

ANNUAL REPORT | ÁRSSKÝRSLA | 2010

**SAGA**  
FJÁRFESTINGARBANKI







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Gunnar Thor Gislason, Chairman

*Gunnar Þór Gíslason*



Hersir Sigurgeirsson, CEO

*Hersir Sigurgeirsson*

## ADDRESS OF CHAIRMAN AND CEO

The Bank started the year 2010 with good equity and liquidity positions following the financial restructuring that was completed at the end of 2009. Given the Bank's strong position, growth in commission income between 2008 and 2009 and expectations of a turnaround in the economy in 2010, the Board and management decided to further expand the Bank's fee-related activities, focus on investment banking activities and serve the business sector in particular, i.e. companies, institutional investors and funds. In line with this, the Bank's Corporate Finance division was strengthened with the acquisition of Möttull ehf., a specialised consultancy in reorganisation, restructuring and mergers of corporations, the Bank's Capital Markets division was strengthened by increasing the number of employees and the Bank established a new division for the development of asset management for the Bank's customers.

## OPERATIONS AND MILESTONES IN 2010 |

The Bank's operations were promising during the first half of the year. The Bank kept its leading position in the primary bond market by underwriting issues for three municipalities and a real estate company, and the Bank's customer base in the secondary market grew considerably. The pipeline in Corporate Finance also grew considerably, and the Bank worked on several major projects that were expected to yield substantial revenues in the second half of the year.

## ÁVARP FORMANNS OG FORSTJÓRA

Saga Fjárfestingarbanki hóf árið 2010 með góða eiginfjár- og lausafjárstöðu í kjölfar fjárhagslegrar endurskipulagningar bankans sem lokið var við í lok árs 2009. Í ljósi sterkrar stöðu bankans, mikils vaxtar í þóknatekjum milli árana 2008 og 2009 og væntinga um viðsnúning í hagkerfinu, var í upphafi árs blásið til sóknar í þóknatengdri starfsemi. Niðurstaða stefnumótunar í upphafi ársins var að leggja áherslu á fjárfestingarbankastarfsemi og þjóna einkum atvinnulífínu, þ.e. fyrirtækjum, stofnanafjárfestum og sjóðum. Í takt við þessa niðurstöðu var Fyrirtækjaráðgjöf bankans efd með kaupum á rágjafarfyrirtækinu Möttli. Markaðsviðskipti bankans voru efd með fjölgun starfsmanna og komið var á fót nýju tekjusviði til uppbyggingar á eignastýringu og eignaumsýslu fyrir viðskiptamenn bankans.

## REKSTUR OG ÁFANGAR 2010 |

Ágætis gangur var í rekstri bankans á fyrri hluta ársins. Bankinn hélt leiðandi stöðu sinni á frummarkaði skuldabréfa með frumútgáfum fyrir þrjú sveitarfélög og fasteignafélag og fjölgaði viðskiptamönnum bankans á eftirmarkaði. Verkefnum í Fyrirtækjaráðgjöf fjölgaði mikið og vann bankinn að nokkrum stórum verkefnum sem útlit var fyrir að myndu skila bankanum talsverðum tekjum á seinni hluta ársins.

Aukin umsvif í starfsemi Saga Fjárfestingarbanka áttu sér öll stað í útibúi bankans í Reykjavík og um mitt ár var húsnæði hans að Skógarhlið 22 orðið of lítið og

The expansion took place in the Reykjavik branch, and at the end of the first half, the branch had become too small and unsuitable for the Bank's operations. In November, the Reykjavik branch was relocated to new, larger and more suitable premises on the 14th floor on Höfðatorg. At the same time, the Bank's name was changed to Saga Investment Bank hf. to underscore the Bank's expertise and unique position as a corporate bank and the only investment bank in Iceland.

Preparations for the custody and settlement company T plus hf. were continued during the year, and at the end of the year, the company received its charter from the Financial Supervisory Authority. The Bank's Securities Services division was transferred to T plus at the end of the year along with four employees. T Plus began formal operation on 1 January in the new year, and the company is off to a good start.

During the second half of the year, the Bank's operations slowed down, and at the end of the third quarter, there was increased evidence that the Bank's budget for the year would not be met. The Corporate Finance division's large projects were either delayed or cancelled, and the primary bond market diminished. As a result, the Bank's commission income in the second half was far below expectations. A crash in the bond market in late September also caused the Bank, like other bond investors, some financial loss that reduced the capital gains that had been achieved in the first

óhentugt fyrir starfsemina. Því var tekin ákvörðun um að flytja starfsemina í stærra og hentugra húsnæði og í nóvember var útibú bankans flutt í nýtt og glæsilegt húsnæði á 14. hæð að Höfðatorgi. Um leið var nafni bankans breytt í Saga Fjárfestingarbanki hf. til að undirstrika sérhæfingu bankans og sérstöðu sem banki atvinnulífsins og eini fjárfestingarbanki landsins.

Undirbúningur fyrir starfsemi vörslu- og uppgjörsfyrirtækisins T Plús hf. var haldið áfram á árinu og undir lok árs fékk það starfsleyfi frá Fjármálaeftirlitinu. Uppgjörssvið bankans var flutt yfir til T Plús í lok árs og fluttust fjórir starfsmenn uppgjörssviðs bankans jafnframt yfir til fyrirtækisins. T Plús hóf formlega starfsemi 1. janúar á nýju ári og hefur starfsemi þess farið vel af stað.

## Nafni bankans var breytt í Saga Fjárfestingarbanki hf. til að undirstrika sérhæfingu bankans.

Á seinni hluta ársins hægðist mjög um í starfsemi bankans og viðskiptaumhverfi hans og í lok þriðja ársfjórðungs voru blikur á lofti um að áætlanir bankans myndu ekki ganga eftir. Stór verkefni Fyrirtækjaráðgjafar annað hvort töfðust eða lögðust af og hverfandi umsvif voru á frummarkaði skuldabréfa. Þóknunatekjur á seinni hluta árs voru fyrir vikið langt undir áætlun. Þá varð einnig hrún á skuldabréfamarkaði í lok september sem olli bankanum eins og öðrum skuldabréfafjárfestum nokkru fjárhagslegu

### Principal results from Saga Investment Bank's policy formulation

- Specialised investment bank for Icelandic companies and business environment
- Spotlight on the dynamic services provided by Corporate Finance and Capital Markets

### Helstu niðurstöður úr stefnumótun Saga Fjárfestingarbanka

- Sérhæfður fjárfestingarbanki fyrir íslensk fyrirtæki og atvinnulíf
- Áhersla á öflugna Fyrirtækjaráðgjöf og Markaðsviðskipti

half and also lowered the Bank's commission income in the secondary market. In addition, the high interest payments on the Bank's subordinated loan led to a negative interest margin for the year.

## BUSINESS STRATEGY |

Towards the end of the year, it became clear that the expected turnaround in the economy had not materialised and that there was no evidence of any change in that respect in the coming quarters. In light of that and the Bank's performance in 2010, the Board and Management undertook an extensive review of the Bank's business model. The result was to place an even greater focus on core operations and cut down all non-performing activities.

The operational restructuring included reducing the number of employees to the extent that was possible without reducing the Bank's income or increasing operational risk. The newly founded Asset Management division was abolished, the Credit Department was merged with Proprietary Trading and Treasury and the employees of the merged division cut by half, and further layoffs were in Corporate Finance, management and support divisions. In all, the number of staff decreased from 37 to 23 in January 2011. In May, it was also decided to combine the operations under one roof by relocating the Bank's headquarters to Höfðatorg, Reykjavík and shutting down the operations in Akureyri, further reducing the number of staff to 17.

tjóni. Gekk á gengishagnað bankans sem náðst hafði á fyrri hluta árs og dró jafnframt úr þóknatekjum á eftirmarkaði. Að auki komu háar vaxtagreiðslur af víkjandi láni bankans niður á vaxtamun sem leiddi til þess að vaxtamunur bankans var neikvæður yfir árið.

## STEFNUMÓTUN |

Undir lok árs varð ljóst að sá viðsnúningur í hagkerfinu sem búist hafði verið við á árinu 2010 hafði látið á sér standa og ekki var útilit fyrir að breyting yrði í þeim efnun næstu misserin. Í ljósi þess og afkomu bankans á árinu réðust framkvæmdastjórn og stjórn í viðamikla endurskoðun á viðskiptalíkani bankans. Niðurstaðan var að leggja enn meiri áherslu á kjarnastarfsemi bankans og skera niður alla þá starfsemi sem ekki var að skila bankanum tekjum umfram kostnað.

Hagræðingin fólst m.a. í fækkun starfsmanna að því marki sem unnt var án þess að það bitnaði á tekjuöflunarmöguleikum eða leiddi til aukinnar rekstraráhættu. Nýstofnað svið Eignaumsýslu var lagt niður, Útlánasvið var sameinað Eigin viðskiptum og Fjárfstýringu og starfsmönnum sameinaðs sviðs fækkað um helming. Fækkað var í Fyrirtækjaráðgjöf sem og yfirstjórn bankans og á stoðsviðum. Samantekið fækkaði starfsmönnum úr 37 í 23 og komu aðgerðirnar til framkvæmda í janúar 2011. Í maí var enn fremur ákveðið að sameina starfsemi bankans undir eitt þak með því að flytja höfuðstöðvar hans að Höfðatorgi í Reykjavík og loka starfsstöðinni á Akureyri. Við það fækkaði starfsmönnum bankans niður í 17.

The result was to place an even greater focus on core operations.

Niðurstaðan var að leggja enn meiri áherslu á kjarnastarfsemi bankans.

## OUTLOOK |

The restructuring undertaken at the beginning of the new year makes the Bank well suited both to endure the low economic activity and to seize opportunities when the economy recovers. However, the Bank's equity declined considerably during the year, and it needs to be increased if the Bank is to continue its operations unchanged.

On this occasion, and in light of the challenging tasks ahead, we take the opportunity to thank the Bank's employees, and those who have left the Bank, for their work on behalf of the Bank's shareholders and clients.

**Gunnar Thor Gislason, Chairman of the Board**  
**Hersir Sigurgeirsson, CEO**

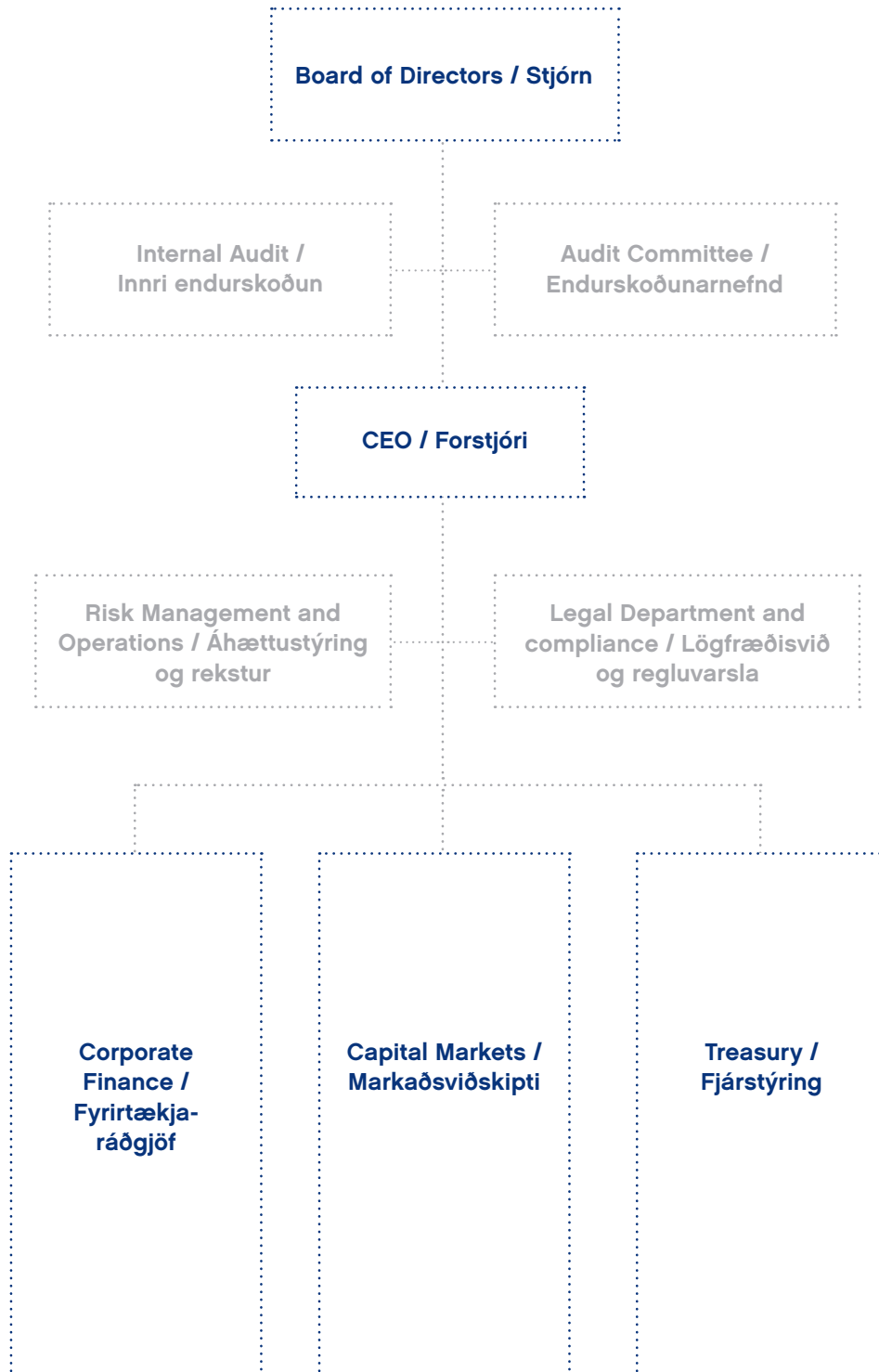
## HORFUR Í STARFSEMI |

Þær hagræðingaraðgerðir sem ráðist var í undir lok ársins 2010 og í upphafi nýs árs gera bankann vel settan, bæði til að þreyja þorrann meðan langþráður viðsnúningur í hagkerfinu og viðskiptaumhverfinu lætur á sér standa, sem og til að fanga byrinn þegar hann gefst. Þó er ljóst að talsvert gekk á eigið fé bankans á árinu og að nauðsynlegt er að auka það á ný, eigi bankinn að geta starfað áfram í óbreyttri mynd.

