new means of funding, as lending activities of financial institutions were limited. Capital Markets met this need by managing bond issues for municipalities. Capital Markets were in charge of the sale of bond classes worth ISK 3 billion for the Municipality of Kopavogur and ISK 1 billion for Arborg Municipality, with Icelandic pension funds representing the majority of buyers. These bond classes were listed on the Iceland Stock Exchange; the first time municipality bond classes were listed on the Exchange since 2005.

The year 2009 has got off to a bright start. Capital Markets have managed bond issues for two municipalities and for the Institute of Regional Development in the first two months of the year; a sign that Saga Capital will play an important role in the funding of municipalities through bond issues for the remainder of the year.

**CORPORATE FINANCE** | Saga Capital's Corporate Finance department provides advice and assistance on acquisitions, sale, mergers and takeovers of companies and operating units. Corporate Finance's activities in 2008 were characterised

markaðinn. Með haustinu hélt hlutfall skuldabréfaveltu áfram að aukast en í kjölfar bankahrunsins stöðvuðust tímabundið nær öll viðskipti með verðbréf. Þegar markaðir voru opnaðir að nýju voru veltutölur mun lægri, bæði á hlutabréfa- og skuldabréfamarkaði.

Bankahrúnið hafði einnig þau áhrif að sveitarfélög landsins þurftu að leita nýrra fjármögnunarleiða þar sem fjármálastofnanir héldu að sér höndum við að veita ný útlán. Markaðsviðskipti Saga Capital mættu þeirri þörf með umsjón skuldabréfaútboða fyrir sveitarfélög. Markaðsviðskipti Saga Capital sáu um sölu á þriggja milljarða skuldabréfaflokki fyrir Kópavogsbæ og eins milljarðs skuldabréfaflokki fyrir Sveitarfélagið Árborg, en stærstu kaupendur skuldabréfanna voru íslenskir lífeyrissjóðir. Þessir skulda bréfaflokkar voru í kjölfarið skráðir í Kauphöll Íslands og var þetta í fyrsta sinn síðan árið 2005 sem skuldabréfaflokkar sveitarfélaga voru skráðir í Kauphöllina.

Árið 2009 fer vel af stað. Markaðsviðskipti hafa haft umsjón með skuldabréfaútboðum tveggja sveitarfélaga og Byggðastofnunar á fyrstu tveimur mánuðum ársins og fyrirséð er að Saga Capital muni sinna mikilvægu hlutverki í fjármögnun sveitarfélaga með skuldabréfaútboðum það sem eftir lifir árs.

**FYRIRTEKJARÁÐGJÖF** | Fyrirtækjaráðgjöf Saga Capital veitir ráðgjöf og aðstoð í tengslum við kaup, sölu, samruna og yfirtöku fyrirtækja og rekstrareininga. Starfsemi Fyrirtækjaráðgjafar árið 2008 einkenndist af miklum hræringum á fjármálamörkuðum og breytingu á öllu starfsumhverfi.

“...Saga Capital will play an important role in the funding of municipalities through bond auctions for the remainder of the year.”

by the seismic events on financial markets and a drastic change in the operational environment.

Despite the difficult conditions, Corporate Finance worked on various projects. As an example, in early 2008 Saga Capital managed the sale of Air Iceland's fleet of Twin Otter aeroplanes, when the airline decided to separate the operation of the Twin Otters from other operations, selling all assets in relation to the planes. Saga Capital was in charge of all advice concerning the separation and sale of the operations.

In March, Corporate Finance oversaw the merger of Íslenskir fjallaleidsögumenn ehf. (Icelandic Mountain Guides) and Íslandsflakkarar ehf.; resulting in one of the largest outdoor activities companies in Iceland, offering a variety of hiking, incentive and adventure trips. Saga Capital also facilitated Icelandic Mountain Guides' purchase of Íslenski ferðamarkadurinn ehf., a company specialising in servicing foreign tourists and selling various day trips, sightseeing tours and other entertainment.

Corporate Finance also played a role in the sale of Islandia Hotel ehf, operator of Islandia Hotel Núpur, located near mount Lomagnupur, around midway between Kirkjubæjarklaustur and Skaftafell.

“...fyrirséð er að Saga Capital muni sinna mikilvægu hlutverki í fjármögnun sveitarfélaga með skuldabréfaútboðum það sem eftir lifir árs.”

Þrátt fyrir erfitt árferði vann Fyrirtækjaráðgjöf að mörgum fjölbreyttum verkefnum. Sem dæmi má nefna að snemma árs 2008 önnuðust starfsmenn Saga Capital sölu á Twin Otter flugvélum Flugfélags Íslands þegar Flugfélagið ákvað að skilja rekstur Twin Otter flugvélna frá öðrum rekstri og selja þær eignir sem fylgdu flugvélunum út úr fyrirtækinu. Saga Capital sá um alla ráðgjöf varðandi aðskilnað á rekstrinum og sölu hans.

Í mars hafði Fyrirtækjaráðgjöf milligöngu um sameiningu Íslenskra fjallaleiðsögumanna ehf. og Íslandsflakkarar ehf. en við þessa sameiningu varð til eitt öflugasta útivistarfyrirtæki landsins í rekstri og sölu á göngu-, hvata- og ævintýraferðum. Saga Capital hafði jafnframt milligöngu um kaup Íslenskra fjallaleiðsögumanna ehf. á Íslenska ferðamarkaðnum ehf. sem hefur sérhæft sig í þjónustu við erlenda ferðamenn og selur fjölbreytt úrval dagsferða, skoðunarferða og afþreyingar.

Þá hafði Fyrirtækjaráðgjöf Saga Capital milligöngu um sölu á Islandia Hotel ehf. sem rekur Islandia Hótel Núpur sem er staðsett í landi jarðarinnar Núpa við Lómagnúp, um miðja vega á milli Kirkjubæjarklausturs og Skaftafells.

Þær gríðarmiklu sviptingar sem urðu á fjármálamörkuðum seinni

The financial crisis in the latter part of 2008 led to a decrease in the trading of companies both domestically and internationally. However, every cloud has a silver lining, as the crisis involves many possibilities and exciting investment opportunities, and it seems likely that company mergers will increase in the course of 2009.

**DEBT FINANCE** | The year 2008 was in many ways an unusual year for lending departments of Icelandic banking institutions. New lending by Saga Capital's Debt Finance division was minimal but nevertheless the value of Saga Capital's loan portfolio increased by 53% in Icelandic krona. The increased lending amount is first and foremost due to the excessive depreciation of the krona, as a large part of the bank's loan portfolio is in foreign currency.

Like other credit institutions in Iceland, Saga Capital has been affected by the great uncertainty on the markets. Many of the bank's clients have fared well while others have experienced major difficulties. The bank's employees have done their best to assist and find solutions for clients in need of such services.

The consequence of these disastrous events is that the bank's provision for bad and doubtful debts and guarantees amounted to ISK 1,955 million for the year 2008 compared to 29 million for 2007.

The year 2009 has got off to a promising start for Debt Finance and despite the difficulties facing the Icelandic economy there is a wide range of opportunities on the horizon for a specialised bank like Saga Capital.

hluta ársins 2008 leiddu meðal annars til minnkandi viðskipta með fyrirtæki á innlendum sem erlendum markaði. En fátt er svo með öllu illt, því ljóst er að í þessum hræringum felast miklir möguleikar og spennandi fjárfestingartækifæri og útlit er fyrir að mikið verði um samruna fyrirtækja þegar líða tekur á árið 2009.

**ÚTLÁNASVIÐ** | Árið 2008 var um margt óhefðbundið ár í útlánastarfsemi íslenskra bankastofnana. Þannig voru nýjar lánveitingar hjá Útlánasviði Saga Capital í lágmarki en þrátt fyrir það jókst upphæð útlána Saga Capital um 53% í íslenskum krónum. Aukning útlánanna var fyrst og fremst knúin áfram af mikilli veikingu krónunnar en stór hluti lánasafns bankans er í erlendri mynt.

Líkt og aðrar lánastofnanir landsins hefur Saga Capital ekki farið varhluta af þeim mikla óróa sem geisad hefur á mörkuðum. Fyrirtækjum í viðskiptum við bankann hefur mörgum vegnað ágætlega en önnur hafa lent í ólgusjó og starfsmenn bankans hafa lagt sig alla fram við að aðstoða og vinna að lausnum með þeim viðskiptavinum sem hafa þurft á því að halda.

Afleiðingin af þessum miklu sviptingum er sú að afskriftir útlána og ábyrgða voru 1,955 milljónir á árinu 2008 samanborið við 29 milljónir árið 2007.

Árið 2009 fer þó vel af stað hjá Útlánasviði og ljóst er að þrátt fyrir þær hremmingar sem íslenskt atvinnulíf er að ganga í gegnum eru mörg tækifæri framundan fyrir sérhæfðan banka eins og Saga Capital.

**PROPRIETARY TRADING** | During the first months of 2008 it was decided to significantly reduce risk in the bank's portfolio. This operation went as planned and by mid-year the bulk of the portfolio consisted of bonds issued in Iceland.

Domestic and foreign financial markets experienced difficulties during the year and at the tail end of 2008 some unprecedented events occurred, resulting in the collapse of the three Icelandic commercial banks. The consequences of this system breakdown are huge and the collapse had a considerable impact on Saga Capital's portfolio. As a result, a massive effort to guarantee and preserve the bank's equity was undertaken. The conclusion is, that despite the major setbacks in 2008, the bank's equity base remains solid, ensuring a safe future for the bank on the domestic market.

“...every cloud has a silver lining, as the crisis involves many possibilities and exciting investment opportunities, and it seems likely that company mergers will increase in the course of 2009.”

**EIGIN VIÐSKIPTI** | Á fyrstu mánuðum ársins 2008 var tekin sú ákvörðun að draga verulega úr áhættu í eignasafni bankans. Sú aðgerð tókst með ágætum og var stærsti hluti eignasafnsins um mitt árið í skuldabréfum útgefnum af innlendum aðilum.

Innlendir og erlendir fjármálamarkaðir áttu erfitt uppdráttar á árinu og á seinni hluta ársins áttu sér stað atburðir sem eiga sér fáar hliðstæður og hrun íslensku viðskiptabankanna þriggja varð staðreynd. Afleiðingar þessa kerfishruns eru gríðarlegar og sviptingarnar höfðu töluverð áhrif á eignasafn Saga Capital. Í kjölfarið hefur mikil vinna verið lögð í að tryggja og varðveita eigið fé bankans. Niðurstaðan er sú að þrátt fyrir þau miklu áföll sem urðu á árinu 2008 er eiginfjárgrunnur bankans áfram sterkur sem tryggir örugga framtíð bankans á innlendum markaði.

“...ljóst er að í þessum hræringum felast miklir möguleikar og spennandi fjárfestingartækifæri og útlit er fyrir að mikið verði um samruna fyrirtækja þegar líða tekur á árið 2009.”

## GOOD CORPORATE GOVERNANCE

Since Saga Capital began operation, it has upheld a policy of comprehensive professionalism in all its activities. Saga Capital's employees strive to secure full confidentiality and equality towards and among their customers, with great emphasis on transparency as regards shareholders and clients. Risk management and compliance are vital parts of the bank's activities, which along with the bank's other operations are regularly reviewed by the Internal Auditor. The Internal Auditor reports his or her findings to the Board and to the Financial Supervisory Authority twice a year.

Saga Capital deems it of the utmost importance to guarantee that the bank's compliance is always first class. The bank's Compliance Officer is independent and thus conducive to Saga Capital's healthy and credible operations. Saga Capital's Compliance Officer is appointed by the bank's Board of Directors, subject to the review of the bank's Internal Auditor and regularly reports to the bank's Board of Directors. The Compliance Officer's obligation is to ensure that the bank's activities are always in accordance with current laws and regulations. Saga Capital has adopted the following rules pertaining to good corporate governance:

**a. Rules of procedure for trading in own account.** The objective of these rules is to ensure impartiality towards customers and equality among them, to prevent conflicts of interest, to guarantee that employees are independent in their work, and

## GÓÐIR STJÓRNARHÆTTIR

Frá stofnun Saga Capital hefur það verið stefna bankans að viðhafa fagleg vinnubrögð í allri starfsemi sinni. Starfsmenn Saga Capital leggja sig fram við að gæta fyllsta trúnaðar og jafnræðis gagnvart viðskiptamönnum sínum og mikil áhersla er lögð á gegnsæi gagnvart hluthöfum og viðskiptamönnum. Þá er rík áhersla lögð á áhættustýringu og regluvörslu sem, ásamt annarri starfsemi bankans, er yfirfarin af innri endurskoðanda með reglubundnum hætti. Innri endurskoðandi skilar skýrslu um störf sín til stjórnar og Fjármálaeftirlitsins tvisvar á ári.

Saga Capital telur mjög mikilvægt að regluvörslu bankans sé ávallt í hæsta gæðaflokki. Regluvörður bankans er sjálfstæður í störfum sínum og stuðlar þannig að heilbrigðum og trúverðugum rekstri Saga Capital. Regluvörður Saga Capital er tilnefndur af stjórn bankans og er undir eftirliti innri endurskoðanda og skilar reglulega skýrslum til stjórnar um störf sín. Regluvörður hefur eftirlit með að starfsemi bankans sé ávallt í samræmi við lög og reglur hverju sinni. Saga Capital hefur sett sér eftirfarandi reglur sem lúta að góðum stjórnarháttum:

**a. Verklagsreglur um eigin viðskipti.** Hafa það að markmiði að stuðla að óhlutdrægni gagnvart viðskiptavinum og jafnræði

„Starfsmenn Saga Capital leggja sig fram við að gæta fyllsta trúnaðar og jafnræðis gagnvart viðskiptamönnum sínum og mikil áhersla er lögð á gegnsæi gagnvart hluthöfum og viðskiptamönnum“

to safeguard confidentiality and credibility relating to Saga Capital's proprietary trading.