Eftir krefjandi ár, og í ljósi þeirra ögrandi verkefna sem framundan eru, er tilefni til að þakka starfsfólki bankans og þeim sem látið hafa af störfum, fyrir störf þeirra í þágu hluthafa og viðskiptavina bankans.

**Gunnar Þór Gíslason, stjórnarformaður**  
**Hersir Sigurgeirsson, forstjóri**





## SHAREHOLDERS

Saga Investment Bank hf. is owned by Saga Eignarhaldsfelag hf. (90.1%) and Hilda hf (9.9%).

The largest shareholders in Saga Eignarhaldsfelag and Hilda as of June 1. 2011 are:

## HLUTHAFAR

Saga Fjárfestingarbanki hf. er að 90,1% í eigu Saga Eignarhaldsfélags hf. og 9,9% í eigu Hildu hf.

Stærstu hluthafar í Saga Eignarhaldsfélagi og Hildu þann 1. júní 2011 eru:

1..... Hvarf eignarhaldsfélag ehf.....	10,73%
2..... Sundagarðar hf .....	10,47%
3..... KEA eignir ehf .....	9,56%
4..... BYR hf.....	7,47%
5..... A.C.S safnreikningur I / Pillar Securitisation S.à.r.l.....	7,33%
6..... AB-fjárfestingar ehf.....	5,23%
7..... Arion banki hf.....	4,29%
8..... G14 ehf.....	4,19%
9..... Þorvaldur Lúðvík Sigurjónsson.....	3,66%
10..... Seggur ehf .....	3,14%
11..... Sparisjóður Svarfdæla .....	3,14%
<b>Total   Samtals.....</b>	<b>69,21%</b>



## OPERATIONAL MILESTONES IN 2010

**TREASURY** | Three of Saga Investment Bank's divisions were merged under Treasury in 2010, which is now responsible for the Bank's balance sheet, both debt and asset portfolios. Day-to-day operations of the Treasury are divided into three departments, each serving various aspects of the balance sheet: Treasury, Proprietary Trading and Debt Finance. The merger resulted in changes in personnel as well as significant financial cost reduction.

Treasury is responsible for financing the Bank's balance sheet on both domestic and international money markets. Treasury is also responsible for liquidity management, foreign currency balances and settlement systems.

Proprietary Trading manages the Bank's asset portfolios, with participation on both domestic and international markets. The Bank's investments are in stocks, bonds and derivatives. In 2010, focus was placed upon risk reduction, which the Bank has achieved. The Bank is active as a market maker on the Iceland Stock Exchange, with bonds issued by the Icelandic State, the Icelandic Housing Fund and several others entities, with good operating results for the Bank. Furthermore, a market making agreement was signed with Icelandair during the year, and existing agreements with other issuers were renewed.

## ÁFANGAR Í REKSTRI ÁRIÐ 2010

**FJÁRSTÝRING** | Á árinu 2010 voru þrjú svið Saga Fjárfestingarbanka sameinuð undir Fjárstýringu, sem nú ber ábyrgð á efnahag bankans, bæði skulda- og eignahlið hans. Starfsemi Fjárstýringar skiptist í þrjár undirdeildir sem annast ólíka þætti efnahagsreikningsins: Skuldastýringu, Eigin viðskipti og Útlánadeild. Í kjölfar endurskipulagningarinnar urðu nokkrar breytingar á starfsmannahaldi sviðanna og í henni fólst jafnframt umtalsverð fjárhagsleg hagræðing.

Starfsemi Fjárstýringar hefur þurft að laga sig að breyttum aðstæðum á innlendum fjármálamarkaði.

Skuldastýring Saga Fjárfestingarbanka annast skuldahlið efnahagsreikningsins með fjármögnun bankans á innlendum og erlendum mörkuðum. Að auki annast Skuldastýring hefðbundna lausafjárstýringu bankans, stýrir gjaldeyrisjöfnuði og annast greiðslumiðlun.

Eigin viðskipti Saga Fjárfestingarbanka annast stýringu á eignahlið bankans með þátttöku á innlendum og erlendum verðbréfamörkuðum. Fjárfestingar bankans eru ýmist í hlutabréfum, skuldabréfum eða afleiðum. Á árinu var haldið áfram að draga úr áhættu á eignahlið

Debt Finance is responsible for providing loans to firms and institutional investors. A broad range of products are available, each tailored for the different needs of each customer. During the year, a significant share of the loan portfolio was sold and the Bank's risk reduced accordingly. New debt finance was limited during the year, reflecting poor market conditions.

The Bank's main market was at a standstill during the year, and Treasury's main focus has been to adjust its operations accordingly. The Bank has reduced its risk successfully and has maintained and improved both debt and asset portfolios.

**CORPORATE FINANCE** | Saga Investment Bank's Corporate Finance division provides advice and assistance in acquisitions, sales, mergers and the restructuring of companies and operating units. Corporate Finance's highlight in 2010 was the purchase of the advisory firm Mottull. With this acquisition, the division has strengthened significantly, both in terms of experience and in relationships with investors and other clients. The addition of the staff from Mottull to the Bank's team will be especially important when the Icelandic economy starts to recover.

A large proportion of Corporate Finance's income is reliant upon success and closing of projects, which in turn is closely correlated to the economy. Early in 2010, it was clear that the economy would not recover as hoped for. It was therefore necessary to change course and enhance focus on regular

bankans og gekk sú vinna ágætlega. Bankinn tekur jafnframt virkan þátt á skuldabréfamarkaði sem viðskiptavaki fyrir Íbúðalánasjóð og Lánasýslu ríkisins og ýmsa aðra útgefendur og gekk sú starfsemi vel á árinu. Jafnframt var skrifað undir viðskiptavakasamninga við Ícelandair á árinu og eldri samningar við aðra útgefendur endurnýjaðir.

Útlánadeild Saga Fjárfestingarbanka annast útlán til fyrirtækja og stofnanafjórfa. Í boði eru fjölbreytt lánsform þar sem leitast er við að uppfylla mismunandi þarfir viðskiptavina bankans. Á árinu var nokkur hluti útlánasafnsins seldur og þannig dregið úr áhættu bankans. Útlánastarfsemi var mjög takmörkuð á árinu og skýrist það fyrst og fremst af ytri markaðsskilyrðum. Ytra umhverfi bankans var almennt erfitt á árinu og hefur starfsemi Fjárfestingarbanka þurft að laga sig að breyttum aðstæðum á innlendum fjármálamarkaði. Það hefur tekist ágætlega, s.s. með því að draga úr áhættu bankans og styrkja stöðir skulda- og eignarhliðar hans.

**FYRIRTEKJARÁÐGJÖF** | Fyrirtækjaráðgjöf Saga Fjárfestingarbanka veitir ráðgjöf og aðstoð í tengslum við kaup, sölu, samruna og endurskipulagningu fyrirtækja og rekstrareininga. Það sem bar hæst í starfsemi Fyrirtækjaráðgjafar á árinu 2010 var stækkun sviðsins með kaupum á ráðgjafarfyrirtækinu Möttli. Með kaupunum á Möttli bættust í hópinn reynslumiklir einstaklingar með sterk sambönd og þekkingu sem munu reynast mikilvæg viðbót til að sækja fram með enn öflugri hætti þegar hægagangur og óvissa í efnahagslífinu minnkar.

income, e.g. with advisory contracts with the state, energy companies and heavy industries. This change of course has resulted in material growth in regular income and a general contract with the state which gives further opportunities for new projects going forward.

Provided that the economy will start to recover in 2011, the Corporate Finance division is in a very favourable position to quickly capitalise on increased activity.

This change of course has resulted in material growth in regular income and a general contract with the state which gives further opportunities for new projects going forward.

**CAPITAL MARKETS** | Saga Investment Bank's Capital Markets division continued as before, with an on-going emphasis on fixed income trading. The Bank maintained a strong position in initial bond issuance for companies and municipalities. In the year 2010, some municipalities had to negotiate with their creditors due to high debt levels. Uncertainty about the outcome of those negotiations has, however, resulted in fewer municipalities issuing bonds in 2010 than in the previous year.

Tekjur af hefðbundnum verkefnum á sviði fyrirtækjaráðgjafar eru í flestum tilfellum tengdar árangri við að verkefni komist á framkvæmdastig, sem aftur er háð umsvifum í efnahagslífinu. Á fyrri hluta ársins 2010 var ljóst að umsvif efnahagslífsins yrðu lítil á árinu og því reyndist nauðsynlegt að breyta áherslum og bæta reglulegt tekjuflæði Fyrirtækjaráðgjafar. Mikil áhersla hefur verið lögð á að styrkja reglulegan tekjugrunn sviðsins, m.a. með aukinni ráðgjöf til opinberra aðila, orkufyrirtækja og orkufreks iðnaðar, með góðum árangri. Fyrirtækjaráðgjöf er nú jafnframt komin með rammasamning við Ríkissjóð, sem mun bæta aðgengi að verkefnum sviðsins hjá opinberum aðilum enn frekar.

Mikil áhersla hefur verið lögð á að styrkja reglulegan tekjugrunn sviðsins, m.a. með aukinni ráðgjöf til opinberra aðila, orkufyrirtækja og orkufreks iðnaðar, með góðum árangri

Að því gefnu að efnahagslífið taki frekar við sér á árinu 2011 munu tækifærin í fyrirtækjaráðgjöf felast í ráðgjöf við fjármögnun verkefna. Fyrirtækjaráðgjöf Saga Fjárfestingarbanka er vel í stakk búin til að grípa þau tækifæri sem bjóðast.

In 2010, the Bank led the sale of a bond issue for real estate funding. The Bank predicts that the financing needs of the real estate market will be met in the coming years with funding through the capital markets rather bank financing, and the Bank is well prepared to take advantages of such opportunities.

In 2010, the operational focus of Capital Markets was to strengthen its market share in secondary trading in the government bond market. The result from that work was acceptable. In conjunction with that operational focus, the number of active clients has grown considerably. The revenues of the Capital Markets division are now more stable and come from a more diverse pool of clients.

The Bank's management is confident that a greater presence in the secondary market will further strengthen the Bank's abilities to execute debt capital market transactions effectively.

## MARKAÐSVIÐSKIPTI | Markaðsviðskipti

Saga Fjárfestingarbanka héldu uppteknum hætti frá fyrra ári með áframhaldandi áherslu á skuldabréfaviðskipti. Bankinn hélt sterkri stöðu í frumútgáfum fyrirtækja og sveitarfélaga. Á árinu 2010 þurftu nokkur sveitarfélög að leita samninga við lánadrottna sína vegna mikilla skulda, en óvissa um hvaða úrlausnir verða ofan á í samningum þeirra hefur leitt til samdráttar í skuldabréfaútgáfum sveitarfélaga árið 2010 frá árinu áður.

Bankinn leiddi sölu á frumútgáfu skuldabréfa til fjármögnunar á fasteignum á árinu 2010. Viðbúin er að fjármögnun fasteigna muni þurfa að leita í gegnum verðbréfamarkaðinn á næstu misserum og er bankinn vel undirbúinn fyrir aukin umsvif á þeim markaði.

Á árinu var lögð áhersla á að auka miðlunartekjur af eftirmarkaðsviðskiptum með ríkisskuldabréf. Árangurinn af þeirri vinnu var ásættanlegur. Samhliða þeirri vinnu varð jafnframt mikil aukning virkra viðskiptavina og eru tekjur sviðsins því stöðugri og dreifðari í dag en verið hefur.

Það er mat bankans að þjónusta vegna viðskipta á eftirmarkaði styrki enn fremur stöðu bankans til að verðleggja og selja frumútgáfur opinberra aðila og einkageirans.





## SAGA INVESTMENT BANK'S CORPORATE GOVERNANCE STATEMENT

Saga Investment Bank is now publishing its Corporate Governance Statement for the second year, but since its establishment, the Bank has placed great importance on transparency and honesty in its operations. In this spirit, the Bank strives to publish as detailed information on its operations as possible, and the Bank's Corporate Governance Statements can be found on its website [www.sagabank.is](http://www.sagabank.is). Saga Investment Bank is a pioneer in this respect and has established and adopted rules of procedure that reach further than regulatory requirements and has immediately published new rules on the Bank's website.

Saga Investment Bank follows the third edition of Corporate Governance Guidelines, first issued in 2004, in co-operation with the Iceland Chamber of Commerce, NASDAQ OMX Iceland hf. and the Confederation of Icelandic Employers. The Corporate Governance Guidelines are intended, among other things, to strengthen the infrastructure of companies and increase public confidence in their operation and are now available on the website of the Icelandic Chamber of Commerce,

[http://www.vi.is/files/Corporate%20Governance%20June%202009\\_867414528.pdf](http://www.vi.is/files/Corporate%20Governance%20June%202009_867414528.pdf).

The following text contains detailed information on individual aspects of Saga Investment Bank's corporate governance. Chapter headings are in accordance to the Guidelines. Helga Hlin Hakonardottir, ([helga@sagabank.is](mailto:helga@sagabank.is)) Attorney at Law and Managing Director of Saga Investment Bank's Legal Department, provides further information upon request.

## STJÓRNARHÁTTAYFIRLÝSING SAGA FJÁRFESTINGARBANKA

Saga Fjárfestingarbanki birtir nú annað árið í röð tæmandi stjórnarháttayfirlýsingu, enda hefur bankinn frá upphafi lagt mikla áherslu á gegnsæi og heiðarleika í starfi sínu. Í þeim anda hefur bankinn ætíð kappkostað að birta sem ítarlegastar upplýsingar um starfsemina og eru stjórnarháttayfirlýsingar bankans að finna á heimasíðu hans, [www.sagabanki.is](http://www.sagabanki.is). Saga hefur verið í fararbroddi hvað þetta varðar og jafnan sett sér ítarlegri verklagsreglur um starfsemi bankans en lög krefjast og birt þær jafnóðum.

Stjórnarháttayfirlýsing Saga byggir á 3. útgáfu Stjórnarháttayfirlýsingar fyrirtækja frá 18. júní 2009, sem gefnir voru út í samstarfi Viðskiptaráðs Íslands, Kauphallar Íslands og Samtaka atvinnulífsins. Stjórnarháttayfirlýsing fyrirtækja er meðal annars ætlað að styrkja innviði fyrirtækja og auka traust almennings á starfsemi þeirra og eru þeir aðgengilegir á heimasíðu Verslunarráðs Íslands [http://www.vi.is/files/CG3lokaweb\\_886826181.pdf](http://www.vi.is/files/CG3lokaweb_886826181.pdf).

Hér að neðan er að finna ítarlegar upplýsingar um einstaka þætti stjórnarháttayfirlýsingar Saga og eru kaflaheitin í samræmi við leiðbeiningar í Stjórnarháttayfirlýsing fyrirtækja. Helga Hlin Hakonardóttir hdl., framkvæmdastjóri Lögfræðisviðs ([helga@sagabanki.is](mailto:helga@sagabanki.is)), veitir nánari upplýsingar ef óskað er.

## LAWS AND REGULATIONS

### 1. References to the rules on corporate governance that Saga Investment Bank follows or is obliged to follow pursuant to law and where such rules can be accessed by the public

In addition to the 3rd edition of the Corporate Governance Guidelines, Saga Investment Bank operates on the basis of Act No. 161/2002 on Financial Undertakings and Act No. 108/2007 on Securities Transactions. The Bank has an operating licence from the Financial Supervisory Authority to operate as a credit undertaking (investment bank). Moreover, the Financial Supervisory Authority monitors the Bank's activities as provided for by law. A summary of the laws and regulations applicable to credit undertakings may be accessed on the website of the Financial Supervisory Authority, <http://fme.is/?PageID=395>.

### 2. Whether Saga Investment Bank departs from the rules or applies none of their provisions, the reason for departure must be stated, as must the measures used instead

As stated earlier, Saga Investment Bank complies with and applies all the provisions of the 3rd edition of the Corporate Governance Guidelines.

### 3. A description of the main aspects of Saga Investment Bank's internal controls and risk management in connection with the preparation of financial statements

Saga Investment Bank's Board of Directors is responsible for establishing a system for risk management and internal auditing and is also responsible for monitoring the effectiveness of such systems. Such systems were adopted immediately upon the establishment of the Bank in order to identify and limit risk in its operation, together with making information disclosure and settlements more reliable. However, this does not completely insure Saga Investment Bank against incorrect disclosure of information or against possible losses, as the nature of the Bank's operation requires it to take risks that may lead to losses.

## LÖG OG REGLUR

### 1. Tilvísanir í þær reglur um stjórnarhætti sem Saga fylgir eða ber að fylgja samkvæmt lögum og hvar slíkar reglur eru aðgengilegar almenningi.

Til viðbótar við 3. útgáfu Stjórnarháttanna fyrir tækja starfar Saga Fjárfestingarbanki m.a. á grundvelli laga nr. 161/2002 um fjármálafyrirtæki og laga nr. 108/2007 um verðbréfavíðskipti. Bankinn hefur starfsleyfi frá Fjármálaeftirlitinu til að starfa sem lánafyrirtæki (fjárfestingarbanki). Fjármálaeftirlitið hefur jafnframt eftirlit með starfsemi bankans eins og lög gera ráð fyrir. Yfirlit yfir viðkomandi lög og reglur um starfsemi lánafyrirtækja má nálgast á heimasíðu Fjármálaeftirlitsins

<http://fme.is/?PageID=31>.

### 2. Hvort Saga Fjárfestingarbanki víki frá hluta reglnanna eða beiti engum ákvæðum þeirra. Greina skal frá ástæðum fráviks og þeim úrræðum sem gripið var til í stað þeirra

Eins og að framan greinir fylgir Saga Fjárfestingarbanki eftir og beitir öllum ákvæðum í 3. útgáfu Stjórnarháttanna fyrir tækja.

### 3. Lýsing á helstu þáttum innra eftirlits og áhættustýringar Saga Fjárfestingarbanka í tengslum við samningu reikningsskila

Stjórn Saga Fjárfestingarbanka ber ábyrgð á að koma á fót kerfi fyrir áhættustýringu og innra eftirlit, en einnig að fylgjast með virkni þess. Slíku kerfi var komið á strax við stofnun bankans til að bera kennsl á og takmarka áhættu í rekstri hans, ásamt því að gera upplýsingagjöf og uppgjör áreiðanlegri. Það tryggir Saga þó hvorki algerlega gegn rangri upplýsingagjöf né mögulegu tapi, enda krefst starfsemi bankans þess iðulega að tekin sé áhætta sem mögulega getur leitt til taps.

Stjórn Saga setur einnig innri reglur varðandi starfsemi bankans, þar á meðal áhættustefnu, útlánareglur, lausafjárstefnu og reglur um aðrar fjárfestingar fyrir eigin reikning. Áhættustýring bankans ber ábyrgð á að bera kennsl á hvers konar áhættu í rekstri hans, meta hana og stýra henni í samvinnu við önnur svið. Hún hefur einnig eftirlit með að innri reglum bankans sé

Saga Investment Bank's Board also establishes internal rules for the operation of the Bank, including risk policies, lending rules, liquidity policies and rules on other investments on its own account. The Bank's Risk Management is responsible for identifying risk in its operation, assessing it and managing it in co-operation with other departments. It is also responsible for monitoring compliance with the Bank's internal rules during decision-making. The Bank's Asset & Liability Committee makes decisions on lending, and forms and supervises the Bank's liquidity policy, the Market Risk Committee as regards control of any market risks and the Security Council as regards operating risk and security issues.

Each department within the Bank prepares an operating plan for the upcoming year's operations. The operation of the Bank as a whole, and each department separately, is settled on a monthly basis. This makes it possible for the Bank's Board of Directors to compare projections, follow changes in operations and take action in the event of substantial diversions.

On 13 April 2007, the Board of Directors of Saga Investment Bank entered into an agreement with Deloitte hf. for internal auditing of the Bank. According to this agreement, Deloitte will annually prepare an internal audit plan specifying the tasks of the Bank's internal auditors. The schedule and supervision based thereon is based on Article 16 of Act No. 161/2002 on Financial Undertakings and on Chapter 1 of the Financial Supervisory Authority's Guideline No. 3/2008 on the work of internal auditing departments within financial undertakings. Deloitte will submit the results of the internal audits directly to the Board, and reviews the results at least semi-annually on Board meetings. Saga's Risk Management is responsible for following internal auditor's observations through.

fylgt í ákvarðanatöku. Lánanefnd bankans tekur ákvarðanir varðandi útlán og mótar og hefur eftirlit með lausafjárstefnu, Markaðsáhættunefnd varðandi stýringu á hvers konar markaðsáhættu og Öryggisráð varðandi rekstraráhættu og öryggismál.

Árlega gerir hvert svið bankans áætlun fyrir rekstur næsta árs. Rekstur bankans í heild og hvers sviðs er gerður upp mánaðarlega, en það gerir stjórn bankans kleift að bera árangur saman við áætlanir, fylgjast með breytingum í rekstri og grípa til aðgerða ef um verulega neikvæðar breytingar er að ræða.

Hinn 13. apríl 2007 gerði stjórn Saga samning við Deloitte hf. um innri endurskoðun bankans. Samkvæmt honum skal Deloitte gera árlega innri endurskoðunaráætlun sem tilgreinir verkefni innri endurskoðenda bankans. Áætlunin og eftirlit samkvæmt henni miðast við 16. grein laga nr. 161/2002 um fjármálafyrirtæki og 1. kafla leiðbeinandi tilmæla Fjármálaeftirlitsins nr. 3/2008 um störf endurskoðunardeilda fjármálafyrirtækja. Innri endurskoðandi skilar niðurstöðum innra eftirlits hverju sinni beint til stjórnar og fer yfir niðurstöður starfa sinna á stjórnarfundum tvisvar á ári. Eigi sjaldnar en árlega gerir innri endurskoðun Fjármálaeftirlitinu grein fyrir niðurstöðum kannana sinna. Áhættustýring bankans ber ábyrgð á að fylgja eftir ábendingum innri endurskoðunar.

## VALUES AND SOCIAL RESPONSIBILITY

### 4. Saga Investment Bank's values, code of ethics and social responsibility policies

The most valuable assets financial undertakings have are trust and credibility, which are again governed by the ethical standards of their employees. Saga Investment Bank focuses on ensuring the Bank's and its employees' trustworthiness and credibility with respect to its shareholders, customers and society. In this respect, the education and knowledge of employees, together with the Bank's rules on ethics and conduct, are important aspects, while results will always depend on the mentality of the employees in question. Moreover, the Bank's management focuses on creating an environment and a culture that is most likely to support and increase the quality of their employees' morals.

The main rules and procedures to this end are as follows:

#### Values

Saga Investment Bank's values are reflected in the acronym **SOLID**, which stands for the values on which the Bank's operations rest. They are:

- Strong team spirit and unity
- Outstanding services
- Leader in the market
- Integrity and dependability
- Discipline and results

These values arose from a policy development session carried out by employees and the Board of Saga Investment Bank in 2008. The Bank's employees are encouraged to adopt these values in their work and in communications with others.

#### Social responsibility

Saga Investment Bank understands that companies not only have an economic impact on their community but also a considerable geographical and social impact. Therefore, it is important that the Bank always

## GILDI OG SAMFÉLAGSLEG ÁBYRGÐ

### 4. Gildi Saga Fjárfestingarbanka, siðareglur og stefna um samfélagslega ábyrgð

Dýrmætasta eign fjármálafyrirtækja er traust og trúverðugleiki sem aftur ræðst af siðferði starfsmanna þeirra. Saga Fjárfestingarbanki leggur höfuðáherslu á að tryggja traust og trúverðugleika bankans og starfsmanna hans gagnvart hluthöfum, viðskiptavinum og samfélaginu. Þar skipa fræðsla og þekking starfsmanna, ásamt siðferðis- og hegðunarreglum bankans, mikilvægan sess en niðurstaðan grundvallast þó alltaf á hugarfari viðkomandi starfsmanna. Stjórnendur leggja því ríka áherslu á að skapa þá umgjörð og menningu sem líklegust er til að hlúa að og stuðla að aukinni siðferðisvitund starfsmanna bankans.

Helstu reglur og starfshættir þessu lútandi eru eftirfarandi:

#### Gildi

Þau gildi sem starfsemi Saga hvílir á endurspeglast í skammstöfuninni **FESTA**. Þau eru:

- Framúrskarandi þjónusta
- Eining og sterk liðsheild
- Skrefinu á undan
- Traust og heilindi
- Agi og árangur

Gildi þessi spruttu upp úr stefnumótunarvinnu starfsmanna og stjórnar Saga árið 2008. Starfsmenn bankans eru hvattir til að tileinka sér þau í starfi sínu og samskiptum.

#### Samfélagsleg ábyrgð

Saga Fjárfestingarbanki gerir sér grein fyrir því að fyrirtæki hafa ekki aðeins hagfræðileg áhrif á nærumhverfi sitt, heldur einnig mikil landfræðileg- og félagsleg áhrif. Því er mikilvægt að bankinn hafi ætíð samfélagslega ábyrgð að leiðarljósi bæði í innri og ytri athöfnum og gjörðum sínum, jafnt í samskiptum bankans við viðskiptavini, starfsmenn, þjónustuaðila og samfélagið í heild.

takes into account its social responsibility in both its internal and external activities, i.e. equally in the Bank's communications with customers, employees, service providers and society at large.

Since its establishment, Saga Investment Bank has actively supported social issues and has provided over 100 grants to diverse projects, both large and small. Among other things, the Bank has formulated the policy of keeping Christmas expenses to a minimum in order to provide a deserving cause with a substantial grant instead. The Bank's employees have for the past three years elected to have the Bank's Christmas grant paid to Mæðrastyrsnefnd (the Society for Assistance to Mothers). Among other projects especially dear to us are various educational grants and support for cultural and musical events.

Saga Investment Bank believes that corporate social responsibility should not be limited to the provisions of grants, but rather that it can have a positive impact on society by diverse means and can set a good example. In light of past events in the Icelandic business sector, Saga Investment Bank is of the opinion that it is extremely important that the Bank guard its reputation and impartiality and continue to operate, as hitherto, sincerely and in an open and transparent manner.