**b. Rules of procedure for the board of directors.** These rules are intended to be conducive to equality in the handling of issues presented to the board; they should guarantee independent proceedings of a high standard while preventing conflicts of interests in Saga Capital's activities. By adopting these rules of procedure the platform for any trading by Board members, affiliated companies and the bank itself is strengthened, while at the same time Board members' access to information on customers is limited.

**c. Saga Capital's rules on measures to counteract money laundering and the funding of terrorism.** These rules of procedure aim at preventing the bank's activities from being used for money laundering or to finance terrorism. By adopting these rules Saga Capital meets the strict demands placed upon financial institutions in connection with such issues both domestically and internationally.

**d. Saga Capital's policy on conflicts of interest.** This policy is intended to prevent conflicts of interest between the bank

þeirra á milli, koma í veg fyrir hagsmunaárekstra, tryggja að starfsmenn séu óháðir í störfum sínum og að fyllsta trúnaðar og trúverðugleika sé gætt í hvívetna í viðskiptum Saga Capital fyrir eigin reikning.

**b. Starfsreglur stjórnar.** Er ætlað að stuðla að jafnræði við meðferð þeirra mála sem koma fyrir stjórn, tryggja vandaða og óháða málsmeðferð sem og að koma í veg fyrir hagsmunaárekstra í starfsemi Saga Capital. Með starfsreglum stjórnar er umgjörð um öll viðskipti stjórnarmanna, tengdra aðila og bankans styrkt og aðgangur stjórnarmanna að upplýsingum um viðskiptamenn takmarkaður.

**c. Reglur Saga Capital um varnir gegn peningþvætti og fjármögnun hryðjuverka.** Hafa það markmið að koma í veg fyrir að starfsemi bankans verði nýtt við peningþvætti eða til þess að fjármagna hryðjuverkastarfsemi. Með reglunum mætir Saga Capital ýrustu kröfum sem gerðar eru í þeim efnum til fjármálafyrirtækja á innlendum og alþjóðlegum vettvangi.

**d. Stefna Saga Capital um hagsmunaárekstra.** Er ætlað er að koma í veg fyrir hagsmunaárekstra, milli bankans og viðskiptavina hans annars vegar og milli viðskiptavina bankans innbyrðis hins vegar, einkum á sviði verðbréfavíðskipta.

Regluvörður hefur eftirlit með að framangreindum reglum sé fylgt í starfsemi bankans og hefur forgöngu um túlkun á reglunum. Hann sér um kynningu á reglunum, endurskoðun þeirra og endurmenntun gagnvart starfsmönnum.

and its customers on the one hand, and internally amongst the bank's customers on the other, particularly in the field of securities transactions.

The Compliance Officer monitors compliance with the above-mentioned rules in the bank's activities, and is the bank's authority when it comes to interpret the rules. The Compliance Officer is responsible for presenting the rules, reviewing them, and for employee training and re-training.

**e. Remuneration policy.** The bank's remuneration policy is proposed by the Board at the annual general meeting, where it is then confirmed. The remuneration policy is binding for the bank's Board of Directors regarding payments in the form of shares in the bank, purchase and selling rights, first options and other kinds of remuneration related to shares in the bank or a development of their price. The objective of presenting and approving the remuneration policy at the bank's annual general meeting is to set rules of proceedings, providing shareholders with increased influence and overview of the bank's policies regarding remuneration for its directors and Board members. This ensures the availability of clear information regarding the remuneration of the bank's senior directors.

From the company's inception, the remuneration of Saga Capital's directors and employees have been moderate and are comparable or lower than the current remuneration of directors at the nationalised commercial banks.

**e. Starfskjarastefna.** Er lögð fram samkvæmt tillögu stjórnar bankans á aðalfundi þar sem hún er staðfest. Starfskjarastefnan er bindandi fyrir stjórn bankans að því er varðar greiðslur í formi hlutabréfa í bankanum, kaup- og sölurétt þeirra, forkaupsrétt og annars konar greiðslna sem tengdar eru hlutabréfum í bankanum eða þróun á verði þeirra. Markmið með kynningu og samþykkt starfskjarastefnu á aðalfundi bankans er að setja málsmeðferðarreglur sem veita hluthöfum aukin áhrif og yfirsýn yfir stefnu bankans varðandi starfskjör stjórnenda og stjórnarmanna. Þannig liggja ávallt glöggar upplýsingar fyrir um starfskjör æðstu stjórnenda bankans.

Starfskjör stjórnenda og starfsmanna Saga Capital hafa frá stofnun bankans verið hófleg og eru sambærileg eða lægri en kjör stjórnenda núverandi ríkisbanka.

**LEIÐBEININGAR UM STJÓRNARHÆTTI FYRIRTEKJA |** Frá stofnun hefur Saga Capital lagt ríka áherslu á góða stjórnarhætti sem mikilvægan þátt í að tryggja nauðsynlegan trúverðuleika bankans og stjórnenda hans. Saga Capital hóf því að eigin frumkvæði innleiðingu á annarri útgáfu Leiðbeininga um stjórnarhætti fyrirtækja, sem gefin var út árið 2005 af Viðskiptaráði Íslands, Kauphöll Íslands og Samtökum atvinnulífsins.

Skipun endurskoðunarnefndar af stjórn bankans er hluti af þessari innleiðingu. Hún hefur eftirlit með gerð reikningsskila, innri eftirlitskerfum, innri endurskoðun, áhættustýringu, endurskoðun ársreiknings og öðrum fjárhagslegum upplýsingum og óhæði

**INSTRUCTIONS ON CORPORATE GOVERNANCE |** Since Saga Capital began operation, the bank has emphasised good governance practices as an important part of guaranteeing the necessary credibility of the bank and its directors. Therefore Saga Capital, on its own initiative, started the implementation of the second edition of the Instructions for Corporate Governance, issued in 2005 by the Iceland Chamber of Commerce, the Iceland Stock Exchange and the Confederation of Icelandic Employers.

The appointment of a review committee is a part of this process. The committee will observe accounting, internal monitoring systems, internal audit, risk management, the audit of annual statements and other financial information, and the independence of the bank's auditor. In addition, the review committee will submit a proposal for choosing an auditor or auditing firm.

Implementation of the Instructions for Corporate Governance will be completed in 2009.

**INFORMED DIRECTORS AND EMPLOYEES |** Good corporate governance is rooted with the bank's directors and employees. Directors and employees must always be informed of their duties and the rights of customers and shareholders at any time.

In the beginning of each operating year of Saga Capital's Board of Directors, all Board members and their substitutes are

endurskoðanda. Endurskoðunarnefnd gerir enn fremur tillögu um val á endurskoðanda eða endurskoðunarfyrirtæki. Innleiðingu Leiðbeininga um stjórnarhætti fyrirtækja verður að fullu lokið á árinu 2009.

**UPPLÝSTIR STJÓRNENDUR OG STARFSMENN |** Rætur góðra stjórnarháttanna liggja hjá stjórnendum og starfsmönnum bankans. Rík áhersla er lögð á að stjórnendum og starfsmenn séu ávallt upplýstir um skyldur sínar og réttindi viðskiptamanna og hluthafa hverju sinni.

Í upphafi hvers starfsárs stjórnar Saga Capital er aðal- og varamönnum í stjórn afhent handbók með helstu lögum og reglum sem gilda um starfsemi bankans og á þeim markaði sem hann starfar. Einnig er þeim afhent handbók sem inniheldur allar innri starfsreglur bankans. Þá er árlega afhent handbók sem unnin er af Lögfræðisviði bankans þar sem ítarlega er farið yfir skyldur og ábyrgð stjórnarmanna. Framan- greindar handbækur eru uppfærðar þegar tilefni gefst til.

Nýjum stjórnendum sem og öðrum starfsmönnum er skylt að taka þátt í sérstöku nýliðanámskeiði þegar þeir hefja störf, þar sem starfsemi Saga Capital og þær reglur sem bankinn starfar eftir eru kynnt. Einnig eru reglulega haldin endurmenntunarnámskeið fyrir alla starfsmenn auk sérstakra námskeiða á viðkomandi sérsviðum starfsmanna.

**FRUMKVÆÐI UM FRAMPRÓUN FJÁRMÁLA-MARKAÐA |** Umrót síðustu missera hefur leitt til falls

handed a manual containing the latest version of the law and regulations applying to the bank's activities and the market in which it operates. They also receive a manual containing all the bank's internal rules of procedure. Annually, a manual composed by the bank's Legal Department is delivered, detailing the duties and responsibilities of Board members. The above manuals are updated when needed.

New directors and other employees are obliged to attend a special course for new recruits when they start working for the bank, where the activities of Saga Capital and the rules governing the bank are presented. There are also regular re-training courses for all employees, in addition to specialised courses in the respective employees' field of expertise.

#### **INITIATIVE FOR THE FORWARD DEVELOPMENT OF FINANCIAL MARKETS** |

The uproar during the last few months has led to the collapse of four Icelandic commercial banks, which have since been nationalised by the government. Currently Saga Capital is one of the largest privately owned financial institutions in Iceland relative to equity. This provides new opportunities as well as a new role, which Saga Capital will take seriously and perform responsibly. Saga Capital has set its sights on always being at the forefront in development and implementation of new and improved corporate governance, taking the initiative in an informed debate on the forward development of financial markets.

fjögurra íslenskra viðskiptabanka sem teknir hafa verið yfir af stjórnvöldum. Nú er svo komið að Saga Capital er eitt stærsta fjármálafyrirtæki á Íslandi í einkaeigu, miðað við eigið fé. Í þessu felast ný sóknarfæri sem og nýtt hlutverk sem Saga Capital mun taka alvarlega og sinna með ábyrgum hætti. Saga Capital hefur einsett sér að vera ávallt í fararbroddi í þróun og innleiðingu nýrra og bættra stjórnarháttanna og taka frumkvæði í upplýstri umræðu um framþróun fjármálamarkaða.

“Saga Capital has set its sights on always being at the forefront in development and implementation of new and improved corporate governance, taking the initiative in an informed debate on the forward development of financial markets.”

„Saga Capital hefur einsett sér að vera ávallt í fararbroddi í þróun og innleiðingu nýrra og bættra stjórnarháttanna og taka frumkvæði í upplýstri umræðu um framþróun fjármálamarkaða.“

## RISK MANAGEMENT

The unprecedented events that have taken place in the Icelandic and international financial markets have radically changed the operational environment of companies and organisations. Under these ever-changing and unstable conditions Saga Capital's emphasis on an accurate, extensive and active risk management has proved its worth time and time again.

**Saga Capital's risk management is based on three elements:**

- 1. Decision making:** An organised platform for all decisions related to risk exposure
- 2. Risk control:** A defined decision making process when risks are taken
- 3. Monitoring:** Active monitoring of existing risks

**The main risk factors in Saga Capital's operations are:**

- 1. Counterparty risk:** The risk of loss due to changed credit standing of a counterparty or borrower
- 2. Market risk:** The risk of loss due to fluctuations in interest rates, the market price of securities or foreign exchange rates
- 3. Operational risk:** The risk of loss due to mistakes, system failures or external events
- 4. Liquidity risk:** The risk of loss due to the bank not being able to meet its liabilities when they are due

	Decision making	Risk control	Monitoring
<b>Counterparty risk</b>	Credit committee	Lending process	Weekly monitoring of loans and defaults  Quarterly review of loan portfolio
<b>Market risk</b>	Market risk committee	Investment process	Daily reports on market, interest rate and currency risks
<b>Operational risk</b>	Security committee	Training of staff  Documented business processes  Separation of operational areas	Registration of operational incidents  Weekly reports on operational incidents
<b>Liquidity risk</b>	Asset liability committee (ALCO)	Financing process	Weekly reports on liquidity position and cash flow

	Ákvarðanataka	Áhættustjórnun	Eftirlit
<b>Mótaðila-áhætta</b>	Lánanefnd	Útlánaferli	Vikulegt eftirlit með útlánnum og vanskilum  Ársfjórðungsleg úttekt á útlánasafni
<b>Markaðs-áhætta</b>	Markaðs-áhættunefnd	Fjárfestingarferli	Daglegar skýrslur um markaðs-, vaxta- og gjaldeyrisáhættu
<b>Rekstrar-áhætta</b>	Öryggisráð	Fræðsla starfsfólks  Skráð verkferli  Aðgreining starfssviða	Skráning rekstrarvika  Vikulegar skýrslur um rekstrarvik
<b>Lausafjár-áhætta</b>	Lausafjárnefnd (ALCO)	Fjármögnunarferli	Vikulegar skýrslur um lausafjárstöðu og greiðsluflæði

## ÁHÆTTUSTÝRING

Þær gríðarlegu sviptingar sem orðið hafa á íslenskum og alþjóðlegum fjármálamarkaði hafa gjörbreytt rekstrarumhverfi fyrirtækja og félaga. Í þessu síbreytilega og óstöðuga umhverfi hefur áhersla Saga Capital á nákvæma, ítarlega og virka áhættustýringu margsannað sig.

**Áhættustýring Saga Capital byggir á þremur liðum:**

- 1. Ákvarðanataka:** Skipulagður vettvangur fyrir alla ákvarðanatöku sem varðar áhættu
- 2. Áhættustjórnun:** Skilgreint ákvörðunarferli þegar tekin er áhætta
- 3. Eftirlit:** Virkt eftirlit með þeirri áhættu sem þegar er til staðar

**Helstu áhættupættir í rekstri Saga Capital eru:**

- 1. Mótaðilaáhætta:** Hætta á tapi vegna breytts greiðsluhæfis mótaðila eða lántakanda
- 2. Markaðsáhætta:** Hætta á tapi vegna breytinga á vöxtum, markaðsgengi verðbréfa eða gengi gjaldmiðla
- 3. Rekstraráhætta:** Hætta á tapi vegna mistaka, kerfisbilana eða ytri atburða
- 4. Lausafjáráhætta:** Hætta á tapi vegna þess að bankinn geti ekki staðið við skuldbindingar sínar þegar þær gjaldfalla



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## ENDORSEMENT BY THE BOARD OF DIRECTORS AND THE CEO

### To the shareholders of Saga Capital Investment Bank hf.

Saga Capital provides its customers with services in relation to corporate advisory service, loans and brokerage services. The financial statements of Saga Capital Investment Bank hf. are prepared according to International Financial Reporting Standards (IFRSs), as adopted by the EU.