### **Conflicts of interest and confidentiality**

Saga Investment Bank's has established a Policy on Conflicts of Interest to prevent conflicts of interest from arising between the Bank and its clients on the one hand, and between different clients of the Bank on the other hand, particularly with regard to trading in financial instruments. Moreover, the Board of Directors has established Rules of Procedure for Proprietary Trading by Saga Investment Bank and its employees. These rules have the purpose of promoting impartiality and equal treatment with regard to clients, preventing conflicts of interest and ensuring the impartiality of employees and confidentiality and integrity in Saga Investment Bank's and its employee's proprietary trading.

Saga hefur frá upphafi stutt dyggilega við samfélagsleg málefni í umhverfi sínu og hefur veitt yfir 100 styrki til margvíslegra verkefna, stórra og smárra. Meðal annars hefur bankinn mótað þá stefnu að halda jólaútgjöldum í algjöru lágmarki en veita í stað þess verðugu málefni veglegan styrk. Starfsmenn bankans hafa nú þrjú ár í röð valið að láta jólastyrki bankans renna til Mæðrastyrsnefndar. Meðal annarra verkefna sem okkur eru kær má nefna ýmis konar menntunartengda styrki og stuðning við menningar- og tónlistarlíf.

Saga telur að samfélagsleg ábyrgð fyrirtækja eigi þó ekki aðeins að birtast í styrkveitingum þeirra heldur geti þau haft jákvæð samfélagsleg áhrif á margvíslegan hátt og gengið á undan með góðu fordæmi. Í ljósi þess, sem á undan er gengið í íslensku viðskiptalífi telur Saga afar mikilvægt að bankinn standi vörð um trúverðugleika sinn og óhlutdrægni og vinni hér eftir sem hingað til af heiðarleika og á opinn og gegnsæjan hátt.

### **Hagsmunaárekstrar og trúnaðarskylda**

Saga hefur sett sér Stefnu um hagsmunaárekstra sem ætlað er að koma í veg fyrir hagsmunaárekstra, annars vegar á milli bankans og viðskiptavina hans og hins vegar á milli viðskiptavina hans innbyrðis, einkum á sviði verðbréfavíðskipta. Jafnframt hefur stjórn bankans sett Verklagsreglur um eigin viðskipti Saga og starfsmanna bankans. Markmið þeirra er að stuðla að óhlutdrægni gagnvart viðskiptavinum og jafnræði á milli þeirra, koma í veg fyrir hagsmunaárekstra, tryggja óhæði starfsmanna og trúnað og trúverðugleika vegna viðskipta Saga og starfsmanna bankans fyrir eigin reikning.

### **Umboðsvandi**

Starfsreglum stjórnar er, til viðbótar við ofangreindar reglur, ætlað að tryggja jafnræði við meðferð mála fyrir stjórn, vandaða og óháða málsmeðferð og koma í veg fyrir hagsmunaárekstra í starfsemi bankans. Í því skyni er Starfsreglum stjórnar bankans ætlað að styrkja umgjörð um viðskipti stjórnarmanna og félaga þeim tengdum við Saga og aðgang stjórnarmanna að upplýsingum um viðskiptamenn.

### Saga Investment Bank's value

**S**trong team spirit and unity

**O**utstanding services

**L**eader in the market

**I**ntegrity and dependability

**D**iscipline and results

### Gildi Saga Fjárfestingarbanka

**F**ramúrskarandi þjónusta

**E**ining og sterk liðsheild

**S**krefinu á undan

**T**raust og heilindi

**A**gi og árangur

#### Agency problem

The Board's Operating Procedures have the added purpose of ensuring equal treatment of different issues executed by the Board of Directors and honest and independent procedures to prevent any kind of conflict of interest in Saga Investment Bank's operations. For this purpose, the Board's Operating Procedures are intended to strengthen Saga Investment Bank's framework for business relations between Board members and their affiliated undertakings and Saga Investment Bank, and the access of Board members to information on customers.

#### Compliance with the law

Saga Investment Bank's Compliance Officer makes presentations for new employees of the Bank on the laws, regulations and rules of procedure applicable to the operation of the Bank. Moreover, courses and other presentations are held when necessary, such as when laws or regulations are amended. Furthermore, staff days are held twice a year to review and revise the Bank's values. There are also weekly meetings to disseminate messages and suggestions on what has been well done and what can be improved.

#### Disclosure of information on failures

Saga Investment Bank has placed great importance on staff not hesitating to notify of any misconduct or suspicion of misconduct they may witness. Employees are specifically encouraged to notify misconduct and are provided with instructions thereof, including the Financial Supervisory Authority's Whistle Blower site, <http://fme.is/?PageID=905>.

#### Eftirfylgni við lög

Regluvörður Saga Fjárfestingarbanka heldur kynningar fyrir nýja starfsmenn bankans um gildandi lög, reglur og verklag í starfsemi hans. Jafnframt heldur bankinn námskeið og aðrar kynningar þegar tilefni eru til, s.s. við breytingar á lögum eða reglum. Þá eru haldnir starfsdagar starfsmanna tvisvar á ári þar sem gildi bankans og stefna eru rifjuð upp og endurskoðuð. Einnig eru vikulegir fundir haldnir til að koma m.a. skilaboðum og ábendingum á framfæri um það sem vel er gert og hitt sem betur má fara.

#### Upplýsingagjöf um misbresti

Saga hefur lagt ríka áherslu á að starfsmenn hiki ekki við að tilkynna um hvers konar misferli eða grun um misferli sem þeir verða vitni að. Starfsmenn eru sérstaklega hvattir til að koma slíkum ábendingum á framfæri og eru kynnt úrræði til þess, þar á meðal svokallað Gjallarhorn Fjármálaeftirlitsins, <http://www.fme.is/?PageID=872>.

## BOARD AND COMMITTEES

### 5. Description of the composition and activities of the Board, management and committees of the Board

#### Board of Directors

The Board of Directors of Saga Investment Bank consists of five members and five alternates, all of whom are elected during the Bank's Annual General Meeting for a term of one year. The CEO attends Board meetings together with the Managing Director of the Legal Department, who acts as the secretary of the Board and as a Key Employee as defined in Article 1 a, paragraph 1, subparagraph 8 in Act No. 161/2002 on Financial Undertakings. The Board meets on average once a month or more often if considered necessary. Saga Investment Bank's Board of Directors manages all the Bank's affairs between shareholders' meetings and protects its interests against all third parties. The Board appoints the CEO, decides on his employment terms and grants powers of procurement. The Board operates in accordance with the Board's Operating Procedures, which contain detailed provisions regarding the activities of the Board, including the independence of the members of the Board, their scope of authority and authorisation to sign for the Bank, division of tasks and procedures of meetings, business dealings of members of the Board and related parties, disclosure of information and confidentiality, performance assessments made by the Board, sub-committees and membership of boards of other companies.

#### Executive Management

The Executive Management of Saga Investment Bank consists of the Bank's CEO and the Managing Directors of Capital Markets, Corporate Finance, Legal Department, Risk Management and Operations and Treasury. The Executive Management meets once a week and reviews principal issues in the operation to the extent permitted by the Bank's rules of procedure, including rules on Chinese Walls. The Executive Management as such does not have

## STJÓRN OG NEFNDIR

### 5. Lýsing á samsetningu og starfsemi stjórnar, framkvæmdastjórnar og undirnefnda stjórna

#### Stjórn

Í stjórn Saga Fjárfestingarbanka sitja fimm aðalmenn og fimm varamenn, en þeir eru allir kosnir á aðalfundi bankans til eins árs í senn. Forstjóri situr stjórnarfundum ásamt framkvæmdastjóra Lögfræðisviðs sem er ritari stjórnar og lykilstarfsmaður skv. 8. tölul. 1. mgr. 1. gr. a í lögum nr. 161/2002 um fjármálafyrirtæki. Stjórn kemur saman að meðaltali einu sinni í mánuði, en oftast er þurfa þykir. Stjórn bankans stýrir öllum málefnum Saga milli hluthafafunda og gætir hagsmuna bankans gagnvart þriðja aðila. Stjórnin ræður forstjóra, ákveður starfskjör hans og veitir prókúruumboð. Stjórnin starfar samkvæmt Starfsreglum stjórnar þar sem kveðið er á um störf hennar, þar á meðal um óhæði stjórnarmanna, valdsvið þeirra og ritun firma, verkaskiptingu og fundarsköp, viðskiptaerindi stjórnarmanna og tengdra aðila, upplýsingagjöf og þagnarskyldu, árangursmat stjórnar, undirnefndir og stjórnarsetu í félögum.

#### Framkvæmdastjórn

Í framkvæmdastjórn Saga Fjárfestingarbanka sitja forstjóri og framkvæmdastjórar Áhættustýringar og rekstrar, Fjárfestingastýringar, Fyrirtækjaráðgjafar, Lögfræðisviðs og Markaðsviðskipta. Framkvæmdastjórn fundar vikulega þar sem farið er yfir helstu málefni í starfsemi, að því marki sem það er heimilt með tilliti til starfsreglna bankans, þar á meðal reglna um Kínamúra. Framkvæmdastjórnin hefur sem slík ekki umboð til að skuldbinda bankann samkvæmt Undirskriftarreglum eða öðrum reglum sem stjórn hefur sett. Samkvæmt þeim hafa þó framkvæmdastjórar, einir sér eða saman, slík umboð eins og nánar greinir í Undirskriftarreglum og öðrum reglum stjórnar.

#### Lánanefnd

Lánanefnd starfar á grundvelli Útlánareglna sem stjórn hefur sett, en samkvæmt þeim sitja í nefndinni forstjóri

authorisation to bind the Bank according to the Signature Rules or other rules established by the Board. According to these rules, however, Managing Directors, individually or collectively, have such authority as further detailed in the Signature Rules and other rules established by the Board.

### **Asset & Liability Committee**

The Asset & Liability Committee operates on the basis of the Lending Rules established by the Board, according to which the Committee consists of the CEO and the Managing Directors of Legal Department, Risk Management and Operations and Treasury, as well as the Executive Director of Treasury. The Committee meets on average once a week or more often when deemed necessary. The goal of Saga Investment Bank's Lending Rules is to ensure that the Bank's lending, guarantees and other credit services serve the main purpose of resulting in normal profits from its operations, while at the same time maintaining a solid asset and liquidity position. Moreover, efforts must be made to provide those seeking services of the Bank with the best possible services at all times. The Committee also forms and supervises the Bank's liquidity policy.

### **Market Risk Committee**

The Market Risk Committee operates on the bases of the rules on the Bank's Proprietary Trading Authorisations as established by the Board. According to these rules, the Committee consists of the CEO and the Managing Directors of Risk Management and Operations and Treasury. The Committee meets on average once a week or more often if considered necessary. The Market Risk Committee makes decisions on all the Bank's own account investments, with the exception of transactions that Proprietary Trading is authorised to handle, provided they fall within defined limits and have received the approval of Risk Management.

og framkvæmdastjórar Áhættustýringar og rekstrar, Fjárstýringar og Lögfræðisviðs, ásamt forstöðumanni Skuldastýringar. Lánanefnd hittist að meðaltali einu sinni í viku, en oftár ef þurfa þykir. Markmið Útlánareglna Saga Fjárfestingarbanka eru að útlán bankans, ábyrgðaveitingar og aðrar fyrirgreiðslur skuli þjóna þeim meginmarkmiðum að eðlilegur tekjuafgangur verði í rekstri hans og að viðhaldið sé traustri eigin- og lausafjárstöðu. Jafnframt skal leitast við að veita þeim er óska eftir fyrirgreiðslu eins góða þjónustu og kostur er á hverjum tíma. Þá mótár Lánanefnd einnig lausafjárstefnu bankans og hefur eftirlit með henni.

### **Markaðsáhættunefnd**

Markaðsáhættunefnd starfar á grundvelli reglna um Heimildir til eigin viðskipta bankans sem stjórn setur. Samkvæmt þeim sitja í nefndinni forstjóri og framkvæmdastjórar Áhættustýringar og rekstrar og Fjárstýringar. Nefndin hittist að meðaltali einu sinni í viku, en oftár ef þurfa þykir. Markaðsáhættunefnd tekur ákvarðanir um allar fjárfestingar bankans fyrir eigin reikning, að frátöldum viðskiptum sem Eigin viðskiptum eru heimil, enda falli þau innan tiltekinna marka og hafi hlotið samþykki Áhættustýringar.

## BOARD SUB-COMMITTEES

### Audit Committee

Saga Investment Bank's Audit Committee is a supervisory committee. Its purpose is to ensure the reliability and transparency of annual financial statements and other financial data issued by Saga Investment Bank. The Committee must verify that the information provided to the Board in relation to the operation, standing and future prospects of Saga Investment Bank is as reliable as possible and provides as clear a view of the Bank's current position at any given time. In this manner, investors and other stakeholders can depend on the quality of the Bank's financial information and the work of its auditors.

The following are members of Saga Investment Bank's Audit Committee:

Halldor Johannsson, Managing Director of KEA  
Steingrímur H. Petursson, Business Administrator  
Úlfar Hauksson, Financial Manager at  
the University of Akureyri

### 6. Arrangement of the appointment of committee members

The Saga Investment Bank Audit Committee is elected by the Bank's Board and must submit reports on its activities to the Board at least once a year.

### 7. Information on the number of Board meetings and committee meetings as well as their attendance

Eleven Board meetings were held during the year 2010. Principal members attended all meetings, with the exception that Gunnar Th. Gíslason was absent on four occasions, Jon Armann was absent once, Sindri Sindrason, former member of the Board, was absent twice and Svanhildur N. Vigfusdóttir was absent on three occasions. Eggert Arni Gíslason, an alternate member of the Board, attended two meetings during the year, Gudmundur Thordarson, another alternate, attended three meetings, Karl Fríðriksson, also an

## UNDIRNEFNDIR STJÓRNAR

### Endurskoðunarnefnd

Endurskoðunarnefnd Saga Fjárfestingarbanka er eftirlitsnefnd og gegnir því hlutverki að tryggja öryggi og gegnsæi ársreikninga og annarra fjárhagsupplýsinga bankans. Nefndin skal staðreyna að þær upplýsingar sem stjórnin fær um rekstur, stöðu og framtíðarhorfur Saga séu áreiðanlegar og gefi sem gleggsta mynd af stöðu bankans á hverjum tíma. Þannig geti fjárfestar og aðrir hagsmunaaðilar reitt sig á gæði fjármálaupplýsinga um bankann og störf endurskoðenda hans.

Eftirtaldir aðilar sitja í Endurskoðunarnefnd Saga:

Halldór Jóhannsson, framkvæmdastjóri KEA  
Steingrímur H. Pétursson, viðskiptafræðingur  
Úlfar Hauksson, fjármálastjóri Háskólans á Akureyri

### 6. Fyrirkomulag skipunar nefndarmanna undirnefnda

Endurskoðunarnefnd Saga Fjárfestingarbanka er kosin af stjórn bankans og skal skila henni skýrslum um störf sín að minnsta kosti einu sinni á ári.

### 7. Upplýsingar um fjölda stjórnarfunda og fundu undirnefnda og mætingu

Á árinu 2010 voru haldnir 11 stjórnarfundir. Aðalmenn mættu á alla fundi, utan þess að Gunnar Þ. Gíslason var fjarverandi fjórum sinnum, Jón Ármann var fjarverandi einu sinni, Sindri Sindrason, fyrrum stjórnarmaður, var fjarverandi tvisvar sinnum og Svanhildur N. Vigfúsdóttir var fjarverandi þrisvar sinnum. Eggert Arni Gíslason varamaður sat tvo fundi á árinu, Guðmundur Þórðarson varamaður sat þrjá fundi, Karl Fríðriksson varamaður sat einn fund og Stefán H. Gunnlaugsson varamaður sat fjóra fundi.

Endurskoðunarnefnd hélt sex fundi á árinu 2010 og mættu nefndarmenn á alla fundi nefndarinnar.

Saga Investment Bank's Board has established its Board's Operating Procedures which are intended to ensure equal treatment of issues executed by the Board of Directors.

Stjórn Saga Fjárfestingarbanka hefur sett sér Starfsreglur stjórnar sem ætlað er að tryggja jafnræði við meðferð mála fyrir stjórn.

alternate, attended one meeting and Stefan H. Gunnlaugsson, another alternate, attended four meetings during the year.

The Audit Committee held six meetings in 2010, and all members of the Committee attended all meetings.

#### **8. Where rules of procedure for the Board and its committees may be accessed**

Saga Investment Bank's Board has established its Board's Operating Procedures which are intended to ensure equal treatment of issues executed by the Board of Directors, and conscientious and independent procedures to prevent any kind of conflict of interests in the Bank's operations. For this purpose, the Board's Operating Procedures are intended to strengthen the Bank's framework for Board members' and their affiliated undertakings' business relations with Saga Investment Bank, and Board members' access to information on customers. Helga Hlin Hakonardottir, (**helga@sagabank.is**), Attorney at Law and Managing Director of Saga Investment Bank's Legal Department, will provide further information on the Board's Operating Procedures.

#### **8. Hvar megi nálgast starfsreglur stjórnar og undirnefnda**

Stjórn Saga Fjárfestingarbanka hefur sett sér Starfsreglur stjórnar sem ætlað er að tryggja jafnræði við meðferð mála fyrir stjórn, vandaða og óháða málsmeðferð og koma í veg fyrir hagsmunaárekstra í starfsemi bankans. Í því skyni er Starfsreglum stjórnar ætlað að styrkja umgjörð um viðskipti stjórnarmanna og félaga þeim tengdum við Saga og aðgang stjórnarmanna að upplýsingum um viðskiptamenn. Helga Hlín Hákonardóttir hdl., framkvæmdastjóri Lögfræðisviðs, veitir nánari upplýsingar um starfsreglur stjórnar (**helga@sagabanki.is**).



## BOARD MEMBERS AND CEO

### 9. Information on Board members

The same parties are members of the Boards of Saga Investment Bank hf., Saga Eignarhaldsfelag hf. and Hilda hf. Saga Eignarhaldsfelag has a 90.01% shareholding in Saga Investment Bank but has no other operation or assets. Hilda has a 9.99% shareholding in Saga Investment Bank. The company took over specific assets and debts from the Bank during the financial restructuring of the Bank in 2009. No operations are carried out in Hilda, but the company has entered into an operating agreement with Saga Investment Bank for the management of its assets.

## STJÓRNARMENN OG FORSTJÓRI

### 9. Upplýsingar um stjórnarmenn

Sömu aðilar skipuðu stjórnir Saga Fjárfestingarbanka hf., Saga Eignarhaldsfélags hf. og Hildu hf. á árinu 2010. Saga Eignarhaldsfélag fer með 90,01% eignarhlut í Saga Fjárfestingarbanka, en hefur hvorki aðra starfsemi né eignir. Hilda fer með 9,99% eignarhlut í Saga Fjárfestingarbanka, en félagið yfirtók tiltekna eignir og skuldir bankans við fjárhagslega endurskipulagningu á efnahag hans á árinu 2009. Engin starfsemi er í Hildu en félagið hefur gert rekstrarsamning við Saga um umsýslu eigna þess.



**Gunnar Thor Gislason** (1965) is the Managing Director of Sundagardar hf. Mr Gislason has a degree in business administration from the University of Iceland and has an MBA degree from London Business School. He has an extensive experience from different managing positions in the financial markets and the food industry.

Mr Gislason was a member of Saga Investment Bank's Board of Directors from 15 March 2008 to 8 May 2009 and returned on the Board on 28 May 2010. Mr Gislason was elected as the Chairman of the Board on 8 April 2011 when Mr Halldor Johannsson, former Chairman, resigned from the Board. Mr Gislason is also a member of the boards of Saga Eignarhaldsfelag hf., Hilda hf., Sundagardar hf., Langasjor ehf., Sild og Fiskur ehf., Matfugl ehf., Brimgardar ehf., Mata hf. and Salathusid ehf.

Mr Gislason and related parties hold 11.52% share in Saga Eignarhaldsfelag hf. and Hilda hf., whereof Mr Gislason holds 1.05% and Sundagardar hf., where he is a managing director and a shareholder, holds 10.47%.

**Gunnar Þór Gíslason** (1965) er framkvæmdastjóri Sundagarða hf. Gunnar Þór er viðskiptafræðingur frá HÍ og með MBA gráðu frá London Business School. Hann hefur víðtæka reynslu af ýmsum stjórnunarstörfum sem tengjast fjármálamörkuðum og matariðnaði.

Gunnar sat í stjórn Saga Fjárfestingarbanka frá 15. mars 2008 til 8. maí 2009 og tók aftur sæti í stjórn 28. maí 2010 og tók jafnframt við stjórnarformennsku 8. apríl 2011 þegar Halldór Jóhannsson fyrrverandi stjórnarformaður sagði sig úr stjórn bankans. Gunnar situr einnig í stjórnnum Saga Eignarhaldsfélags hf., Hildu hf., Sundagarða hf., Langasjó ehf., Sild og Fiski ehf., Matfugli ehf., Brimgörðum ehf., Mata hf. og Salathúsinu ehf.

Gunnar Þór og tengdir aðilar eiga 11,52% eignarhlut í Saga Eignarhaldsfélagi og Hildu, þar af á Gunnar Þór 1,05% og Sundagarðar hf., þar sem Gunnar Þór er framkvæmdastjóri og hluthafi, eiga 10,47%.



**Eggert Arni Gíslason** (1961) is the Managing Director of Mata hf. Mr Gíslason has a degree in business administration from the University of Iceland and is a certified securities broker. He has many years' experience of company operations, acquisitions and diverse investment activities.

Mr Gíslason was a member of the Board of Directors of Saga Investment Bank from 8 May 2009 to 28 May 2010, when he took a position as an alternate member. Mr Gíslason returned on the Board as a principal member on 8 April 2010 when Halldor Johannsson resigned from the Board. Mr Gíslason is, moreover, a board member of Saga Eignarhaldsfélag hf., Hilda hf., Brimgardar ehf., Langisjor ehf., Matfugl ehf. and Mata hf., together with being the Chairman of the Board of Sild og Fiskur ehf. and Sundagardar hf.

Mr Gíslason does not own any shares in Saga Investment Bank. However, he is a shareholder and Chairman of the board of Sundagardar hf. which has a 10.47% shareholding in Saga Eignarhaldsfélag hf. and Hilda hf.

**Eggert Árni Gíslason** (1961) er framkvæmdastjóri Mötu hf. Eggert er viðskiptafræðingur frá Háskóla Íslands og löggiltur verðbréfamíðlari. Hann hefur margra ára reynslu af fyrirtækjarekstri, fyrirtækjakaupum og ýmsum fjárfestingum.

Eggert var aðalmaður í stjórn Saga Fjárfestingarbanka frá 8. maí 2009 til 28. maí 2010 og frá þeim tíma sem varamaður þar til hann tók sæti aðalmanns á ný þann 8. apríl þegar Halldór Jóhannsson fyrrverandi stjórnarformaður sagði sig úr stjórn bankans. Eggert er einnig meðstjórnandi í Saga Eignarhaldsfélagi hf., Hildu hf., Brimgörðum ehf., Langasjó ehf., Matfugli ehf. og Mötu hf. ásamt því að vera stjórnarformaður í Sild og fiski ehf. og Sundagörðum hf.

Eggert á engin hlutabréf í Saga Fjárfestingarbanka, Saga Eignarhaldsfélagi eða Hildu, en er hluthafi og gegnir stjórnarformennsku í Sundagörðum hf. sem á 10,47% hlut í Saga Eignarhaldsfélagi og Hildu.



**Gunnar Thor Gudmannsson** (1956) is the Managing Director of Vogaver ehf. Mr Gudmannsson has a secondary school certificate and extensive experience in company operation, investments and membership on the board of directors of companies.

Mr Gudmannsson has been a member of the Board of Directors of Saga Investment Bank since 2008, first as an alternate and then as a principal member since 8 May 2009. He is also a member of the boards of Saga Eignarhaldsfélag hf., Hilda hf., Steelers Holding ehf., Yztafell ehf., Oflun ehf., Vogaver ehf. and Verslunarmidstodin Thjodbraut ehf.

Mr Gudmannsson owns a 0.37% shareholding in Saga Eignarhaldsfélag hf. and Hilda hf. through the investment company Vogaver ehf. He has no stakeholder interests in customers, competitors or shareholders owning more than a 10% shareholding in the Bank, other than Saga Eignarhaldsfélag hf. and Hilda hf.

**Gunnar Þór Guðmannsson** (1956) er framkvæmdastjóri Vogavers ehf. Gunnar hefur stúdentspróf og viðtæka reynslu af fyrirtækjarekstri, fjárfestingum og stjórnarsetu.

Gunnar hefur verið varamaður í stjórn Saga Fjárfestingarbanka frá 2008 og aðalmaður frá 8. maí 2009. Hann situr einnig í stjórnnum Saga Eignarhaldsfélags hf., Hilda hf., Steelers Holding ehf., Yztafells ehf., Öflunar ehf., Vogavers ehf. og Verslunarmiðstöðvarinnar Þjóðbrautar ehf.

Gunnar á 0,37% í Saga Eignarhaldsfélagi og Hildu í gegnum fjárfestingarfélagið Vogaver ehf. Hann hefur engin hagsmunatengsl við viðskiptaaðila, samkeppnisaðila eða hluthafa sem eiga meira en 10% hlut í Saga Fjárfestingarbanka, aðra en Saga Eignarhaldsfélag og Hildu.



**Halldor Johannsson** (1972) is the Managing Director of KEA svf. Mr Johannsson holds a degree in business administration from the Department of Auditing and Accounting of the University of Iceland. He has extensive experience of financing, investments, merger consulting, administrative positions, board memberships and chairmanship of many companies.

Mr Johannsson was the Chairman of the Board of Saga Investment Bank from 2007 and resigned from the Board in April 2010 as well as the boards of Saga Eignarhaldsfélag hf. and Hilda hf. Mr Johannsson is a member of the boards of Fjarfestingarfélagid Urdir ehf., Eignarhaldsfélagid Fludir ehf., Nordurvegur ehf., Thekkingarvordur ehf., KEA eignir ehf., Islandsbref ehf. and Fasteignafélagid Klappir ehf.

Mr Johannsson does not own any shares in Saga Investment Bank, Saga Eignarhaldsfélag or Hilda. However, he is the Chairman of the board of KEA eignir ehf. which has a 9,56% shareholding in Saga Eignarhaldsfélag hf. and Hilda hf. KEA eignir ehf. is fully owned by KEA svf.

**Halldór Jóhannsson** (1972) er framkvæmdastjóri KEA svf. Halldór er viðskiptafræðingur af endurskoðunar- og reikningshaldssviði Háskóla Íslands. Hann hefur viðtæka reynslu af fjármögnun, fjárfestingum, samrunaráðgjöf, stjórnunarstörfum, stjórnarsetum og formennsku í fjölmörgum fyrirtækjum.