**Return and equity.** The Bank incurred a loss on its operation in the year 2008 in the amount of ISK 3,673 million according to the income statement. Equity at year end amounted to ISK 6,178 million according to the balance sheet. The Bank's equity ratio calculated according to law on financial companies was 15,1% at year end 2008. According to the law, the ratio shall not be lower than 8%. The Bank's Board of Directors proposes that no dividends shall be paid to shareholders in the year 2009 due to the operating year 2008, but there is no precondition for dividend payment according to law. Reference is made to the financial statements for further information on allocation of profit or loss and other changes in equity.

**Overview of main events of the year.** At the beginning of October, an Emergency Act on financial markets was passed and resolution committees were established to take over the commercial banks. The fall of the banks and the development of financial markets in general has significantly affected the operation of the Bank and has had as well extensive effect on

the business environment. The ability of the Bank's customers to repay their liabilities with the Bank has decreased and precautionary write-downs have thus increased considerably. It will take some time to evaluate the definitive effect of the fall of the banks. The Bank had both assets and liabilities in the commercial banks at the time they were taken over by the Icelandic Financial Supervisory Authority. The Bank has assessed these balances and recognised the effect in the financial statements.

During the year, the Bank interceded liquidity facility to Glitnir bank hf. and Kaupthing bank hf. with REPO and securities lending transactions with the Icelandic Central Bank. As collateral for the mortgage credit from the Icelandic Central Bank the Bank provided bonds purchased from Glitnir bank hf. and Kaupthing bank hf. Following the fall of both Glitnir bank hf. and Kaupthing bank hf., the Bank had to provide further assets as collateral for the mortgage credit from the Icelandic Central Bank. At the end of the year, the State Treasury acquired from the Icelandic Central Bank its claim on the Bank according to the mortgage credit and thereby the relevant collaterals were transferred to the State Treasury. Notes 37 and 46 to the financial statements include further information thereon.

**Shareholders.** At year end 2008, the Bank's total share capital amounted to ISK 9,700 million, whereof the Bank's own shares amounted to ISK 127 million. Shareholders numbered 97 at year

end compared to 93 the previous year. At year end, two shareholders held more than 10,0% in the issued share capital of the Bank, Þorvaldur Lúðvík Sigurjónsson, with a 12,1% share and Sundargarðar ehf., with a 10,3% share.

**Opinion and endorsement by the Board of Directors and the CEO.** According to the best knowledge of the Board of Directors and the CEO, the financial statements of the Bank are in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU and it is the opinion of the Board of Directors and the CEO that the financial statements give a fair view of the Bank's financial performance in the year 2008, assets, liabilities and its financial standing as at 31 December 2008 and changes in cash and cash equivalents during the year 2008.

Furthermore, it is the opinion of the Board of Directors and the CEO that the financial statements and the endorsement by the Board of Directors and the CEO include a fair overview of the development and results in the Bank's operation, its standing and describes the Bank's main risk exposure.

The Board of Directors and the CEO of Saga Capital Investment Bank hereby confirm the Bank's financial statements for the year 2008 by means of their signatures.

Akureyri, 21 April 2009.

### The Board of Directors

**Halldor Johannsson,** Chairman

**Johann Antonsson**

**Robert Melax**

**Gunnar Thor Gislason**

**Sindri Sindrason**

**Thorvaldur Ludvik Sigurjonsson,** CEO

## INDEPENDENT AUDITOR'S REPORT

To the Board of Directors and shareholders of Saga Capital Investment Bank hf.

We have audited the accompanying financial statements of Saga Capital Investment Bank hf., which comprise the balance sheet as at December 31, 2008, and the income statement, statement of equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

### Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these 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 account-

ing estimates that are reasonable in the circumstances.

**Auditor's Responsibility.** Our responsibility is to express an opinion on these 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 financial statements give a true and fair view of the financial position of the Bank as at December 31, 2008, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU.

**Emphasis of matter.** Without qualifying our opinion, we would like to draw the attention to note 48 to the financial statements, which discusses probable effect of unimplemented provisions of EU Directives on the Bank's equity ratio.

Akureyri, 21 April 2009.

**KPMG Endurskoðun Akureyri hf.**

Arnar Arnason



Reynir Stefan Gylfason



## INCOME STATEMENT FOR THE YEAR 2008

	Notes	2008	2007
Interest income		4,217,623	1,068,583
Interest expenses		( 3,227,442)	( 927,747)
<b>Net interest income from ordinary operation</b>	19	<u>990,180</u>	<u>140,836</u>
Financial liability recognised through profit or loss	19	6,970,229	0
<b>Net interest income</b>		<u>7,960,409</u>	<u>140,836</u>
Fee income		286,490	415,265
Fee expenses		( 206,701)	( 103,575)
<b>Net fee income</b>	20	<u>79,788</u>	<u>311,690</u>
Expenses on financial assets and liabilities	21	( 10,797,125)	( 908,361)
Various operating revenue		47,750	7,750
<b>Total other operating income</b>		<u>( 10,749,375)</u>	<u>( 900,611)</u>
<b>Net operating income (negative)</b>		<u>( 2,709,178)</u>	<u>( 448,085)</u>
Salaries and salary related expenses	23	435,663	243,193
Other operating expenses		445,513	267,055
Depreciation of property, plant and equipment	41-42	40,973	19,974
<b>Total operating expenses</b>		<u>922,149</u>	<u>530,222</u>
Impairment loss on loans	7-8	1,895,965	29,245
<b>Loss before income tax</b>		<u>( 5,527,292)</u>	<u>( 1,007,552)</u>
Income tax	27	1,854,055	182,871
<b>Loss for the year</b>		<u>( 3,673,237)</u>	<u>( 824,681)</u>

Notes on page 55 - 102 are an integral part of these financial statements | Amounts are in ISK thousand

## BALANCE SHEET 31 DECEMBER 2008

	Notes	2008	2007
<b>Assets</b>			
Cash and cash equivalents	29	393,557	1,059,303
Receivables from credit institutions	30-31	1,104,945	803,779
Trading assets	32	11,092,757	22,888,547
Financial assets designated at fair value	35-37	10,620,957	6,039,068
Loans to customers	38-40	3,587,854	3,656,459
Intangible assets	41	33,908	36,617
Property, plant and equipment	42	70,109	67,421
Deferred tax asset	43	2,037,507	183,451
Other assets	44	367,873	3,713,418
<b>Total assets</b>		<u>29,309,467</u>	<u>38,448,063</u>
<b>Liabilities</b>			
Trading liabilities	45	64,308	232,688
Borrowings	46	22,397,372	23,297,521
Other liabilities	47	670,081	5,168,251
<b>Total liabilities</b>		<u>23,131,761</u>	<u>28,698,460</u>
<b>Equity</b>			
Share capital		9,573,331	9,554,645
Share premium		1,045,163	1,022,283
Other restricted capital		59,774	0
Accumulated deficit		( 4,500,562)	( 827,325)
<b>Total equity</b>	48-49	<u>6,177,706</u>	<u>9,749,603</u>
<b>Total assets and liabilities</b>		<u>29,309,467</u>	<u>38,448,063</u>

Notes on page 55 - 102 are an integral part of these financial statements | Amounts are in ISK thousand

## STATEMENT OF EQUITY FOR THE YEAR 2008

	Share Capital	Share premium	Other restricted capital	Accumulated deficit	Total
<b>Changes in equity in the year 2007</b>					
Equity at 1 January 2007	5,000	0	0	( 2,644)	2,356
Paid in share capital	9,666,314	1,074,784	0	0	10,741,098
Purchased own shares	( 116,669)	( 52,501)	0	0	( 169,170)
Loss for the year	0	0	0	( 824,681)	( 824,681)
<b>Equity as at 31 December 2007</b>	<u>9,554,645</u>	<u>1,022,283</u>	<u>0</u>	<u>( 827,325)</u>	<u>9,749,603</u>
<b>Changes in equity in the year 2008</b>					
Equity at 1 January 2008	9,554,645	1,022,283	0	( 827,325)	9,749,603
Accrued cost due to share options	0	0	59,774	0	59,774
Sold own shares	173,686	34,526	0	0	208,212
Purchased own shares	( 155,000)	( 11,646)	0	0	( 166,646)
Loss for the year	0	0	0	( 3,673,237)	( 3,673,237)
<b>Equity as at 31 December 2008</b>	<u>9,573,331</u>	<u>1,045,163</u>	<u>59,774</u>	<u>( 4,500,562)</u>	<u>6,177,706</u>

Notes on page 55 - 102 are an integral part of these financial statements | Amounts are in ISK thousand

## CASH FLOW STATEMENT FOR THE YEAR 2008

	Notes	2008	2007
<b>Cash flows from operating activities:</b>			
Loss before income tax		( 5,527,292)	( 1,007,552)
Operating items not affecting cash flows:			
Indexation recognised		341,624	0
Financial liability stated at fair value	19	6,970,229	0
Accrued cost due to share options	23	59,774	0
Amortisation of intangible assets	41	17,668	6,253
Depreciation of property, plant and equipment	42	23,306	13,721
Impairment loss on loans	7-8	1,895,965	29,245
Changes in operating assets and liabilities:			
Receivable from credit institutions		( 301,166)	( 803,779)
Trading assets		11,795,790	( 22,888,547)
Financial assets designated at fair value		( 4,581,889)	( 6,039,068)
Loans and receivables		( 1,613,374)	( 3,685,704)
Other assets		3,345,545	( 3,713,393)
Trading liabilities		( 168,380)	232,688
Borrowings		5,728,456	23,297,521
Other liabilities		( 4,751,802)	232,688
<b>Net cash used in operating activities</b>		<u>( 706,005)</u>	<u>( 9,395,774)</u>

Cash Flow Statement continued on next page:

Notes on page 55 - 102 are an integral part of these financial statements | Amounts are in ISK thousand

**Investing activities:**

Investment in intangible assets	41	( 14,958)	( 42,007)
Investment in property, plant and equipment	42	( 25,994)	( 75,956)

**Net cash used in investing activities**

	( 40,953)	( 117,963)
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**Financing activities:**

Paid in share capital		0	10,741,097
Sold own shares		208,212	0
Purchased own shares		( 127,000)	( 169,170)

**Net cash flows from financing activities**

	81,212	10,571,927
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Cash and cash equivalents, (decrease) increase	( 665,745)	1,058,190
Cash and cash equivalents at 1 January	1,059,303	1,113

**Cash and cash equivalents at year end**

29	393,558	1,059,303
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**Investments and financing activities without cash flow effect:**

Loans and receivables		39,646	0
Redeemed own shares		( 39,646)	0

Notes on page 55 - 102 are an integral part of these financial statements | Amounts are in ISK thousand

**NOTES TO THE FINANCIAL STATEMENTS****GENERAL INFORMATION****1. General information on Saga Capital Investment Bank hf.**

Saga Capital Investment Bank hf. is an Icelandic limited liability company with its headquarters at Hafnarstraeti 53, Akureyri.

The objectives of Saga Capital Investment Bank hf. are to provide its customers with services in relation to corporate advisory service, loans and brokerage services.

**2. Basis of preparation****a) Statement of compliance**

The Financial Statements have been prepared in accordance with International Financial Reporting standards (IFRS), as adopted by the EU.

The Financial Statements of Saga Capital Investment Bank hf. were approved by its Board of Directors on 21 April 2009.

**b) Basis of measurement**

The Bank's financial statements have been prepared on the historical cost basis except for:

- trading assets and liabilities, including derivatives, which are recognised at fair value,
- financial assets designated at fair value are recognised at fair value

Note 18 includes further information regarding measurement of fair values.

**c) Functional and presentation currency**

These financial statements are prepared and presented in Icelandic kronas, which is the Bank's functional currency. All financial information presented in Icelandic kronas has been rounded to the nearest thousand unless otherwise stated.

**d) Use of estimates and judgements**

The preparation of the financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions, that affect the application of accounting policies and the reported amount of assets and liabilities as well as income and expenses. The estimates and underlying assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying amounts of assets and liabilities that are not readily apparent from other sources. 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 estimates are revised and in any future periods affected.

In particular, information about significant areas of estimation uncertainty and critical judgements in applying accounting

policies that have the most significant effect on the amounts recognised in the financial statements are included in note 4.

## SIGNIFICANT ACCOUNTING POLICIES

3. The accounting policies set out below have been applied consistently to all periods presented in these financial statements.

### a) Foreign currency

Transactions in foreign currencies are translated at exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated to the functional currency at the exchange rate at that date. Non-monetary assets and liabilities stated at cost value in foreign currencies are translated to Icelandic kronas at the transaction date. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated to the functional currency at the exchange rate at the date that the fair value was determined. Foreign currency differences arising on retranslation are recognised in the income statement.

### b) Interest income and expenses

The effective interest rate is the rate that exactly discounts the estimated future cash payment 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 in the balance sheet. When the effective interest rate is calculated the Bank estimates cash

Amounts are in ISK thousand

flow considering all contractual provisions of the financial instrument but does not allow for future credit losses. The effective interest rate is established on initial recognition of the financial asset and liability recognised at amortised cost value.

Interest income and expenses recognised in the income statement consist of:

- Interest income on receivables from credit institutions, based on the effective interest method and amortised cost,
- interest income on loans to customers, based on the effective interest method and amortised cost,
- interest expenses on borrowings and other financial liabilities, based on the effective interest method and amortised cost,
- fair value changes of trading assets and liabilities attributable to interest income and expense,
- fair value changes in financial assets designated at fair value attributable to interest income and expense.

When a loan bears lower interest rates than market interest rates it is recognised at fair value upon initial recognition. Fair value is calculated as the present value of future payments, using market interest rate at the date of origination. The difference between the nominal amount of the loan and fair value is recognised in the income statement. Subsequently interest expense is calculated applying the interest rate used in determining the fair value.