Halldór var stjórnarformaður Saga Fjárfestingarbanka frá 2007 en sagði sig úr stjórn bankans í apríl sl. sem og stjórnnum Saga Eignarhaldsfélags og Hildu. Halldór situr í stjórnnum Fjárfestingarfélagsins Urða ehf., Eignarhaldsfélagsins Flúða ehf., Norðurvegi ehf., Þekkingarverði ehf., KEA eignum ehf., Íslandsbréfum ehf. og Fasteignafélaginu Klöppum ehf.

Halldór á engin hlutabréf í Saga Fjárfestingarbanka, Saga Eignarhaldsfélagi eða Hildu, en er stjórnarformaður KEA eigna ehf. sem á 9,56% hlut í Saga Eignarhaldsfélagi og Hildu. KEA svf. er eini eigandi KEA eigna ehf.



**Jon Armann Gudjonsson** (1968) is an independent attorney and is a member of the Resolution Committee of Sparisjodabankinn. Mr Gudjonsson has a degree in law from the University of Iceland and is a certified attorney and securities broker. Mr Gudjonsson has been an independent attorney since 1994, specialising in law of finance and corporations.

Mr Gudjonsson was elected on the Board of Saga Investment Bank on 28 May 2010 and is also a member of the following boards: Aflgjafi, Alskil, AN-Holding, Arnarhylur, Behrens, Bilval, Cafe-Holding, Dvalinn, Eignafelagid, Eignarhaldsfelagid Bjorg, Eignarhaldsfelagid Hvarf, Euro-Asia, Fasteignafelag SPB, Fasteignafelag Sudurnesja, Faxatindur, Fjarfestingarfelagid Teigur, Fjarmognun 12, Fjarmognun 6, Fjarmognun 7, Fjarmognun 8, GKP, Graenaborg, Grimansfell, Hagalind, Haskolagarðar, Haskolavellir, Helluland, Hilda, Hotel Hafnarfjörður, Homp, Hraunmoli, HV2, Icelandair Group, Invest-group, I-tech, Kambaland, Kletthals, Kollekt, Leigufelagid, Lindberg, Logborg, RT-veitingar, Saga Eignarhaldsfelag, SBNIIGP, Seven Miles, Skjol, Spor, Sporbaugur, Staltak, Thorlaksverk and Vestur.

Mr Gudjonsson does not hold any shares in Saga Investment Bank, Saga Eignarhaldsfelag or Hilda, but he is a member of the Resolution Committee of Sparisjodabankinn, which holds Eignarhaldsfelagid Hvarf, which again holds 10.73% share in Saga Eignarhaldsfelag and Hilda.

**Jón Ármann Guðjónsson** (1968) er sjálfstætt starfandi lögmaður og situr jafnframt í skilanevnd Sparisjóða-bankans. Jón Ármann er lögfræðingur frá Háskóla Íslands og með héraðsdómslögmannsréttindi og próf í verðbréfavíðskiptum. Hann hefur starfað sem sjálfstætt starfandi lögmaður síðan 1994 með aðaláherslu á fjármuna- og hlutafélagarétt.

Jón Ármann var kosinn í stjórn Saga Fjórðingabanka 28. maí 2010 en hann situr einnig í stjórnnum eftirfarandi félaga: Aflgjafi, Alskil, AN-Holding, Arnarhylur, Behrens, Bilval, Cafe-Holding, Dvalinn, Eignarhaldsfelagið Björg, Eignafelagið, Eignarhaldsfelagið Hvarf, Euro-Asia, Fasteignafelag SPB, Fasteignafelag Sudurnesja, Faxatindur, Fjórðingarfelagið Teigur, Fjármögnun 12, Fjármögnun 6, Fjármögnun 7, Fjármögnun 8, GKP, Grímansfell, Grænaborg, Hagalind, Háskólagarðar, Háskolavellir, HV2, Helluland, Hilda, Hótel Hafnarfjörður, Hraunmoli, Hömp, Icelandair Group, Invest-group, I-tech, Kambaland, Klettháls, Kollekt, Leigufelagið Skjól, Lindberg, Lögborg, RT-veitingar, SBNIIGP, Seven Miles, Saga Eignarhaldsfelag, Spor, Sporbaugur, Stáltak, Vestur og Þorlaksverk.

Jón Ármann á engin hlutabréf í Saga Fjórðingabanka, Saga Eignarhaldsfelagi eða Hildu, en situr í skilanevnd Sparisjóðabankans, móðurfelagi Eignarhaldsfélagsins Hvarfs, sem á 10,73% hlut í Saga Eignarhaldsfelagi og Hildu.



**Svanhildur Nanna Vigfusdóttir** (1977) is a private investor in Denmark. Ms Vigfusdóttir holds a degree in business administration from the University of Iceland, has an MA in international business and marketing and has been employed in the financial sector for 11 years. From 1999 to 2002, she was employed by FBA (subsequently Íslandsbanki-FBA), first in Capital Markets and later as the bank's Director of Internet Banking. During the period 2002–05, Ms Vigfusdóttir was the Managing Director of Financing for KB Bank and the Director of Treasury for Straumur-Burðaras from 2005 to 2007.

Ms Vigfusdóttir was elected to the Board of Directors of Saga Investment Bank on 8 May 2009. She is also a member of the board of Skeljungur hf., and is the Managing Director and board member of S-fasteignir and O-fasteignir.

Ms Vigfusdóttir has no shareholding in Saga Investment Bank, Saga Eignarhaldsfélag or Hilda. She has no stakeholder interest in customers, competitors or shareholders owning more than a 10% shareholding in the Bank.

**Svanhildur Nanna Vigfúsdóttir** (1977) starfar við eigin fjárfestingar í Danmörku. Svanhildur er viðskiptafræðingur frá Háskóla Íslands, hefur meistaraþráðu í alþjóðaviðskiptum og markaðsfræðum og hefur starfað við fjármálastarfsemi í 11 ár. Á árunum 1999-2002 starfaði hún hjá FBA (síðar Íslandsbanka-FBA), fyrst á sviði markaðsviðskipta og varð síðar forstöðumaður netviðskipta bankans. Árin 2002-2005 var Svanhildur forstöðumaður fjármögnunar hjá KB banka og framkvæmdastjóri fjárfestingar Straums-Burðarás 2005-2007.

Svanhildur var kosin í stjórn Saga Fjárfestingarbanka 8. maí 2009, en hún situr einnig í stjórn Skeljungs hf. og er framkvæmdastjóri og stjórnarmaður í S-fasteignum og Ö-fasteignum.

Svanhildur á engin hlutabréf í Saga Fjárfestingarbanka, Saga Eignarhaldsfélagi eða Hildu og hefur engin hagsmunatengsl við viðskiptaaðila, samkeppnisaðila eða hluthafa sem eiga meira en 10% hlut í bankanum.



## 10. Information on which Board members are independent of Saga Investment Bank and major shareholders

The Board members and alternates of Saga Investment Bank are in 2010 also members of the Board of Saga Eignarhaldsfélag and Hilda, which control all shares in Saga Investment Bank.

The majority of the Board and alternates of the Boards of Saga Investment Bank were in 2010 independent of Saga Investment Bank, Saga Eignarhaldsfélag and Hilda, and the following Board members and alternates are independent from major shareholders of the latter two companies:

### Board of Directors

Gunnar Thor Gudmannsson  
Svanhildur Nanna Vigfúsdóttir

### Alternates:

Gudmundur Örn Thordarson  
Stefan Hedinn Gunnlaugsson  
Karl Friðriksson

## 11. Principal aspects in the Board's performance assessment

In early 2010, Saga Investment Bank's Board of Directors assessed its work, operating practices and procedures, the necessity of appointing sub-committees and the Bank's progress, in accordance with the Board's Rules of Procedure.

Continued uncertainty and reactions to the consequences of the banking sector collapse characterised the Board's and management's work in 2010. While the Bank's

## 10. Upplýsingar um hvaða stjórnarmenn eru óháðir Saga Fjárfestingarbanka og stórum hluthöfum

Stjórnarmenn og varastjórnarmenn Saga Fjárfestingarbanka sátu einnig á árinu 2010 í stjórn Saga Eignarhaldsfélags og Hildu, sem fara með allt hlutfé í Saga Fjárfestingarbanka.

Meirihluti stjórnarmanna og varamanna í stjórn Saga Fjárfestingarbanka á árinu 2010 er óháður bankanum, Saga Eignarhaldsfélagi og Hildu og eftirtaldir stjórnarmenn og varamenn í stjórn eru óháðir stórum hluthöfum tveggja síðasttöldu félaganna:

### Aðalstjórn

Gunnar Þór Guðmannsson  
Svanhildur Nanna Vigfúsdóttir

### Varastjórn

Guðmundur Örn Þórðarson  
Stefán Héðinn Gunnlaugsson  
Karl Friðriksson

## 11. Helstu þætti í árangursmati stjórnar

Í ársbyrjun 2011 lagði stjórn Saga Fjárfestingarbanka mat á störf sín, verklag og starfshætti, nauðsyn á skipun undirnefnda stjórnar og framgang bankans, í samræmi við Starfsreglur stjórnar.

Áframhaldandi óvissa og uppgjör vegna afleiðinga bankahrunsins einkenndu áfram störf stjórnar og yfirstjórnar bankans. Á meðan rekstrarumhverfi bankans er háð jafn mikilli óvissu og raun ber vitni og endurreisn efnahagslífsins skammt á veg komin, hefur reynt ögrandi að móta nákvæma framtíðarstefnu fyrir bankann og viðskiptamenn hans. Þess í

operating environment is subject to considerable uncertainty and economic recovery slower than expected, it has proved challenging to develop a detailed future strategy for the Bank and its customers. Instead, it has been necessary to adapt its activities continuously to the constantly changing environment, and therefore the prospects of the Bank as well.

Success has been achieved in further strengthening internal controls and procedures in collaboration with internal and external auditors and the Audit Committee. Furthermore, regular reporting from the management to the Board has been reviewed, along with preparations and material submitted before Board meetings. The Board's working procedures and practises are continuously reviewed, and it is the Board's opinion that those are in good order.

Towards the end of the year 2010, a loud debate reverberated about financial institutions' reputational risk, and the Bank was involved in the debate accordingly. As a consequence, the Board met on a weekly basis, while the Bank and some of its employees were in the media spotlight, and kept a close eye on whether the Bank's reputation suffered or could suffer therefrom.

Several changes have taken place in the Bank's management in recent months, but it is the Board's opinion that Saga Investment Bank is comprised of a solid and experienced management team, skilled with valuable experience and knowledge. The management team also possesses the necessary skills and professional networks to continue to lead Saga Investment Bank as an independent investment bank in its important role in the reconstruction of the Icelandic economy.

stað hefur reynst nauðsynlegt að laga starfsemina frá einum tíma til annars að síbreytilegum aðstæðum sem upp koma í efnahagsumhverfi bankans og þar með framtíðarhorfum.

Vel hefur unnist í að styrkja enn frekar innri eftirlits- og verkferla í samstarfi við innri og ytri endurskoðendur bankans og Endurskoðunarnefnd. Þá hefur reglubundin upplýsingagjöf til stjórnar verið endurskoðuð ásamt undirbúningi fyrir fundi stjórnar og er það mat hennar að störf, verklag og starfshættir séu í góðu horfi.

Undir lok ársins varð hávæer umræða um orðsþorsáhættu fjármálafyrirtækja og fór bankinn ekki varhluta af henni. Af því tilefni fundaði stjórn vikulega á meðan bankinn og starfsmenn hans voru í kastljósi fjölmiðla og fylgdist grannt með því hvort orðspor bankans bæri skaða þar af.

Nokkrar breytingar hafa orðið á yfirstjórn bankans á síðastliðnum mánuðum, en það er mat stjórnar að Saga Fjárfestingarbanki hafi á að skipa þéttskipuðu og reyndu liði stjórnenda sem býr yfir dýrmætri reynslu og þekkingu. Stjórnendur bankans búa jafnframt yfir nauðsynlegri færni og tengslum til að leiða Saga Fjárfestingarbanka áfram sem óháðan fjárfestingarbanka í mikilvægu hlutverki hans við endurreisn íslensks efnahagslífs.

## 12. Information on Saga Investment Bank's CEO and a description of his main duties

Dr Hersir Sigurgeirsson (1972) is the CEO of Saga Investment Bank. Dr Sigurgeirsson holds a PhD degree in applied mathematics and an MSc degree in financial mathematics from Stanford University. Dr Sigurgeirsson was previously the Managing Director of Risk Management and Operations of the Bank from its establishment and worked in risk management and proprietary trading at Kaupthing Bank from 2003–2006. Dr Sigurgeirsson was also an assistant professor of economics at the University of Iceland from 2006 to 2010.

Mr Sigurgeirsson has been the CEO of Saga Investment Bank since 15 February 2011. He is also the chairman of the board of T Plus, an associate held by Saga Investment Bank, the managing director of Hilda and Saga Eignarhaldsfélag and the managing director and chairman of the Board of Hersir Sigurgeirsson ehf. Mr Sigurgeirsson owns no shares in Saga Investment Bank, Saga Eignarhaldsfélag or Hilda. He has no stakeholder interests in customers, competitors or shareholders owning more than a 10% shareholding in the Bank, other than Saga Eignarhaldsfélag and Hilda.