### c) Fee income and expenses

The Bank provides its customers with various services in exchange for fees. Among this income is income due to contracts made on behalf of customers, fee income due to securities and bond transactions, in addition to other income. Fee income is recognised in the income statement as the service is provided. Fees for performance based services are recognised when premises for the performance are met with.

Fee expenses are mainly payments due to service acquired by the Bank. They are expensed as the service is received.

### d) Net (expenses) income on financial assets and liabilities

Net (expenses) income on financial assets and liabilities include net income and expenses on trading assets and liabilities as well as on financial assets designated at fair value, and comprise of dividend income and foreign exchange difference, and all realised and unrealised fair value changes, except for fair value changes attributable to interest income and expense. Interest income and expenses on trading assets, trading liabilities and financial assets designated at fair value are recognised among interest income and expenses.

### e) Employee benefits

#### i) Defined contribution plans

The Bank pays a contribution to pension funds due to the Bank's employees and the obligation is recognised in the income statement as salary related expenses as they are incurred.

### ii) Share options

The fair value of options granted to employees is determined at grant date and recognised as an employee expense over the period in which the employees become unconditionally entitled to the options, with a corresponding increase in equity. The annual amount recognised as an expense is adjusted to reflect actual vesting. The fair value of options is determined applying the Black-Scholes valuation formula. The fair value is based on assumptions regarding share price, the strike price in the contracts, expected volatility of share price, contract period, expected dividend payments and risk free rates based on government securities.

### f) Income tax expense

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

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

A deferred tax asset is calculated and recognised in the financial statements. The calculation is based on the difference between balance sheet items according to the tax return on the one hand, and the financial statements on the

other, taken into account carry forward tax losses. Difference of balance sheet items, as thus stated, is due to the fact that income tax assessment is based on different premises than the Bank's financial statements and is in main respect a temporary difference between the recognition of income and expenses in the tax return on the one hand, and in the financial statement on the other.

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

#### **g) Financial assets and liabilities**

##### **i) Recognition and derecognition of financial assets and liabilities**

Purchase and sale of financial assets are recognised on the date of transaction. They are recognised at the date that the Bank enters into an obligation to purchase or sell the asset, except for loans and receivables, which are recognised when funds are transferred to the borrower.

Financial assets are derecognised when the right to receive cash flow from the asset no longer exists or when the Bank has transferred considerably all risks and rewards from the ownership.

A Financial liability is recognised when the Bank becomes a part of the contractual terms of an instrument. A financial liability is derecognised when the Bank's obligation is settled by payment, the creditor has renounced the claim or the liability lapses.

The Bank makes transactions where recognised assets in the balance sheet are transferred but the risk and reward is retained in part or in full. If all or nearly all risk and reward is retained the recognition of the asset in the balance sheet continues. Transfer of assets where nearly all risk and reward is retained consists for example of securities lending and repurchases.

The right and obligations retained upon transition are each recognised as assets and liabilities, whichever is applicable. Upon transition where control over the asset is retained the Bank continues to recognise the asset to the extent that the participation continues to cover and on the basis of the extent of the effects due to value changes of the transferred asset.

In certain transactions the Bank retains its right to provide services to transferred assets in exchange for fees. The recognition of an asset is discontinued in full if it meets with all the relevant requirements thereon. An asset or a liability is recognised as for what relates to service rights depending on whether the service fee is sufficiently high in order to cover the cost due to the

service (asset) or whether it is too low so that it will not be able to cover the cost of the service (liability).

##### **ii) Classification**

See note 3. h), i), j), k) and l).

##### **iii) Off-setting**

Financial assets and liabilities are set off and the net amount is recognised in the balance sheet when the legal right exists on off-setting and the Bank intends to settle on a net basis.

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 trading activities.

##### **iv) Amortised cost measurement of financial assets and liabilities**

The amortised cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, deducting principal repayments, considering cumulative discount or premium using the effective interest method. Premium and discounting is the difference between the initial recognition of the relevant financial instrument on the one hand and the nominal amount on the other. In calculating the amortised cost of financial assets impairment loss is also taken into account, if any.

##### **v) Fair value measurement**

Fair value of financial assets and liabilities listed in an active market is the same as their listed value. Valuation methods are applied to other financial instruments in the calculation of their fair value. A financial asset or a financial liability is considered to be listed in an active market if official price is available from a stock exchange or other independent party and if the price reflects real and regular market transactions between unrelated parties.

Fair value of financial instruments not listed in an active market is determined by using valuation methods reviewed on a regular basis. All valuation models used shall be approved and tested to ensure that the results reflect the data used.

Valuation methods can consist in the use of prices in recent transactions between unrelated parties, use of the value of other financial instruments comparable to the instrument in question or the discounted cash flow or other valuation models. When applying valuation methods all factors are used that market parties would use in a valuation and the methods are in accordance with generally accepted methods for the valuation of financial instruments. The Bank verifies on a regular basis its valuation methods and makes tests thereon by using prices obtained from active markets with the same instrument, without adjustments or changes, or that are based on market information.

Amounts are in ISK thousand

Financial instruments are recognised at fair value upon initial recognition. Market prices are considered to be the best indication of fair value, even though fair value according to valuation models is different from market values. If there is a difference between the fair value due to a valuation method it is recognised in the income statement based on the premises at each time and no later than when market information becomes observable.

#### vi) Impairment of financial assets

The carrying amount of the Bank's financial assets, other than trading assets and financial assets designated at fair value, is reviewed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated.

An impairment is recognised in the income statement whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount.

Two methods are used to calculate impairment losses, one based on an assessment of individual loans and the other based on a collective assessment. Losses expected as a result of future events, no matter how likely, are not recognised.

Objective evidence of impairment includes information about the following events and conditions:

- significant financial difficulty of the borrower;

Amounts are in ISK thousand

- a breach of contract, such as a default on installments or on interest or principal payments;
- the bank grants the borrower, due to legal reasons or reasons related to business and related to the borrower's financial difficulty, a concession in form of refinancing, which the Bank would otherwise not consider;
- it is likely that the borrower will be bankrupt or will undergo a financial reorganisation;
- active market is no longer available for the relevant financial asset due to financial difficulty; or
- Observable indicators indicating measurable decrease in the estimated future cash flow from a loan group from the initial recognition of the assets, though a decrease can not yet be identified on single assets in the group, including:
  - unfavourable changes in the borrower's or the group's payment standing; or
  - general macro-economical or local economical reasons related to assets in the group.

#### Individually assessed loans

Impairment losses on individually assessed loans are determined by an evaluation of the exposures on a case-by-case basis. The Bank assesses at each balance sheet date whether there is any objective evidence that individual loans are impaired. This method is applied to all individually significant loans. The assessment takes into account:

- the Bank's overall risk towards the customer;
- amounts and timing of estimated

- payments and redemptions;
- likely payments to the Bank upon liquidation or bankruptcy;
- how complex it is to determine the total amounts and assessment of all receivables from borrowers and the extent of legal and insurance related uncertainty at hand;
- sales value of collaterals (factors mitigating credit risk) and probability of redemption; and
- probable reduction of cost upon collection of outstanding amounts.

Impairment losses are measured as the difference between the carrying amount of loans and receivables and the present value of estimated cash flows discounted at the assets' original effective interest rate. When a loan has variable interests the discount rate used is the same and the current effective interests of the loan. Losses are recognised in an allowance account, which will be entered to the reduction of their carrying amount.

#### Collectively assessed loans

Where loans have been individually assessed and no evidence of loss has been identified, these loans are grouped together on the basis of similar credit risk characteristics for the purpose of calculating a collective impairment loss. This loss covers loans that are impaired at the balance sheet date but which will not be individually identified as such until some time in the future. The collective impairment loss is determined after taking into account:

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

Estimates of changes in future cash flows for 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 changes in the probability of losses on the group and their magnitude. The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Bank to minimise any differences between loss estimates and actual losses.

#### Write-off

Loans are written-off, partially or in full, when there is no realistic probability that they will be redeemed.

#### Reversal of impairment

If, in a subsequent period, the amount of an impairment loss decreases and the decrease can be related objec-

tively to an event occurring after the impairment was recognised, the previously recognised impairment loss is recognised in the income statement.

#### Calculation of the recoverable amount

The recoverable amount of the Bank's investments in financial assets recognised at amortised cost value are calculated as the present value of the estimated discounted future cash flow, based on the original effective interest method.

The recoverable amount of other assets is the higher of the net fair value or their value in use. When the recoverable amount is assessed, the estimated future cash flow is discounted based on the pre-tax discount rate, which reflects current market conditions and the risk inherent with the asset. For an asset not generating much independent cash flow the recoverable amount is estimated for the cash generating unit to which the asset appertains.

#### h) Cash and cash equivalents

Cash and cash equivalents include cash, demand deposits in the Central Bank and repayable on demand receivables from credit institutions.

Cash and cash equivalents in the balance sheet are recognised with accrued interests.

#### i) Loans and receivables from credit institutions

Loans and receivables from credit institutions consist of

Amounts are in ISK thousand

restricted deposits with the Central Bank and other credit institutions. Receivables from the Central Bank and credit institutions in operation are recognised in the balance sheet with accrued interests but receivables from credit institutions taken over by the resolution committees are recognised without accrued interests.

#### i) Trading assets

Trading assets are mainly acquired in order to make profit on short term value changes or on broker fees. Trading assets consist of bonds, shares and derivatives with positive fair value.

Trading assets are measured at fair value. Realised and unrealised profit and loss on those assets is recognised in the income statement. Fair value changes are recognised on the one in net interest income and expenses (interest factor of fair value changes) and on the other, among net income and expenses on financial assets and liabilities (fair value changes due to other factors). Interest and dividend income on those assets is recognised in interest income and dividends in the income statement. Trading assets are not reclassified after initial classification.

Derivatives are financial instruments or other contracts, which value is based on changes in underlying factors (such as price of securities, goods or bonds, indices, currencies or interest rates), and require no or insubstantial initial investments compared to other comparable contracts

with comparable connection to changes in market factors and that are settled at a determined time in the future.

The Bank uses derivatives in order to gain on short term price changes and to hedge against financial risk.

Derivatives are recognised among trading assets and liabilities in the balance sheet. They are recognised at fair value. Fair value changes are recognised in the income statement as interests (among interest income and interest expenses) and exchange rate difference (among net income and expenses on financial assets and liabilities). Derivative agreements with positive balance are recognised in trading assets and derivative agreements with negative balance are recognised in trading liabilities.

Embedded derivatives, which are a part of other contracts are treated as separate derivatives when economic characteristics and risk are not closely connected with the host contract, of which they are part, and the entire instruments is not recognised at fair value through profit and loss.

The fair value of derivatives is determined in accordance with the accounting policy defined in note 3(g)(v).

#### j) Trading liabilities

Trading liabilities consist of derivatives with negative fair value, shortsellings and securities loans related to shares and bonds.

#### k) Financial assets designated at fair value

The Bank designates certain financial assets upon initial recognition as financial assets at fair value, where fair value changes are recognised in the income statement, when such classification includes more appropriate information due to the following:

- i) the classification eliminates or significantly reduces accounting mismatch in measurement or recognition, which could arise when assets or liabilities are measured or profit or loss thereon is recognised in a different way, or
- ii) financial assets and/or financial liabilities are managed and return thereon is measured on a fair value basis according to the Bank's risk management and investment policy and information to key management is provided in this way.

#### l) Loans

Loans mainly consist of non-derivative financial instruments with fixed or determinable payments that are not listed in an active market, except for those instruments that the Bank designates and recognises at fair value. Loans consist of loans that the Bank grants to customers, loans granted by the Bank together with other credit institutions and purchased loans that are unlisted and the Bank does not intend to sell in the nearest future.

Loans are initially stated at fair value, which is the loan amount in addition to all transaction cost. Loans are then

measured at amortised cost value, which is calculated based on the effective interest method. Accrued interests are recognised as part of the carrying amount of loans.

#### m) Sales and repurchase agreement

Sales and repurchase agreements are agreements on sale and repurchase of securities with the terms that the securities are repurchased at a fixed date and price. Purchase and resale agreements are agreements made on the purchase and resale of securities with the terms that the securities are resold at a fixed date and price. Initially received cash and cash equivalents with accrued interests is recognised in the balance sheet as loan from financial companies and the Central Bank. Initially paid cash and cash equivalents with accrued interests is recognised as receivables from credit institutions. Accrued interests are recognised as interest expenses or interest income over the term of each contract.

According to sales and repurchase agreements, control over securities remains with the Bank during the contractual term and the securities are continually recognised in the balance sheet.

#### n) Lease agreements

The Bank classifies lease agreement based on whether the risk and rewards inherent with the ownership of the leased asset are transferred to the Bank or not. A finance lease is a lease contract where risk and rewards inherent with the assets are materially

transferred over to the lessee. An operating lease contract is any lease not considered to be a finance lease contract.

Lease payments according to an operating lease where the Bank is the lessee are expensed on a straight-line basis over the contractual term of the lease agreement.

#### o) Intangible assets

Intangible assets, other than goodwill, are recognised at cost less impairment and amortisation. Subsequently incurred cost due to intangible assets is capitalised if it increases the value of the asset. All other cost is expensed in the income statement when incurred. Amortisation is recognised on a straight-line basis in the income statement based on the estimated useful life of intangible assets. Intangible assets are amortised from the time that they are taken into use. Software is amortised over a three year period.

#### ó) Property, plant and equipment

Items of property, plant and equipment are capitalised at cost less accumulated depreciation and impairment. Subsequently incurred cost due to renewal of single items of property, plant and equipment is capitalised as property, plant and equipment, if it is likely that future economic benefits embodied within the item will go to the Bank and the cost can be assessed reliably. All other cost is expensed in the income statement when incurred. Depreciation is recognised on a straight-line basis in the income statement based on the useful life of single items of property, plant and equipment. Estimated useful lives are specified as follows:

Furnishings .....5 years  
Tools and equipment .....3 years  
Vehicles .....5 years

Residual value is remeasured on an annual basis.

#### p) Impairment loss on other assets than financial assets

In addition to impairment loss on financial assets (see note 3(g)(vi)), an evaluation is made at each reporting date on whether the Bank's assets, other than deferred tax asset, have incurred impairment loss. If any such indication exists the recoverable amount of the relevant asset is evaluated. The recoverable amount of the asset is the higher of its value in use or the fair value taking into account sales cost. In evaluating the value in use the estimated cash flow discounted on pre-tax discount rate is used, which reflects the market value of money and the risk factors inherent with the asset.

Impairment loss recognised in prior periods is measured at each reporting date to assess whether the impairment loss has increased or whether the impairment is no longer detected. Impairment loss is reversed if there is change in estimates used in determining the recoverable amount and they indicate that impairment is no longer detected. Impairment loss is only reversed to the extent that the carrying amount of the asset after impairment reversal does not exceed the carrying amount, taking into account depreciation, as if no impairment had been detected.

#### q) Borrowings

The Bank's borrowings are mainly from financial companies

and the State. Borrowings are initially recognised at fair value less transaction cost. Borrowings are then measured at the amortised cost value based on the effective interest rates. Accrued interests are recognised as a part of the carrying amount of borrowings. When a loan bears lower interest rates than market interest rates it is recognised at fair value upon initial recognition. Fair value is calculated as the present value of future payments, using market interest rate at the date of origination. The difference between the nominal amount of the loan and fair value is recognised in the income statement. Subsequent interest expense is calculated applying the interest rate used in determining the fair value.

#### r) Other assets and liabilities

Other assets and liabilities are stated at cost value.

#### s) Financial guarantees

Financial guarantees are contracts that require the Bank to repay a specific amount to the guarantee holder due to a loss that it incurs when a debtor can not meet with its obligation on due date in accordance with the terms of a debt instrument.

Liabilities due to financial guarantees are initially recognised at fair value and the fair value is recognised in the income statement over the estimated term of the contract. The contract is then recognised at the higher of the initial fair value, taking into account fee income recognised, or the present value of estimated payments when the a payment due to a guarantee is considered to be

Amounts are in ISK thousand

likely. Financial guarantees are recognised in the balance sheet among other liabilities.

#### t) Equity

##### i) Treasury shares

Share capital acquired from a shareholder (treasury shares), including transaction cost is recognised as a reduction in equity. Profit and loss arising due to sale, purchase, issue and write down of own shares is not recognised in the income statement but in equity.

##### ii) Accumulated deficit

Loss of the year is recognised in accumulated deficit.

##### iii) Dividends

Dividends on share capital are recognised as a reduction in equity in the period they are approved in an Annual General Meeting.

#### u) New 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 financial statements. These amendments are not considered to have significant effect on the Bank's financial statements when they will be introduced:

- IFRS 8 Operating segments, becomes effective for periods starting 1 January 2009 or later.

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- IAS 1 Presentation of Financial Statements, becomes effective for the Bank's 2009 financial statements.
- IAS 23 Borrowing costs, becomes effective for the Bank's 2009 financial statements.
- IFRS 3 Merger of companies, will become effective for the Bank's financial statements for the year 2010.
- IFRS 2 Share-based payment - vesting condition and cancellations, becomes effective for the Bank's financial statements for the year 2009, with retrospective effect if it will be confirmed by the European Union.
- IAS 32 Financial instruments: Presentation, and IAS 1 Presentation of financial statements - puttable financial instruments and obligations arising upon liquidation will become effective for the Bank's financial statements for the year 2009, with retrospective application if they will be confirmed by the EU.
- IAS 39 Financial instruments: Recognition and measurement - Eligible hedged items, will become effective for the Bank's financial statements for the year 2010, with retrospective application if it will be confirmed by the EU.
- IFRIC 13 Customer Loyalty Programmes, becomes effective for the Bank's 2009 financial statements if it will be confirmed by the European Union.
- IFRIC 15 Agreements for the Construction of Real Estate, will become effective for the Bank's 2009 financial statements if confirmed by the EU.
- IFRIC 17 Distribution of Non-cash assets to owners, will become effective for the Bank's financial statements for the year 2010 if confirmed by the EU.

- IFRIC 12 Service Concession Arrangements, took effect in the year 2008 but has not been applied to these financial statements as the standard is yet not confirmed by the EU.

#### 4. Management's estimates and judgement in relation to the application of accounting policies

The Bank's management makes decisions, assessments and assumptions that may have effect on items in the Bank's balance sheet in the next accounting year. Management revalues on a regular basis decisions and assessments based on historical experience of previous years and other appropriate factors, such as estimated future events when decisions on assumptions and assessments are made. The items that are mainly subject to evaluation uncertainty are on the one hand impairment of loans, and on the other, fair value determination of financial instruments.

##### a) Impairment loss on loans

The Bank reviews its loan portfolio in order to test for impairment every three months. Before a decision is made on the recognition of impairment loss the Bank must assess whether there is objective evidence indicating a measurable decrease in the estimated future cash flow either from single loans or from a loan portfolio before the decrease becomes perceptible with single loans in the portfolio. Those can be indications of changes in the borrower's credit facility or economic conditions. The management uses estimates that are based on the historical experience of assets with comparable risk characteris-

tics and objective evidence of impairment loss when the future cash flow shall be evaluated. The methodology and assumptions used in both evaluating amounts and timing of future cash flow are reviewed on a regular basis aiming at reducing the difference between estimated loss and actual loss.

##### b) Fair value of derivative agreements

Fair value of derivative agreements not listed in active markets is determined by use of valuation methods, which are reviewed on a regular basis by independent employees. All valuation methods used must be approved and tested in order to ensure that the results reflect the data used.

Note 18 to the financial statements includes further information on the evaluation methods used in determining fair value of financial instruments.

#### RISK MANAGEMENT

5. The Bank faces various types of risks related to its daily operation. Management devotes a significant portion of its time to the management of these risks. The mainstays of effective risk management are the identification of significant risk, the quantification of the risk exposure, actions to limit risk and the constant monitoring of risk. The most significant of these risks are discussed below. The core risks are credit risk, liquidity risk and market risk. Market risk consists of currency risk, interest risk and price risk.

The role of the Bank's risk management is on the one hand to measure and monitor risk exposure in the Bank's operation, and on the other, to manage that risk. The former role consists mainly in implementing and developing methods to assess any type of risk, and to have broad access to all important information for risk evaluation and review. The latter consists among other things in setting reasonable benchmarks on certain risk factors in accordance with the policy of the Board of Directors, and in assigning risk management to other divisions. Risk management handles reports and submits information and reports to the Icelandic Financial Supervisory Authority, the Icelandic Central Bank, the Board of Directors and the administration as well as supervising information safety in the Bank's operation.

The Bank has various monitoring mechanisms and warning systems, aimed at identifying any type of risk at initial level. Risk management and financial management reviews the Bank's liquidity and currency balance on a daily basis. The Bank's market risk is carefully monitored each time. A system is used that immediately detects when risk benchmarks have been exceeded. Furthermore, profit/loss on any of the Bank's listed financial instrument is monitored on a daily basis. Risk management and the credit division review default on loans and collaterals for securities lendings no less than once a week, and risk management and the division of market transactions review collaterals for swaps on a daily basis. In addition risk management reviews on a daily basis the division of market transactions review collaterals for

Amounts are in ISK thousand

swaps on a daily basis. In addition, risk management reviews on a weekly basis operating occurrences detected in the past week.

#### **The Bank's risk policy**

Many risk factors can affect the Bank's operation. The Bank's Board of Directors sets with the Bank's risk policy a benchmark for acceptable risk limits in daily operation regarding risk factors that could affect income and equity, and the Bank's will to take risk in respect of estimated profit. The CEO and the Managing Director of risk management follow the Board of Directors' decision on the Bank's benchmarks for risk and risk policy. Furthermore, it is the role of the Bank's internal auditor to monitor the operation in order to ensure compliance with rules in accordance with the Bank's Board of Directors' Articles of Association.

Market risk is the biggest single risk factor in the Bank's operation. A market risk committee, consisting of the CEO, the Managing Director of risk management and Managing Director of equity management, follows benchmarks set by the Board regarding market risk.

Counterparty risk is a considerable risk factor in the Bank's operation and consists mainly in counterparty risk due to loans to customers. The Bank's Board of Directors establishes credit policies which set the aim and acceptable limits for counterparty risk. A loan committee, which consists of CEO, Managing Directors of risk management and legal

division and Managing Director of the loan department, makes decisions on all of the Bank's loans and complies with the Board of Directors' policy. For each of the Bank's counterparty, whether in lending transactions or derivative transactions, the Bank performs a risk assessment and gives the counterparty a credit rating, which is used in the risk assessment. Credit ratings are reviewed two times a year for the Bank's biggest customers.

#### **Risk management process and risk control**

##### **a) Contracts including counterparty risk**

Counterparty risk is the risk that the counterparty does not fulfill its obligation towards the Bank. The Bank's main counterparty risk arises in relation to loan grantings. The maximum amount of counterparty risk in this respect is stated in the book value of assets in the balance sheet. Counterparty risk consists in the Bank's various other financial assets, such as derivative agreements and market bonds and current counterparty risk is reflected in the book value of those assets in the balance sheet. In addition to the aforementioned counterparty risk, the Bank also faces counterparty risk due to off-balance sheet items such as guarantees granted.

**Loans:** The Bank's main assets are loans. In order to maintain and improve the quality of the Bank's loan portfolio it is important to continually monitor the current loan portfolio and review all loan applications thoroughly where those that do not fulfill requirements for loan granting are immediately rejected. It is the Bank's policy that interests on granted

loans reflect both the related risk and cost. This means that an in-depth assessment of single customers, their financial standing and guarantees makes the premises for loan granting. A special credit rating system, which takes into account the customers' financial standing and collaterals, is used by the Bank and each prospective debtor is evaluated with that system before loan granting is approved.

**Derivatives:** The Bank enters into derivatives with its customers including forward agreements, swaps, options and other comparable agreements, where value is subject to interest rate, foreign exchange rate, price of shares or price indices. The Bank monitors derivatives with open balances and sees to that there are at all times sufficient collaterals at hand. Collaterals vary depending on the customer and the type of instrument. In general, collaterals are required in order to meet possible loss on a contract. Acceptable collaterals for derivatives are assets that can be redeemed on a short notice, such as cash or market shares. If the balance of derivatives goes below a certain limit further collaterals are required. Counterparties in derivatives are evaluated using the the Bank's credit rating system in the same way as debtors.

##### **b) Loan processing and authorisations**

The Bank's loan committee reviews and makes decisions in all loan issues except when the risk is higher than 10% of the Bank's equity, in which case the approval of the Board of Directors is needed. Credit policies approved by the Bank's Board of Directors include limits on employees' credit autho-

risations and limits on risk towards different counterparties. The Bank's legal department supervises all document preparation related to loans. According to Article 30 of law no. 161/2002, no single risk obligation or liability due to related parties may be higher than 25% of a financial company's equity as defined in the law. A statement including all obligations amounting to 10% or more of equity is submitted to the Financial Supervisory Authority every three months. According to provisions of the loan agreement with the State, no single risk obligation shall be over 20% of CAD equity.

#### c) Counterparty risk monitoring

Risk management monitors counterparty risk. The department handles numerical analysis of the loan portfolio, assesses estimated loss, probable risk inherent with the loan portfolio and systematically monitors defaults. The results are presented to the management with emphasis on possible risk within the loan portfolio in terms of counterparty risk, risk in single sectors and countries. The Bank's loan process is continually being reviewed in terms of data collecting, loan authorisations, loan applications, document preparation, assessment and registration of collaterals.

#### Loan impairment

Contribution due to loss on loans is recognised when there is certain indication that the Bank will not be able to redeem the entire amount receivable, for example loans, obligations, guarantees etc., according to initial contractual provisions or

Amounts are in ISK thousand

comparable provisions. Allowance for impairment due to loss on loans is reduced by the carrying amount of loans in the balance sheet but allowance for impairment due to off balance sheet items, such as due to obligations and guarantees is recognised among other liabilities. Contribution to the depreciation account is entered as impairment loss on loans. The depreciation account for loans is assessed, mainly in relation to single counterparties or a group of counterparties according to the following rules:

#### a) Individually assessed impairment

A receivable is considered to be impaired when there is clear indication that the Bank will not be able to collect the entire receivable according to initial contractual provisions. Counterparty risk is assessed on the basis of the standing of the borrower, his overall financial standing, assets and payment history, possibility of financial support by financially responsible guarantors and sales value of insurances, where applicable.

Estimated recoverable amount is the current value of estimated cash flow from the loan, calculated by using initial interests of the loan. Impairment is the difference between the carrying amount and estimated recoverable amount. Upon impairment loss interest income, on the basis of initial terms of the receivable, is no longer recognised but the increase in the current value of impaired receivables from previous periods is recognised among interest income.

Impaired loans are reviewed and assessed at least every three months. All subsequent changes in amounts and timing of estimated cash flow compared to previous assessments, which lead to changes in the depreciation account are expensed as impairment loss on loans.

Impairment is only reversed when loan quality has improved sufficiently in order to give reason that the principal and interests in accordance with initial contractual provisions of the loans can be redeemed in time. Final write-offs are made when a receivable, in part or in full, is considered to be unredeemable. Final depreciations are recognised as reduction in the total value of the receivable against the depreciation account or as impairment loss on loans in the income statement. Repayments of previously depreciated receivables are recognised as reduction in expensed impairment loss on loans.

#### b) Collective impairment loss

All loans not recognised in a specific allowance for impairment loss are grouped in a uniform loan portfolio and impairment loss is assessed on the entire loan portfolio. Allowance due to overall assessment of impairment loss is entered as impairment loss on loans in the income statement and to the reduction of loan balance. As impairment is not recognised for each individual loan, interest is calculated on all loans according to contractual provisions.

All loans where there is no impairment loss with the counterparty are grouped in an economic uniform loan portfolio,

and impairment is tested on loans within the group. Impairment due to overall assessment of impairment loss is entered as expenses due to loss on loan and leads to a counter recording on the loan balance. As depreciation is not entered for each individual loan, interest is calculated on all loans according to contractual provisions.