According to the Articles of Association of Saga Investment Bank, the CEO is responsible for the daily operation of the Bank and represents the Bank in all matters relating to normal operations. He is responsible for the accounts, recruiting staff and for ensuring that the activities of the Bank are in accordance with applicable legislations. The CEO is under obligation to provide the members of the Board of Directors, as well as the Bank's auditors/examiners, with any information pertaining to the operation of the Bank which they may request and as required by law. Moreover, the CEO is under obligation to inform the Board on a regular basis and in detail of the operation of Saga Investment Bank, its largest customers, largest defaults, the quality of the Bank's loan portfolio and services to related parties.

## 12. Upplýsingar um forstjóra Saga Fjárfestingarbanka og lýsing á helstu skyldum hans

Dr. Hersir Sigurgeirsson (1972) er forstjóri Saga Fjárfestingarbanka. Hersir er með Ph.D. gráðu í hagnýtri stærðfræði og M.Sc. gráðu í fjármálastærðfræði frá Stanford Háskóla. Hersir var framkvæmdastjóri Áhættustýringar og rekstrar bankans frá stofnun og starfaði við áhættustýringu og eigin viðskipti Kaupþings á árunum 2003-2006. Þá var Hersir lektor við Hagfræðideild Háskóla Íslands á árunum 2006 – 2010.

Hersir hefur verið forstjóri Saga Fjárfestingarbanka frá 15. febrúar 2011, en hann er einnig formaður stjórnar T Plús hf., sem er hlutdeildarfélag í eigu bankans, og framkvæmdastjóri Saga Eignarhaldsfélags og Hildu og framkvæmdastjóri og stjórnarformaður eignarhaldsfélagsins Hersir Sigurgeirsson ehf. Hersir á engin hlutabréf í Saga Fjárfestingarbanka, Saga Eignarhaldsfélagi eða Hildu. Hann hefur engin önnur hagsmunatengsl við viðskiptaaðila, samkeppnisaðila eða hluthafa sem eiga meira en 10% hlut í bankanum.

Samkvæmt samþykktum Saga Fjárfestingarbanka fer forstjóri með stjórn á daglegum rekstri bankans og kemur fram fyrir hönd hans í öllum málum sem varða venjulegan rekstur. Hann sér um reikningshald, ráðningu starfslíðs og ber ábyrgð á að starfsemi bankans sé í samræmi við viðeigandi lög. Forstjóra ber að veita stjórnarmönnum og endurskoðendum eða skoðunarmönnum allar þær upplýsingar sem þeir kunna að óska um rekstur bankans og veita ber samkvæmt lögum. Þá ber forstjóra að upplýsa stjórn ítarlega með reglubundnum hætti um rekstur Saga, stærstu viðskiptaaðila, stærstu vanskil, gæði útlánasafns og fyrirgreiðslu við venslaða aðila.

### 13. Information on violations of laws and regulations that the appropriate supervisory or ruling body has determined

No complaints or comments have been sent to Saga Investment Bank from customers or others involving charges of violations on the part of the Bank, or its employees, of laws or regulations applicable to its operation. However, there is uncertainty as to if foreign currency loans held by the Bank will be deemed to have been illegally linked to foreign currencies similar to certain loan types held by other Icelandic credit institutions.

Saga Investment Bank's former CEO and an Executive Director at the Bank are under investigation by the special prosecutor in relation to assumed offences by the directors of Glitnir Bank, in relation to transfers of shares in Glitnir and FL-Group, Glitnir's loans to Stim and other following arrangements. Assumed offences of the directors of Glitnir sjodir and GLB FX's fund manager are also being investigated, in relation to Glitnir sjodir's purchase of a bond issued by Stim, from Saga Investment Bank. However, no evidence or other data has been provided assuming any criminal behaviour of the aforementioned employees of Saga, no claims have been made towards the Bank and no charges have been issued in relations to the investigation.

### 13. Upplýsingar um brot á lögum og reglum sem viðeigandi eftirlits- og / eða úrskurðaraðili hefur ákvarðað

Engar kvartanir eða athugasemdir hafa borist Saga Fjárfestingarbanka frá viðskiptavinum eða öðrum vegna ávirðinga um brot bankans eða starfsmanna hans á lögum eða reglum sem um starfsemi hans gilda. Hins vegar er uppi vafi um lögmæti tiltekinna erlendra láns samninga bankans eins og tiltekna láns samninga allra annarra íslenskra lánastofnana.

Fyrirverandi forstjóri Saga og forstöðumaður hjá bankanum hafa fengið stöðu grunaðra í rannsókn sérstaks saksóknara á ætluðum brotum stjórnenda Glitnis Banka í tengslum við viðskipti með hlutabréf í Glitni og FL-Group, lánveitingar Glitnis til Stíms og ráðstafanir sem fylgdu í kjölfarið. Einnig lýtur rannsóknin að ætluðum brotum stjórnenda Glitnis sjóða og sjóðsstjóra GLB FX í tengslum við kaup GLB FX á vijkjandi skuldabréfi útgefnu af Stím af Saga. Engin gögn hafa verið lögð fram sem sýnt geta fram á saknæma háttsemi framangreindra starfsmanna bankans, né heldur hafa kröfur verið gerðar á hendur bankanum eða ákærur verið gefnar út á hendur umræddum starfsmönnum.

#### 14. Arrangement of communications between shareholders and the Board

Saga Investment Bank publishes news of its operation on the Bank's website. Moreover, the Bank issues press releases in the event of significant changes in the Bank's operations or if the Bank has brokered major transactions. In addition, the Bank's shareholders regularly receive newsletters from the Bank's CEO and are generally encouraged in such letters to contact the CEO directly if they have any questions.

At Saga Investment Bank's Annual General Meetings, the Bank's activities are reviewed in detail, and moreover, shareholders' meetings are called if considered necessary, as was done in December 2009 due to the restructuring of the Bank's finances.

Saga Investment Bank's shareholders are encouraged on the Bank's website to send any questions to the Bank's Board of Directors through Helga Hlin Hákonardóttir, Attorney at Law and Managing Director of the Legal Department ([helga@sagabank.is](mailto:helga@sagabank.is)).

#### 14. Fyrirkomulag samskipta hluthafa og stjórnar

Saga Fjárfestingarbanki birtir fréttir af starfsemi sinni á heimasíðu bankans og sendir jafnframt út fréttatilkynningar ef markverðar breytingar hafa orðið á starfsemi bankans eða ef hann hefur haft milligöngu um stærri viðskipti. Að auki fá hluthafar bankans reglulega send fréttabréf frá forstjóra og eru þar jafnan hvattir til að hafa beint samband við hann ef einhverjar spurningar vakna í huga þeirra.

Á aðalfundum Saga er farið ítarlega yfir starfsemi bankans og ennfremur kallað til hluthafafunda ef sérstök ástæða er til, en það var síðast gert í desember 2009 vegna endurskipulagningar á efnahag bankans.

Á heimasíðu Saga eru hluthafar jafnframt hvattir til að senda fyrirspurnir til stjórnar fyrir milligöngu fjárfestatengils bankans, Helgu Hlinar Hákonardóttur hdl., framkvæmdastjóra Lögfræðisviðs ([helga@sagabank.is](mailto:helga@sagabank.is)).



**SAGA INVESTMENT BANK** Financial Statements 2010



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## ENDORSEMENT AND STATEMENT BY THE BOARD OF DIRECTORS AND THE CEO

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

Saga Investment Bank hf. (the Bank) provides corporate advisory services, lending and capital markets services. The Bank's financial statements are prepared according to International Financial Reporting Standards (IFRSs), as adopted by the EU.

**Results and equity.** The Bank's loss for the year 2010 amounted to ISK 1,777 million according to the income statement, of which ISK 1,026 million were due to the write-down of the Bank's tax asset. Equity at year end amounted to ISK 823 million according to the balance sheet. The Bank's statutory capital base (CAD) amounted to ISK 938 million. Capital ratio, which is calculated according to the Act on Financial Undertakings, was 19.7% at year-end 2010. According to the Act, the ratio may not be lower than 8%. The Bank's Board of Directors proposes that no dividend will be paid to shareholders in the year 2011 due to the year 2010, as there are no premises for dividend payment according to law. Reference is made to the financial statements for further information on the attribution of loss and other changes in equity.

**Overview of main events of the year.** In November 2010 the Bank changed its name from Saga Capital Investment Bank hf. to Saga Investment Bank hf. and relocated its Reykjavik branch from Skógarhlíð 22 to the 14th floor on Höfðatorg.

During the year, the Bank acquired the company Möttull ehf., a specialized consultancy in reorganization, restructuring and mergers of corporations, which merged with the Bank's Corporate Finance division, strengthening the Bank's position as the leading corporate advisory in Iceland.

The Bank signed market making agreements with the Icelandic Government Debt Management Agency, the Municipality Credit Iceland (MCI) and the Icelandic Housing Financing Fund (HFF), to issue and act as market maker in bonds issued by the Treasury, MCI and HFF. The Bank also held its position as the market leader in bond underwriting for municipalities and other public and semi-public bodies.

During the year, the Bank co-founded the FME licensed custody and settlement company T Plus hf. with Icelandic Securities hf. and Stapi Pension Fund. Four employees of the bank joined the company and the Bank's entire custody and settlement services were outsourced to T Plus at year end.

The ability of the Bank's customers to meet with their obligations towards the Bank has still deteriorated but provision for credit losses has decreased from the last two years and amounted to ISK 181 million, compared to 1,072 million in 2009. Loans to customers amounted at year-end to ISK 915 million.

**Events after the reporting date.** At the beginning of the year 2011 the Board of Directors and the Management restructured the Bank's operations to limit its further operating losses if economic conditions in Iceland in general do not improve. The restructuring consisted of merging the divisions of Debt Finance and Proprietary Trading, shutting down the Bank's Investment Advisory, reducing the number of employees to 22, and cutting down other operating expenses.

On February 15 the Board of Directors appointed Mr. Hersir Sigurgeirsson, the former Managing Director of Risk Management, as the Bank's CEO, after the former CEO resigned his position.

In accordance with paragraph 4 of Art. 52 of the Act on Financial Undertakings, which took effect on 1 April, Mr. Halldór Jóhannsson, chairman, and Mr. Bjarni H. Helgason alternate Board member, resigned from the Board of Directors. The provision prevents employees of a party, which is closely related to another regulated entity, to take a seat on the Board. Mr. Jóhannsson and Mr. Helgason are both employees of KEA, which has a qualifying holding in Sparisjóður Höfðhverfinga, a local savings bank. Mr. Eggert Árni Gíslason, alternate member of the Board, took a seat on the Board of Directors in place of Mr. Jóhannsson and Mr. Gunnar Þór Gíslason vice chairman took over as chairman of the Board.

On 12 April 2011 the assets reported as "Assets held for sale" on the balance sheet were sold for ISK 775 million.

**Shareholders.** The Bank has two shareholders, the holding companies Saga Eignarhaldsfélag hf., which holds 90.01% of the outstanding share capital, and Hilda hf. which holds the remaining 9.99%. Two shareholders held more than 10% in the two holding companies at year end, Hvarf ehf. with a 10.73% share and Sundagarðar hf. with 10.47%.

**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 2010, assets, liabilities and its financial standing as at 31 December 2010 and changes in cash and cash equivalents during the year 2010.

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 2010 by means of their signatures.

Reykjavík, 15 April 2011

#### The Board of Directors

**Gunnar Þór Gíslason**, Chairman of the Board



**Eggert Árni Gíslason**



**Gunnar Þór Guðmannsson**



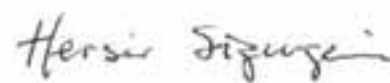
**Jón Ármann Guðjónsson**



**Svanhildur Nanna Vigfúsdóttir**



**Hersir Sigurgeirsson**, CEO



## INDEPENDENT AUDITOR'S REPORT

To the Board of Directors and Shareholders of Saga Investment Bank hf.

We have audited the accompanying financial statements of Saga Investment Bank hf, which comprise the statement of balance sheet as at December 31, 2010, statements of income, changes in equity and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

**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, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

**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 ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from 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 judgment, 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 reason-

ableness 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 Saga Investment Bank as at December 31, 2010, 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.

**Report on the Board of Directors report.** Pursuant to the legal requirement under Article 106, Paragraph 1, Item 5 of the Icelandic Financial Statement Act No. 3/2006, we confirm that, to the best of our knowledge, the report of the Board of Directors accompanying the financial statements includes the information required by the Financial Statement Act if not disclosed elsewhere in the Financial Statements.