Loans with renegotiated loan terms at year end 2008 amount to ISK 1,823 million.

## Higest probable credit risk

### 6. The Bank's highest probable credit risk is specified as follows:

	2008	2007
Receivable from credit institutions	1,104,945	803,779
Loans to customers	3,587,854	3,656,459
Trading assets:		
Government bonds	6,143,594	6,143,594
Housing bonds	2,758,788	20,360,129
Bank notes	50,708	0
Derivatives	147,079	95,129
Financial assets designated at fair value:		
Bank notes	6,014,099	4,120,438
Other financial institutions	1,946,459	642,2258
Corporate bonds	100,000	1,023,991
Credit risk related to off balance sheet items:		
Guarantees	60,000	113,000
	<u>21,913,526</u>	<u>31,309,628</u>

## Allowance for impairment

### 7. Changes in the allowance for impairment on loans account are specified as follows:

	Special contribution	General contribution	Total
<b>2008</b>			
Allowance for impairment on loans at the beginning of the year	29,245	0	29,245
Impairment loss on loans during the year	1,553,655	88,678	1,642,333
Guarantees, recognised as other liabilities	253,632	0	253,632
<b>Allowance for impairment on loans at year end</b>	<u>1,836,532</u>	<u>88,678</u>	<u>1,925,210</u>
<b>2007</b>			
Impairment loss on loans during the year	29,245	0	29,245
<b>Allowance for impairment on loans at year end</b>	<u>29,245</u>	<u>0</u>	<u>29,245</u>

Amounts are in ISK thousand

### 8. Impaired loans and individually assessed allowance for impairment are specified as follows by customers:

2008	Amount of impaired loans	Impairment	Carrying amount
Customers:			
Industry	251,657	100,967	150,690
Real estate companies	216,974	109,755	107,219
Holding companies	2,471,839	1,585,898	885,941
Individuals	164,303	39,912	124,391
<b>Individually assessed allowance</b>	<u>3,104,773</u>	<u>1,836,532</u>	<u>1,268,241</u>
Expensed guarantees to the amount of ISK 254 million are a part of impairment due to holding companies.			
2007			
Customers:			
Holding companies	298,283	29,245	269,038
<b>Individually assessed allowance</b>	<u>298,283</u>	<u>29,245</u>	<u>269,038</u>

Loans and guarantees to the total amount of ISK 1,896 million have been expensed. Impairment loss on loans is recognised in the depreciation account and expensed guarantees are recognised among other liabilities.

### 9. Loans in default but not impaired:

	2008	2007
Default for 30-89 days	338,482	0
Default for 90-179 days	120,362	0
<b>Remaining balance of loans in default but not impaired</b>	<u>458,844</u>	<u>0</u>

These are loans where contractual interest and principal payments are in default but the Bank's management believes that an impairment has not been incurred due to collaterals for the loans or the borrowers' payment capacity and based on at which level the loan is in the collection process.

Total defaults at year end 2008 amount to ISK 18 million.

## Liquidity risk control and management

10. Liquidity risk is the risk that the Bank will not be able to meet its financial obligations as they fall due. The Bank's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due. The Bank must have sufficient liquidity in order to be able to meet both its foreseeable and unforeseeable payment obligations. The Bank has set rules regarding liquidity and financing in order to ensure and maintain flexibility. The rules consist among other things in access to credit lines, loan facilities and financial assets, which easily and quickly can be liquidated, such as treasury bills and treasury bonds.

Furthermore, liquidity risk is monitored with reports on liquidity ratio, which are sent on a monthly basis to the Central Bank of Iceland. The liquidity ratio shows the proportion between assets and liabilities depending on their due date. In order to determine the liquidity base the Central Bank of Iceland assesses single asset groups so the ratio is prudently assessed.

The Bank's undiscounted financial assets and liabilities are specified as follows by maturity at year end 2008:

2008	Total	Up to 1 month	1 - 3 months	3 - 12 months	1 - 5 years	More than 5 years
Financial assets						
Cash and cash equivalents	393,557	393,557	0	0	0	0
Trading assets	11,092,757	1,886,224	9,053,016	153,517	0	0
Financial assets at fair value	10,620,957	0	0	8,058,060	2,562,897	0
Loans to customers	4,692,800	816,189	921,262	371,101	2,466,734	117,514
Other financial assets	348,537	348,537	0	0	0	0
<b>Total financial assets</b>	<b>27,148,608</b>	<b>3,444,507</b>	<b>9,974,278</b>	<b>8,582,678</b>	<b>5,029,631</b>	<b>117,514</b>
Financial liabilities						
Trading liabilities	54,173	54,173	0	0	0	0
Borrowings	29,367,601	8,946,162	0	418,160	12,001,967	8,001,312
Other financial liabilities	313,712	255,980	57,732	0	0	0
<b>Total liabilities</b>	<b>29,735,486</b>	<b>9,256,315</b>	<b>57,732</b>	<b>418,160</b>	<b>12,001,967</b>	<b>8,001,312</b>
<b>Net financial assets and liabilities</b>	<b>( 2,586,878)</b>	<b>( 5,811,808)</b>	<b>9,916,546</b>	<b>8,164,518</b>	<b>( 6,972,336)</b>	<b>( 7,883,798)</b>

Amounts are in ISK thousand

2007	Total	Up to 1 month	1 - 3 months	3 - 12 months	1 - 5 years	More than 5 years
Financial assets						
Cash and cash equivalents	1,059,303	1,059,303	0	0	0	0
Trading assets	22,888,547	22,888,547	0	0	0	0
Financial assets at fair value	6,039,068	0	0	3,304,357	2,734,711	0
Loans to customers	4,460,238	306,775	1,800,206	473,386	1,799,307	80,563
<b>Total financial assets</b>	<b>34,447,156</b>	<b>24,254,625</b>	<b>1,800,206</b>	<b>3,777,743</b>	<b>4,534,018</b>	<b>80,563</b>
Financial liabilities						
Trading liabilities	232,688	1,530	231,158	0	0	0
Borrowings	23,297,521	22,944,079	0	353,442	0	0
<b>Total financial liabilities</b>	<b>23,530,209</b>	<b>22,945,609</b>	<b>231,158</b>	<b>353,442</b>	<b>0</b>	<b>0</b>
<b>Net financial assets and liabilities</b>	<b>10,916,947</b>	<b>1,309,016</b>	<b>1,569,048</b>	<b>3,424,302</b>	<b>4,534,018</b>	<b>80,563</b>

The remaining balance analysis shows undiscounted payments based on the first period the relevant financial assets and liabilities could be redeemed (financial assets) or be paid (financial liabilities). The estimated cash flow of those assets and liabilities is considerably different from what therein is stated, it is for example not taken into account that on demand loans from financial companies will be paid in full in the period stated in the previous analysis.

## Market risk control and management

11. The Bank's policy is to monitor closely the Group's market risk and see to it that limits set by the Board are not exceeded. Market risk is managed by setting limits on assessments and risk benchmarks, which is then monitored by the risk management on a daily basis. Risk due to large investments and investments in ill-liquid assets, such as unlisted securities stocks with low turnover, and stricter requirements are made to data collecting and value assessments of such investments. The market risk committee reviews on a regular basis the Bank's market risk and takes action when necessary.

### Interest rate risk

12. The Bank's operation faces risk due to interest rate fluctuations to the extent that interest bearing assets (including investments) and interest bearing liabilities have different maturity are recalculated at different points of time or at different amounts. As for variable interest rates of assets and liabilities, the Bank is also at risk due to fluctuations of various variable interest benchmarks, such as interest on deposits and LIBOR-interests and other different types of interests. The operation of risk management also consists in the optimisation of net interest income, provided that market interests are in accordance with the Bank's business policies.

The chart shows interest rate risk, i.e. interest sensitivity based on 100 basis points change in interests, where a profit or loss is recognised over the useful live of an open risk, by currency and maturity. The chart only shows net difference between loans and financing in each period. An insubstantial part of loans has fixed interests, or between 1 and 2% of the Bank's loan portfolio.

#### Sensitivity analysis of effects of interest rate changes in net interest income compared to equal interest rate shift of 1 percent (100 basis points):

	100 bp equal increase	100 bp equal decrease
2008		
Year end	34,309	34,309
Average balance during the year	41,724 (	41,724)
Highest balance during the year	55,259 (	55,259)
Lowest balance during the year	34,309 (	34,309)
<hr/>		
2007		
Year end	35,969	35,969
Average balance during the year	12,652 (	12,652)
Highest balance during the year	37,536 (	37,536)
Lowest balance during the year	0 (	0)

Amounts are in ISK thousand

### Indexation risk

13. The balance of the amount of indexed and unindexed assets and liabilities shall be systematically managed. It shall be taken into account that indexed assets are in general higher than indexed liabilities. In this relation, indexation balance is calculated on a monthly basis, i.e. the proportion between the difference of indexed assets and liabilities on the one hand, and equity on the other.

	2008	2007
Indexed assets	4,640,786	20,625,841
Indexed liabilities	13,053,239	0
<b>Total indexation exposure</b>	<b>( 8,412,453)</b>	<b>20,625,841</b>

Increase in indexed liabilities in excess of indexed assets is explained by a borrowing from the State, cf. note 46.

### Price risk

14. Price risk is the risk of changes in market prices. The Bank's balances in shares and bonds are most sensitive to such changes. Price risk management is separated from currency risk.

### Currency risk

15. Currency risk is the risk of losses due to unfavourable movements in foreign currencies. The Bank's open currency balance for each currency is monitored. The Bank aims at limiting currency risk and monitors it in respect of the Bank's total equity.

16. Breakdown of financial assets and liabilities by currencies at year end 2008:

	EUR	USD	DKK	Other currencies
<b>2008</b>				
Financial assets				
Cash and cash equivalents	6,253	1,969	654	5,085
Receivable from credit institutions	7	0	0	0
Trading assets	0	50,708	1,361,448	0
Financial assets designated at fair value	0	745,336	1,231,686	1,149,043
Loans to customers	881,750	100,093	0	1,746,089
<b>Total assets</b>	<b>888,010</b>	<b>898,106</b>	<b>2,593,788</b>	<b>2,900,217</b>
Financial liabilities				
Borrowings	0	20,946	165,464	0
Other liabilities	0	0	5,820	57,732
	0	20,946	171,284	57,732
Net balance in the balance sheet	888,010	877,160	2,422,504	2,842,485
Net balance off balance sheet	0	( 50,765)	0	0
Net balance of currency	888,010	826,395	2,422,504	2,842,485
<b>2007</b>				
Financial assets				
Cash and cash equivalents	2,192	20,332	8,312	51,336
Receivable from credit institutions	541,640	0	0	7,251
Trading assets	2,797	4,688	2,513	36,908
Financial assets designated at fair value	0	0	0	237,414
Loans to customers	569,999	202,055	848,810	968,522
<b>Total assets</b>	<b>1,116,629</b>	<b>227,075</b>	<b>859,636,1</b>	<b>1,301,432</b>

Amounts are in ISK thousand

Financial liabilities				
Trading liabilities	8,652	1,014	3,123	6,492
Other liabilities	114,659	3,466	0	69,524
	123,311	4,480	3,123	76,016
Net balance sheet exposure	993,318	222,594	856,513	1,225,416
Net off balance sheet exposure	( 1,107,177)	( 235,608)	( 843,739)	( 1,230,924)
Net currency exposure	( 113,859)	( 13,014)	12,774	( 5,508)

The following table shows the effect of currency rate movements on return before tax based on equal strengthening (weakening) of the Icelandic krona against all of the aforementioned currencies.

**Sensitivity analysis of the currency rate movements effect on return before tax:**

	30% equal strengthening of the ISK	30% equal weakening of the ISK
<b>2008</b>		
Year end	( 2,450,486)	2,450,486
Average balance	( 559,019)	559,019
Highest balance during the year	( 3,148,340)	3,148,340
Lowest balance during the year	274	( 274)
<b>2007</b>		
Year end	5,194	( 5,194)
Average balance	119,487	( 119,487)
Highest balance during the year	385,041	( 385,041)
Lowest balance during the year	5,194	( 5,194)

## Operating risk

17. Operating risk is the risk arising due to direct or indirect loss due to various reasons related to the Bank's development, work procedures personnel issues technology or bank infrastructure. External reasons, other than credit, market or liquidity risk, can be due to legal claims or generally accepted company work procedures.

Operating risk arises due to the Bank's entire operation and relates to all of its units. The Bank aims at finding a balance between limiting risk and loss and optimising gains without restricting employees' initiative.

The Bank's key management develops and implements the policies for each unit. Management relies upon the Bank's general benchmarks developed for risk management for each of the following items:

- Requirements on appropriate work division
- Reports on policies and work procedures
- Development of a contingency plan
- Training of employees
- Distribution of risk and risk control
- Protocol and operating procedures

The Bank's monitoring system for market risk consists in central registration of all operating events in a special loss data base, where among others the loss amount directly related to the event and the actions taken in order to prevent that event from recurring, is designated. The Bank's man-

Amounts are in ISK thousand

agement receives on a weekly basis a summary of operating events registered in the loss data base. In addition, risk management performs on a regular basis risk assessments on operating risk in each of the Bank's division.

## Fair value of financial instruments

18. The fair value of a financial instrument is the amount that can be received for the instrument in a transaction on an arm's length basis of willing parties, i.e. not through forced sale or liquidation. The existence of a known value in an active market is the best indicator of fair value and when it is available the Bank uses it in the assessment of monetary assets and liabilities. If a registered price for a financial instrument does not reflect real and regular transactions in an active market or if the price is not quoted, fair value is calculated with the relevant valuation method.

As for listed and marketable shares and bonds and certain derivative agreements the fair value is obtained by using quoted market price. Those instruments are stated in the balance sheet under the item trading assets and liabilities or as financial assets designated at fair value.

Financial instruments that do not have a quoted market price are measured with generally accepted valuation methods where market information is used. Among generally accepted valuation methods are transactions between willing and unrelated parties in arm's length transactions, information on the fair value of a similar instrument, cash flow analysis and other generally accepted valuation methods used by market participants.

## NOTES TO THE INCOME STATEMENT

### Net interest income

19. Interest income and expenses are specified as follows:

	2008	2007
<b>Interest income:</b>		
Interest income on items not designated at fair value:		
Interest income on receivables from credit institutions	99,657	131,357
Interest income on loans	680,928	225,307
Other interest income	0	6,261
	<u>780,585</u>	<u>362,925</u>
Interest income on items measured at fair value:		
Interest income on market securities	2,278,805	578,123
Interest income on derivatives	1,158,233	127,535
	<u>3,437,038</u>	<u>705,658</u>
<b>Total interest income</b>	<u>4,217,623</u>	<u>1,068,583</u>
<b>Interest expenses:</b>		
Interest expenses on items not designated at fair value:		
Interest expenses on securities	743,598	0
Interest expenses on other borrowings	2,282,001	730,778
Other interest expenses	9,974	5,100
	<u>3,035,573</u>	<u>735,878</u>
Interest expenses on items designated at fair value:		
Interest expenses on derivatives due to hedges	191,869	191,869
	<u>3,227,442</u>	<u>927,747</u>
<b>Total interest expenses</b>	<u>3,227,442</u>	<u>927,747</u>
<b>Net interest income on ordinary operation</b>	<u>990,181</u>	<u>140,836</u>

In addition to net interest income, the discount of a Government loan is recognised as income. The discount is due to the difference between contractual interests and market interests and amounts to ISK 6,970 million. The discount is amortised over the next seven years.

**Net interest income**

20. Fee income and expenses are specified as follows:	2008	2007
Fee on securities transactions	177,182	276,658
Fee on loans	1,875	27,142
Other fee income	107,433	111,465
<b>Fee income</b>	<b>286,490</b>	<b>415,265</b>
Fee on securities transactions	153,697	70,037
Other fee expenses	53,004	33,538
<b>Fee expenses</b>	<b>206,701</b>	<b>103,575</b>
<b>Net fee income</b>	<b>79,788</b>	<b>311,690</b>

**(Expenses) income on financial assets and liabilities**

21. Net (expenses) income on financial assets and liabilities are specified as follows:	2008	2007
a. Dividends	62,360	8,399
Net income on trading assets and liabilities	( 2,751,192)	( 896,989)
Net income on financial assets designated at fair value	( 9,012,204)	( 114,133)
Net foreign exchange difference	903,911	94,361
<b>Net expenses on financial assets and liabilities</b>	<b>( 10,797,125)</b>	<b>( 908,361)</b>
b. Net (expenses) income on trading assets and liabilities are specified as follows:		
Shares and related derivatives	( 3,064,770)	( 741,450)
Bonds and related derivatives	313,577	155,539
<b>Net expenses on trading assets and liabilities</b>	<b>( 2,751,192)</b>	<b>( 896,989)</b>
c. Net (expenses) income on financial assets designated at fair value are specified as follows:		
Shares and related derivatives	( 130,037)	( 139,897)
Bonds and related derivatives	( 8,882,167)	( 25,764)
<b>Net expenses on financial assets designated at fair value</b>	<b>( 9,012,204)</b>	<b>( 114,133)</b>

Amounts are in ISK thousand

**Personnel**

22. Total number of employees is specified as follows:

Average number of employees calculated as full time equivalent units	33	21
Number of full time equivalent units at year end	33	32

23. Salaries and salary related expenses are specified as follows:

Salaries	306,398	206,018
Contribution to pension fund	28,517	19,697
Other salary related expenses	40,975	17,478
Expensed due to share options	59,774	0
<b>Salaries and salary related expenses</b>	<b>435,663</b>	<b>243,193</b>

### Management's salaries

24. Salaries of management, purchase options and shares at year end are specified as follows:

	Salaries	Benefits	Share option	Share capital	Share of financially related parties
CEO					
Thorvaldur Ludvik Sigurjonsson	18,000	518	50,000	1,170,455	0
Board of Directors:					
Halldor Johannsson, Chairman	1,800	0	0	0	983,498
Johann Antonsson	1,200	0	0	70,000	336,295
Gunnar Thor Gislason	900	0	0	100,000	1,000,000
Robert Melax	0	0	0	700,000	0
Sindri Sindrason	900	0	0	0	0
Sigurdur G. Gudjonsson, former board member	300	0	0	225,000	0
Orn Arnar Oskarsson, former board member	300	0	0	0	0
Elisabet Sigurdardottir, reserve director	100	0	0	0	0
Fridrik Fridriksson, reserve director	50	0	0	50,000	0
Gunnar Thor Gudmannsson, reserve director	100	0	0	35,000	0
Stefan Hedinn Gunnlaugsson, reserve director	50	0	0	10,000	0
Managing Directors (7)	91,870	8,277	250,000	610,000	0
	115,570	8,795	300,000	2,970,455	2,319,793

Included in the above shares of financial related parties are shares of spouses and children that are minors and shares owned by companies controlled by management.

Amounts are in ISK thousand

### Auditors' fees

25. Auditors' fees are specified as follows:

	2008	2007
Audit of financial statements	8,808	1,164
Internal audit	7,199	628
Review of interim financial statements	4,081	2,622
Other services	12,596	5,212
Auditors' fees	32,684	9,626

## Income tax

26. The Bank's effective tax ratio during the year was 33.5%. A change in the effective tax ratio is mainly due two factors:

In May 2008, the Icelandic Parliament, Althingi, approved to decrease the income tax ratio from 18% to 15% as of 1 January 2008 and the change enters into effect for the tax assessment for the year 2009. Therefore, the tax asset has decreased by ISK 31 million compared to 31 December 2007. The decrease is expensed in the income statement.

In May 2008, the Parliament also approved to authorise companies, provided that certain requirements are fulfilled, to deduct profit on the sale of shares from taxable income. A deduction is only allowed if carry forward taxable loss, including the loss of the year, has been adjusted. The authorisation applies to sales profit arising in the year 2008 or later. The effect on the Bank's financial statements is that income tax liability due to shares in companies is no longer recognised in the balance sheet.

Amounts are in ISK thousand

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

		2008		2007
Increase in calculated tax asset		1,854,056		182,871
<b>Recognised income tax</b>		<b>1,854,056</b>		<b>182,871</b>
Effective tax ratio		2008		2007
Loss before income tax		( 5,527,292)		( 1,007,552)
Income tax on the loss of the year	( 15,0%)	829,094	18,0%	( 181,359)
Effect of the change in tax ratio	0,6%	( 30,575)	0,0%	0
Tax exempt dividends	( 0,3%)	19,058	0,2%	( 1,512)
Expensed due to share options	0,2%	( 8,966)	0,0%	0
Financial liability designated at fair value	( 18,9%)	1,045,534	0,0%	0
(Other items	0,0%	( 90)	0,0%	0
Effective income tax	33,5%	1,854,055	18,2%	( 182,871)

## NOTES TO THE BALANCE SHEET

### Financial assets and liabilities

28. According to the International Accounting Standard IAS 39 Financial instruments: recognition and measurement, financial assets and liabilities are divided into specific categories. The classification has an effect of how the relevant financial instrument is measured. Those categories to which the Bank's financial assets and liabilities pertain and their basis of measurement are specified as follows:

- Trading assets and liabilities - stated at fair value in the income statement.
- Financial assets and liabilities designated at fair value - stated at fair value in the income statement.
- Loans and receivables - stated at amortised cost.
- Other financial liabilities - stated at amortised cost value.

The following table specifies the categorisation of the Bank's financial assets and liabilities and their fair value.

	Trading assets and liabilities	Fin. assets and liabilities at fair value	Loans and receivables	Other on amortised cost value	Carrying amount	Fair value
<b>2008</b>						
Cash and cash equivalents	0	0	393,557	0	393,557	393,557
Receivable from credit institutions	0	0	1,104,945	0	1,104,945	1,104,945
Trading assets	11,092,757	0	0	0	11,092,757	11,092,757
Fin. assets designated at fair value	0	10,620,957	0	0	10,620,957	10,620,957
Loans to customers	0	0	3,587,854	0	3,587,854	3,590,653
Other financial assets	0	0	348,537	0	348,537	348,537
	<u>11,092,757</u>	<u>10,620,957</u>	<u>5,434,893</u>	<u>0</u>	<u>27,148,607</u>	<u>27,151,406</u>
Trading liabilities	64,308	0	0	0	64,308	64,308
Borrowings	0	0	0	22,397,372	22,397,372	22,397,372
Other financial liabilities	0	0	0	313,712	313,712	313,712
	<u>64,308</u>	<u>0</u>	<u>0</u>	<u>22,711,084</u>	<u>22,775,392</u>	<u>22,775,392</u>

Amounts are in ISK thousand

	Trading assets and liabilities	Fin. assets and liabilities at fair value	Loans and receivables	Other on amortised cost value	Carrying amount	Fair value
<b>2007</b>						
Cash and cash equivalents	0	0	1,059,303	0	1,059,303	1,059,303
Receivable from credit institutions	0	0	803,779	0	803,779	803,779
Trading assets	22,888,547	0	0	0	22,888,547	22,888,547
Fin. assets designated at fair value	0	6,039,068	0	0	6,039,068	6,039,068
Loans to customers	0	0	3,656,459	0	3,656,459	3,653,830
Other financial assets	0	0	3,603,551	0	3,603,551	3,603,551
	<u>22,888,547</u>	<u>6,039,068</u>	<u>9,123,092</u>	<u>0</u>	<u>38,050,707</u>	<u>38,048,078</u>
Trading liabilities	232,688	0	0	0	232,688	232,688
Borrowings	0	0	0	23,297,521	23,297,521	23,297,521
Other financial liabilities	0	0	0	4,573,098	4,573,098	4,573,098
	<u>232,688</u>	<u>0</u>	<u>0</u>	<u>27,870,619</u>	<u>28,103,307</u>	<u>28,103,307</u>

### Cash and cash equivalents

29. Cash and cash equivalents are specified as follows:

	2008	2007
Bank accounts	393,557	157,886
Money market loans	0	901,418
<b>Cash and cash equivalents</b>	<u>393,557</u>	<u>1,059,303</u>

### Receivable from credit institutions

30. Receivable from credit institutions are specified as follows:

Bank accounts	1,104,945	803,779
<b>Receivable from credit institutions</b>	<b>1,104,945</b>	<b>803,779</b>

31. Receivables from credit institutions are specified as follows by maturities:

Up to 3 months	929,671	803,779
From 3 months to 1 year	175,274	0
<b>Receivable from credit institutions</b>	<b>1,104,945</b>	<b>803,779</b>

### Trading assets

32. Trading assets are specified as follows:

Bonds	9,103,724	20,854,606
Shares	1,841,954	1,938,812
Derivatives	147,079	95,129
<b>Trading assets</b>	<b>11,092,757</b>	<b>22,888,547</b>

### Derivatives

33. The Bank has entered into a derivative contract to the amount of ISK 51 million against its bond holding. The contract is against listed securities, which are carried at fair value.

Amounts are in ISK thousand

34. Derivatives, maturity of principal and carrying amount are specified as follows:

	Carrying amount			Total	Principal amount	
	Up to 3 months	Over 3 months and up to 1 year	Over 1 year		Assets	Liabilities
<b>2008</b>						
Unlisted						
currency and interest rate swaps:						
Options	292,600	0	605,558	898,158	44,270	10,620
<b>Total</b>	<b>292,600</b>	<b>0</b>	<b>605,558</b>	<b>898,158</b>	<b>44,270</b>	<b>10,620</b>
Unlisted						
securities derivatives:						
Forward agreements	1,460,114	0	0	0	102,809	35,088
<b>Total</b>	<b>1,460,114</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>102,809</b>	<b>35,088</b>
<b>Total derivatives</b>	<b>1,752,714</b>	<b>0</b>	<b>605,558</b>	<b>898,158</b>	<b>147,079</b>	<b>45,708</b>
<b>2007</b>						
Unlisted						
currency and interest swaps:						
Forward						
currency swaps	3,741,637	0	0	3,741,637	20,533	19,282
<b>Total</b>	<b>3,741,637</b>	<b>0</b>	<b>0</b>	<b>3,741,637</b>	<b>20,533</b>	<b>19,282</b>
Unlisted						
securities derivatives:						
Forward agreements	2,282,993	0	0	2,282,993	26,350	0
Stock agreements	846,522	0	0	846,522	6,528	213,406
<b>Total</b>	<b>3,129,515</b>	<b>0</b>	<b>0</b>	<b>3,129,515</b>	<b>32,878</b>	<b>213,406</b>
Unlisted						
bond derivatives						
Bond agreement	1,035,751	0	0	1,035,751	41,718	0
<b>Total</b>	<b>1,035,751</b>	<b>0</b>	<b>0</b>	<b>1,035,751</b>	<b>41,718</b>	<b>0</b>
<b>Total derivatives</b>	<b>7,906,903</b>	<b>0</b>	<b>0</b>	<b>7,906,903</b>	<b>95,129</b>	<b>232,688</b>

### Financial assets designated at fair value

<b>35.</b> Financial assets designated at fair value are specified as follows:	2008	2007
Securities	2,544,779	252,414
Bonds	8,076,178	5,786,654
<b>Financial assets designated at fair value</b>	<b>10,620,957</b>	<b>6,039,068</b>

### 36. Securities designated at fair value are specified as follows:

Shares in foreign financial institutions	1,231,686	0
Shares in other companies	1,313,093	252,414
<b>Securities designated at fair value</b>	<b>2,544,779</b>	<b>252,414</b>

### 37. Bonds designated at fair value are specified as follows:

Bonds of domestic financial institution	8,060,558	4,762,662
Bonds of other companies	15,620	1,023,991
<b>Bonds designated at fair value</b>	<b>8,076,178</b>	<b>5,786,654</b>

The Bank has expensed an estimated loss to the amount of ISK 9,538 million due to the fall of the Icelandic commercial banks in fall 2008, but the Bank had receivables to the amount of ISK 18,729 million from Glitnir bank hf. and Kaupthing bank hf. due to bonds and derivatives. The aforementioned charge is based on the estimated redemption of the aforementioned receivables according to information from the banks' resolution committees. In the evaluation it is assumed that the Bank has the right to off-set assets and liabilities with the bank, but the Bank's liabilities with the two commercial banks amounted to ISK 3,400 million upon their fall. Final settlement of the Bank's assets and liabilities with the banks has not been carried out and therefore a final loss can differ from estimates.

In March 2009, an agreement was made with Glitnir bank hf. on the settlement of forward agreements, which has been taken into account in the financial statements. Furthermore, the Bank has a right to off-set the amount of ISK 2.4 billion with Glitnir bank hf. and the Bank's bond holding has been decreased by that amount.

Amounts are in ISK thousand

### Loans to customers

<b>38.</b> Loans to customers are specified as follows:	2008	2007
Bonds	5,259,433	3,685,704
Allowance for impairment	( 1,671,578)	( 29,245)
<b>Loans to customers</b>	<b>3,587,854</b>	<b>3,656,459</b>

### 39. Loans to customers are specified as follows by customers:

Industry	4,1%	4,1%
Trade	1,5%	0,0%
Services	4,5%	1,6%
Real estate companies	20,2%	9,0%
Holding companies	40,8%	72,0%
Individuals	28,9%	13,3%
<b>Loans to customers</b>	<b>100,0%</b>	<b>100,0%</b>

### 40. Loans to customers are specified as follows by maturities:

On demand loans	32,254	306,775
Up to 3 months	775,530	996,427
3 months to 1 year	195,827	473,386
1 to 5 years	2,466,729	1,799,307
More than 5 years	117,514	80,563
<b>Loans to customers</b>	<b>3,587,854</b>	<b>3,656,459</b>

### Intangible assets

<b>41.</b> Intangible assets are specified as follows:	Software	
Intangible assets at the beginning of the year	36,617	863
Additions during the year	14,958	42,007
Amortisation during the year	( 17,667)	( 6,253)
<b>Intangible assets at year end</b>	<b>33,908</b>	<b>36,617</b>

### Property, plant and equipment

42. Property, plant and equipment is specified as follows:

	2008	2007
	Furnishings, tools and equipment	
Total value at the beginning of the year	67,421	5,186
Additions during the year	25,994	75,956
Total value at year end	93,415	81,142
Depreciated during the year	( 23,306)	( 13,721)
<b>Carrying amount of property, plant and equipment at year end</b>	<b>70,109</b>	<b>67,421</b>

### Tax asset

43. Tax asset is specified as follows:

Tax asset at the beginning of the year	183,451	580
Recognised deferred tax asset	1,854,055	182,871
<b>Tax asset at year end</b>	<b>2,037,506</b>	<b>183,451</b>

### Other assets

44. Other assets are specified as follows:

Unsettled securities transactions	281,700	3,603,551
Various assets	67,635	79,618
Prepaid expenses	18,537	30,249
<b>Other assets</b>	<b>367,873</b>	<b>3,713,418</b>

Unsettled securities transactions were settled within three days from the balance sheet date.

### Trading liabilities

45. Trading liabilities are specified as follows:

Derivatives with financial institutions	10,620	211,876
Other derivatives	35,088	20,812
Securities loans	18,600	0
<b>Trading liabilities</b>	<b>64,308</b>	<b>232,688</b>

Amounts are in ISK thousand

### Borrowings

46. Borrowings are specified as follows:

	2008	2007
Loans from the Icelandic Government and Central Bank	20,390,314	16,289,989
Loans from other financial institutions	563,434	6,121,401
Other loans	1,443,624	886,131
<b>Borrowings</b>	<b>22,397,372</b>	<b>23,297,521</b>

Borrowings are specified as follows by maturities:

Up to 1 month	8,946,162	0
1 to 3 months	0	22,944,079
3 months to 1 year	418,160	353,442
1 to 5 years	6,223,118	0
Over 5 years	6,809,932	0
<b>Borrowings</b>	<b>22,397,372</b>	<b>23,297,521</b>

On 23 March 2009, the bank signed a loan contract with the Ministry of Finance, on behalf of the Icelandic Government, to the total amount of ISK 19,682 million due to the settlement of the Bank's debt with the Central Bank and the Icelandic Government. The loan contract is based on settlement of liabilities in December 2008. These are receivables guaranteed mainly with a pledge in bonds of Glitnir bank hf. and Kaupthing bank hf., in addition to a loan portfolio, Government bonds and cash. The loan is repayable over the next seven years with indexation and 2% interests. During the first two years, only interest is paid and subsequently the loan is paid with even instalments over five years. The first instalment of the loan is due on 27 December 2011.

The Bank applies International Financial Reporting Standards in preparing the financial statements. As interests according to the loan terms are considerably lower than market interests, according to the IFRS, payments on the loan shall be discounted based on market interests, which were estimated at 12%, and the loan shall be recognised at fair value upon initial recognition. The difference thus arising is recognised in the income statement. Due to this, the amount of ISK 6,970 million is recognised as income in the financial statements for the year 2008. The carrying amount of the loan is ISK 13,053 million at year end 2008. Subsequently, effective interests are expensed in the income statement based on the same rate as for the initial discounting of the payments, or 12%.

The loan agreement includes various provisions. Following are the main provisions:

- Dividends shall not be paid to shareholders during the loan term, unless a corresponding principal payment on the loan is made.
- Purchase of own shares to the reduction of share capital is not authorised (indirect dividends), except for purchase of own shares in a trading book and redemption/off-setting of own shares for the settlement of loans and other obligations, as permitted by law at each time.
- Equity ratio (CAD-ratio) may not be lower than 10% over the loan term.
- Should the Bank's liquidity standing deteriorate and become unacceptable by the Central Bank or the equity goes below 10% during the loan term the creditor can request that the loan, based on its remaining balance at that time, including interests and all cost, be transformed into share capital based on the split ratio 1.

#### Other liabilities

47. Other liabilities are specified as follows:

	2008	2007
Unsettled securities transactions	181,021	4,573,098
Trade payables	57,381	278,079
Expensed guarantees	253,632	0
Other liabilities	178,047	317,074
<b>Other liabilities</b>	<b>670,081</b>	<b>5,168,251</b>

Unsettled securities transactions were settled within three days from the balance sheet date.

Amounts are in ISK thousand

#### Equity

48. The nominal value of the Bank's share capital amounted to ISK 9,700 million at year end. Own shares amounted to 127 million and are deducted in the balance sheet. The Bank has pledged own share to the nominal value of ISK 338 million as collateral for loans to the carrying amount of ISK 547 million. The Bank also has further collaterals due to the biggest loans. The Bank's equity and pledged own shares thus amount to ISK 719 million or 7,4% of the Bank's share capital.

The Annual General Meeting has authorised the Bank's Board of Directors to increase share capital by issue of new shares to the nominal value of ISK 2,300 million and the authorisation is valid until the Annual General Meeting in year 2009.

Equity ratio is calculated in accordance with Article 84 of the law on financial undertakings and is 15,1% at year end 2008. According to the law, the ratio may not be lower than 8,0%. According the provisions of a loan agreement with the State, equity ratio shall be calculated in accordance with law and shall be at least 10%.

The year 2008 was the first year that the Bank calculated its equity ratio in accordance with Basel II, which displaced the older regulation. The main change incurred by the new rules was that now a special risk base due to operating risk is calculated. The risk base, according to the Basel II is the total of the weighted risk factors, such as credit risk, securities risk, interest rate risk, currency risk and operating risk inherent with the operation of a financial company.

The ratio is calculated as follows:	2008	2007
Equity	6,177,706	9,749,603
Equity Shares in other financial companies	( 2,319,468)	( 474,068)
<b>Total equity base</b>	<b>3,858,238</b>	<b>9,275,535</b>

Total equity requirement is specified as follows:

Credit risk	1,305,786	462,436
Market risk	743,699	948,010
<b>Equity requirement</b>	<b>2,049,485</b>	<b>1,410,446</b>

Equity base in excess of equity requirement	1,808,753	7,865,089
<b>Equity ratio</b>	<b>15,1%</b>	<b>52,6%</b>

The Financial Supervisory Authority has introduced to the Bank the yet not implemented EU Directive, which discusses the handling of the discounting effect of benefitting terms of financial companies' financial liabilities. Should this Directive be implemented in Iceland it can have a decreasing effect on the Bank's CAD equity ratio. Should the Directive be implemented in law, it will not have a decrease effect on the the banks equity.

<b>49.</b> The Bank's share capital increase during the year is specified as follows:	2008	2007
Effective share capital at the beginning of the year	9,554,645	5,000
Paid in share capital	28,686	9,666,314
Purchased own shares	( 155,000)	( 116,669)
Own shares sold	145,000	0
<b>Effective share capital at year end</b>	<b>9,573,331</b>	<b>9,554,645</b>
Own shares at year end	126,669	116,669

Amounts are in ISK thousand

#### Pledged assets

50. The following table includes the Bank's assets pledged as collaterals for its liabilities and obligations:

	2008	2007
<b>Loans and receivables from credit institutions</b>		
Restricted deposits	734,949	0
Other receivables from credit institutions	175,273	0
Loans	4,437,976	0
<b>Total</b>	<b>5,348,198</b>	<b>0</b>
<b>Trading liabilities</b>		
Government bonds	8,897,062	1,404,675
Bonds	50,708	0
Shares	1,725,843	0
<b>Total</b>	<b>10,673,613</b>	<b>1,404,675</b>
<b>Financial assets designated at fair value</b>		
Bonds	8,111,266	414,284
Shares	2,146,503	0
Derivatives	44,270	0
<b>Total Total</b>	<b>10,302,039</b>	<b>414,284</b>
<b>Total pledged assets</b>	<b>26,323,850</b>	<b>1,818,959</b>

## Related parties

51. The Bank's related parties are its management, managing directors and parties that have considerable influence as major shareholders in the Bank. Information on related parties are the following.

	2008	2007
Loans to the Director and Managing Directors (6)	145.814	137.832
Loans to Directors of the Board and companies related to them	4.111	816.265
	<u>149.925</u>	<u>954.097</u>

During the year, the Bank expensed impairment loss on loans to key employees and private limited companies owned by them to the total amount of ISK 452 million. Among the loans are direct loans to the amount of ISK 198 million and guarantees due to employees' loans with other financial companies, to the total amount of ISK 254 million. Expensed guarantees to the amount of ISK 254 million have been recognised among other liabilities.

During the year 2008, a company owned by a former Managing Director was taken over as extinguishment of the company's debt with the Bank to the amount of ISK 76 million. The Company's only asset was share in the Bank to the total amount of around ISK 50 million. Based on the Bank's management's evaluation, the value of the shares amounts to approximately ISK 40 million and that amount is recognised as reduction in equity. The Company's liabilities in excess of the aforementioned shares amounted to ISK 36 million, which is expensed as impairment loss on loans.

In December 2008, the Bank purchased a 40% share in the Norwegian real estate company City Center Properties AS but the share was owned by one of the Bank's Board members. The purchase price amounted to ISK 661 million. The purchase price was entirely used to settle the seller's loan with the Bank. The seller purchased furthermore the share option of the aforementioned share from the Bank. The share option can be exercised until 9 June 2010. If the share option is exercised the purchase value shall correspond to the selling price in addition to accrued interests, less the purchase price of the share option.

Transactions with related parties have been made on comparable terms of transactions with unrelated parties.

Amounts are in ISK thousand

## OFF BALANCE SHEET ITEMS

52. The Bank has entered into guarantees for its customers amounting to ISK 314 million at year end. Guarantees provided to the amount of ISK 254 million due to loans to holding companies owned by the Bank's Managing Director have been expensed and recognised among other liabilities.

53. On 31 December 2008, the Company was bound by non-cancellable operation lease contracts on real estates and vehicles. The lease agreements are in accordance with general terms on a rental market for industrial housing. Lease payments change in accordance with price indices. Contract terms due to vehicles are for up maximum of three years.

54. The Bank has entered into a rental agreement on real estates used in the operation. The agreements are for up to seven years and the Bank has the priority purchase right to the assets or the right to extend the term at the end of the agreements. Lease payments are specified as follows over the lease term:

	2008	2007
0 to 1 year	37.970	33.223
1 to 5 years	130.972	125.564
Over 5 years	23.307	42.609
<b>Minimum lease payments during the contractual term</b>	<u>192.249</u>	<u>201.396</u>

## Share options

**55.** On 27 August 2007, the Bank's Board of Directors agreed a share option schedule that grants the Bank's employees the right to purchase shares in the Bank. In December, share option agreements were made, which grant Managing Directors the right to purchase 350,000 thousand shares at a contractual rate of 1.4. The option may be exercised during the period from 1 August to 1 September 2010. At the same time share option agreements were made with other employees of the Bank, which grant them the right to purchase 130,000 thousand shares. One third of the option may be exercised during the period from 1 August to 1 September each year, first time in year 2008 and last time in year 2010. The option is at the strike price 1.4 in the first exercise period, 1.47 in the second and 1.54 in the third. Employees have the right to defer to exercise their right within the contractual term but the strike price increase to the price valid in the period that the option is exercised.

Cost due to the agreements has been calculated on the basis of the Black-Scholes valuation model and is expensed during the contractual term among salaries and salary related expenses, for the first time in the year 2008. A counter recognition will be made to a special item among equity where the option agreements will be settled by cession of shares. Estimated cost due to the agreements is ISK 193 million. Important premises used in the calculation of values are specified as follows:

Share options granted in the year 2007	480.000
Fair value of share options at agreement date	192.662
Share option rate	1,40 -1,54
Estimated fluctuation (weighted average fluctuation)	23,0%
Risk free interests (based on treasury bonds)	12,5%

Expensed cost due to share options in the year 2008 amounted to ISK 60 million after taking into account expired share options to the amount of ISK 71 million due to former employees. The Bank's employees did not exercise their share option in the year 2008.

## Events after the balance sheet date

**56.** No events have taken place after the balance sheet date that would require any adjustments and corrections to the financial statements for the year 2008. The financial statements will be presented in a shareholders' general meeting for approval.

Amounts are in ISK thousand





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