Reykjavík, 15 April 2011

**KPMG ehf.**

Sigurður Jónsson



Reynir Stefán Gylfason



## INCOME STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2010

	Notes	2010	2009
<b>Continuing operations</b>			
Interest income		626.927	1.268.638
Interest expense		( 647.909 )	( 594.581 )
<b>Net interest (expenses) income</b>	18	( 20.982 )	674.057
Fee income		381.857	508.192
Fee expense		( 79.175 )	( 130.129 )
<b>Net fee income</b>	19	302.683	378.063
Net income (expenses) on financial assets and liabilities	20	99.811	( 81.701 )
Other income		546	153
<b>Total other operating income</b>		100.356	( 81.548 )
<b>Net operating income</b>		382.057	970.572
Salaries and salary related expenses	21- 22	486.146	437.196
Other operating expenses		417.828	461.813
Depreciation of property and equipment		48.883	53.754
<b>Total operating expenses</b>		952.857	952.762
<b>(Loss) / Profit before impairment and income tax</b>		( 570.800 )	17.810
Impairment loss on loans	8	( 180.658 )	( 1.071.582 )
<b>Loss before income tax</b>		( 751.458 )	( 1.053.772 )
Income tax		( 1.025.567 )	( 962.985 )
<b>Loss from continuing operation</b>		( 1.777.025 )	( 2.016.757 )
<b>Discontinued operation</b>			
Loss from discontinued operation (net of income tax)		0	( 813.975 )
<b>Loss for the year</b>		( 1.777.025 )	( 2.830.732 )

Notes on pages 59 - 90 are an integral part of these Financial statements

## BALANCE SHEET AS AT 31 DECEMBER 2010

	Notes	2010	2009
<b>Assets</b>			
Cash and cash equivalents		1,222,505	1,559,735
Loans to financial institutions	25,42	2,453,336	2,082,068
Trading assets	26,34,42	3,158,390	3,741,769
Financial assets designated at fair value	27	149,761	570,481
Assets held for sale	28,42	762,648	0
Loans to customers	29,42	914,467	3,093,768
Intangible assets	30	34,171	35,025
Property and equipment	31	112,699	68,684
Deferred tax assets	32	225,000	1,250,567
Other assets	33	154,054	208,741
<b>Total assets</b>		<b>9,187,028</b>	<b>12,610,838</b>
<b>Liabilities</b>			
Trading liabilities	34	4,575,693	4,252,552
Borrowings	35	2,847,864	3,940,177
Subordinated loans	36	684,880	1,624,463
Other liabilities	37	255,803	171,174
<b>Total liabilities</b>		<b>8,364,240</b>	<b>9,988,366</b>
<b>Equity</b>			
Share capital	38	2,813,564	7,360,955
Share premium		( 20,403 )	2,440,841
Accumulated deficit		( 1,970,372 )	( 7,179,324 )
<b>Total equity</b>	39	<b>822,789</b>	<b>2,622,472</b>
<b>Total liabilities and equity</b>		<b>9,187,028</b>	<b>12,610,838</b>

## STATEMENT OF CHANGES IN EQUITY FOR THE YEAR 2010

	Notes	Share capital	Share premium	Other restricted	Accumulated deficit	Total
<b>Changes in equity in the year 2009</b>						
Equity at 1 January 2009		9,573,331	1,045,163	59,774	( 4,500,562 )	6,177,706
Accrued cost - share options		0	0	92,197	0	92,197
Relinquished share options		0	0	( 151,971 )	151,971	( 0 )
Purchased treasury shares		( 2,212,376 )	1,395,678	0	0	( 816,698 )
Loss for the year		0	0	0	( 2,830,732 )	( 2,830,732 )
<b>Equity at 31 December 2009</b>		<u>7,360,955</u>	<u>2,440,841</u>	<u>0</u>	<u>( 7,179,324 )</u>	<u>2,622,472</u>
<b>Changes in equity in the year 2010</b>						
Equity at 1 January 2010		7,360,955	2,440,841	0	( 7,179,324 )	2,622,472
Reduction of share capital	38	( 4,529,052 )	( 2,456,925 )	0	6,985,977	0
Purchased treasury shares		( 18,339 )	( 4,319 )	0	0	( 22,658 )
Loss for the year		0	0	0	( 1,777,025 )	( 1,777,025 )
<b>Equity at 31 December 2010</b>		<u>2,813,564</u>	<u>( 20,403 )</u>	<u>0</u>	<u>( 1,970,372 )</u>	<u>822,789</u>

Notes on pages 59 to 90 are an integral part of these Financial statements

## STATEMENT OF CASH FLOWS FOR THE YEAR 2010

	2010	2009
<b>Cash flows from operating activities:</b>		
Loss from continuing operation	( 1.777.025 )	( 2.016.757 )
Adjustment for:		
Net interest (expenses) income	20.982	( 674.057 )
Dividends on financial assets designated at fair value	( 12.455 )	( 2.063 )
Net (gain) loss on financial assets held for trading	( 234.835 )	1.735.186
Net loss (gain) on financial assets designated at fair value	103.809	( 1.648.107 )
Net foreign exchange (gain) loss	43.671	( 3.315 )
Depreciation of property and equipment	48.883	53.754
Impairment loss on loans	180.658	1.071.582
Income tax	1.025.567	962.985
Change in loans to financial institutions	( 371.267 )	( 977.123 )
Change in trading assets	394.663	5.598.826
Change in financial assets designated at fair value	655.555	11.698.584
Change in loans to customers	265.051	( 343.819 )
Change in other assets	82.666	152.924
Change in trading liabilities	323.141	4.188.244
Change in borrowings	( 985.849 )	( 18.540.209 )
Change in other liabilities	69.121	( 582.755 )
Interest received	540.050	1.055.245
Dividends received	12.455	2.063
Interest paid	( 594.899 )	( 511.560 )
<b>Net cash (used in) / from operating activities</b>	<b>( 210.059 )</b>	<b>1.219.626</b>
<b>Cash flow from investing activities:</b>		
Acquisition of subsidiary, net cash acquired	( 50.399 )	0
Acquisition of property and equipment	( 54.215 )	( 30.084 )
Acquisition of intangible assets	0	( 27.863 )
Proceeds from sale of property and equipment	100	4.500
<b>Net cash used in investing activities</b>	<b>( 104.513 )</b>	<b>( 53.448 )</b>
<b>Cash flow from financing activities:</b>		
Purchased own shares	( 22.658 )	0
<b>Net cash flows used in financing activities</b>	<b>( 22.658 )</b>	<b>0</b>
<b>Cash and cash equivalents, (decrease) increase</b>	<b>( 337.231 )</b>	<b>1.166.179</b>
<b>Cash and cash equivalents at 1 January</b>	<b>1.559.735</b>	<b>393.557</b>
<b>Cash and cash equivalents at year end</b>	<b>1.222.505</b>	<b>1.559.735</b>

During the year 2010, loans amounting to ISK 1,044 million were used to pay up subordinated debt. Loans amounting to ISK 186 million and financial assets designated at fair value amounting to ISK 576 million were reclassified as assets held for sale.

Notes on pages 59 to 90 are an integral part of these financial statements

## NOTES TO THE FINANCIAL STATEMENTS

### 1. General information on Saga Investment Bank hf.

Saga Investment Bank hf. is an Icelandic limited liability company with its headquarters at Hafnarstraeti 53, Akureyri. The objectives of Saga Investment Bank hf. are to provide its customers with services in relation to corporate advisory, loans and capital markets. In November 2010 the Bank changed its name from Saga Capital Investment Bank hf. to Saga Investment Bank hf.

### 2. Basis of preparation

#### a. Statement of compliance

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

The financial statements of Saga Capital Investment Bank hf. were approved by its Board of Directors on 15 April 2011.

#### 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 3 (g) 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 IFRSs 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 5.

#### e. Changes in accounting policies

On 1 January 2010 the bank changed its accounting methods regarding interest income and expenses from trading assets and liabilities. Interest income from bonds in the trading book and interest expenses of trading liabilities are now calculated at the market yield but were previously calculated based on the nominal interest rates on the bonds.

Comparative figures in the income statement have been changed to reflect the above changes. The items affected and their amounts are as follows:

- The item "Interest income" increased by ISK 139,151 thousand.
- The item "Net income on financial assets and liabilities" decreased by ISK 139,151 thousand.

This representation is deemed more appropriate than the previous method and provides better information about interest income and expenses of the trading assets and liabilities.

A few new standards, amendment to standards and interpretations have not taken effect by year-end 2010 and have not been applied in the preparation of the financial statements. It is not expected that those standards, amendments and interpretations will have significant effect on the Bank's financial statements when they come into force, except for IFRS 9 Financial Instruments. IFRS 9 will be applicable from the beginning of 2013 if endorsed by the EU. The potential impact of IFRS 9 on the Bank's operations has not been evaluated.

### 3. Significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these financial statements. Certain comparative amounts have been reclassified to conform with the year's presentation. No revenues or expenses are recognised directly in equity and the loss for the year is therefore equal to comprehensive loss. Therefore, the Bank only presents an income statement.

#### a. Foreign currencies

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 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 when 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 when the service is received.

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

Net income (expenses) 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**

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.

#### **f. Income tax**

Income tax comprises current and deferred tax. Income tax 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 reporting 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 tempo-

rary 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 are retained in part or in full. If all or nearly all risk and reward are retained the recognition of the asset in the balance sheet continues. Transfer of assets where nearly all risk and reward are retained consists for example in securities lending and repurchases. The rights and obligations retained in the transfer are recognised separately as assets and liabilities as appropriate. In transfer where control over the asset is retained, the Bank con-

continues to recognise the asset to the extent of its continuing involvement, determined by the extent to which it is exposed to changes in the value 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 a legal right to set-off exists 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.

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 reporting 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;
- a breach of contract, such as a default on instalments 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 reporting 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 have been impaired at the reporting date but which will not be individually identified as such until sometime 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 objectively 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 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 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.

**í. 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 are recognised in the income statement. Fair value changes are recognised on the one hand 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 are

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, whose values are 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.

#### **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:

- 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
- 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 granted solely by the Bank, or together with other credit institutions, to customers, and purchased unlisted loans that 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 contracts on sale and repurchase of securities on the condition that the securities are repurchased at a pre-established date and price. Purchase and resale agreements are contracts on the purchase and resale of securities on the condition that the securities are resold at a pre-established date and price. Initially received cash in addition to accrued interests is recognised in the balance sheet as deposit with financial institutions and the Central Bank. Initially paid cash in addition to accrued interests is recognised as receivable from credit institutions. Accrued interests are recognised as interest income over the useful life 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 and equipment**

Items of property and equipment are capitalised at cost less accumulated depreciation and impairment losses. Subsequently incurred cost due to renewal of single items of property and equipment is capitalised as property 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 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 institutions. 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 payment due to a guarantee is considered to be 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.

#### 4. Going concern

Management has evaluated the Bank's ability to continue as a going concern. It is the opinion of the management that the Bank's going concern is established for the foreseeable future. Management is not aware of any significant uncertainty that might affect the aforementioned evaluation. Therefore, the financial statements are presented based on the premises that the Bank will be able to continue as a going concern.

#### 5. Use of estimates and judgements

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

#### 6. Risk management

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 benchmarking 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 or 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 lending 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 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 largest 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 treasury, follows benchmarks set by the Board regarding market risk.

Credit risk is a considerable risk factor in the Bank's operation and consists mainly in credit risk due to loans to customers. The Bank's Board of Directors establishes credit policies which set the aim and acceptable limits for credit 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 executes with the Board of Directors' policy. For each of the Bank's credit, whether in lending transactions or derivative transactions, the Bank performs a risk assessment and gives the credit a credit rating, which is used in the risk assessment. Credit ratings are reviewed two times a year for the Bank's largest customers.

### Risk management process and risk control

#### a. Contracts including credit risk

Credit risk is the risk of a counterparty not fulfilling its obligation towards the Bank. The Bank's main credit risk arises in relation to loan granting. The maximum amount of credit risk in this respect is stated in the book value of assets in the balance sheet. Credit risk consists in the

Bank's various other financial assets, such as derivative agreements and market bonds and current credit risk is reflected in the book value of those assets in the balance sheet. In addition to the aforementioned credit risk, the Bank also faces credit risk due to off-balance sheet items such as guarantees granted

**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 derivative agreements 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 sufficient collaterals at all times. Collaterals vary depending on the customer and the type of instrument. In general, collaterals are required in order to meet possible loss resulting from an agreement. Acceptable collaterals for derivatives are assets redeemable on a short notice, such as cash or market shares. If the balance of a derivatives goes below a certain limit further collaterals are required. Counterparties in derivatives agreements are evaluated using the Bank's credit rating system in the same way as debtors.

#### b. Loan processing and authorisations

The Bank's loan committee reviews and decides on all loan issues except when the risk of a single loan exceeds 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 authorisations and limits on risk towards different counterparties. The Bank's legal department supervises all loan documentation. According to Article 30 of law no. 161/2002, no single risk obligation or liability due to related parties may exceed 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 Hilda's loan agreement with Eignasafn Seðlabanka Íslands, no single risk obligation shall exceed 20% of the Bank's CAD equity.

### c. Credit risk monitoring

Risk management department monitors credit 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 credit 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 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 allowance account is entered as impairment loss on loans. The allow-

ance 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. Credit 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 allowance 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 write-offs are recognised as reduction in the total value of the receivable against the allowance account or as impairment loss on loans in the income statement. Repayments of previously impaired 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 losses are grouped in a uniform loan portfolio and impairment losses are assessed on the entire loan portfolio. Allowance due to overall assessment of impairment losses is entered as impairment losses 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 are no impairment losses 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 losses is entered as expenses due to loss on loan and leads to a counter recording on the loan balance. As allowance is not entered for each individual loan, interest is calculated on all loans according to contractual provisions.

## 7. Highest probable credit risk

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

	2010	2009
Cash and cash equivalents	1.222.505	1.559.735
Receivable from financial institutions	2.453.336	2.082.068
Trading assets:		
Government bonds	2.020.741	1.049.086
Housing bonds	977.497	2.433.196
Bank notes	0	229.863
Financial assets designated at fair value:		
Corporate bonds	50.000	100.000
Assets held for sale:		
Loans to customers	186.435	0
Loans to customers	914.467	3.093.768
Other assets	127.700	187.409
<b>Total</b>	<u>7.952.680</u>	<u>10.735.125</u>
Credit risk related to off-balance sheet items:		
Guarantees	0	1.150.000
<b>Total</b>	<u>7.952.680</u>	<u>11.885.125</u>

## 8. Allowance for impairment

Changes in the allowance for impairment on loan accounts are specified as follows:

	Specific allowance	Collective allowance	Total
<b>2010</b>			
Allowance for impairment on loans at the beginning of the year	2.490.558	9.721	2.500.278
Impairment loss on loans during the year	171.658	9.000	180.658
Written - off on loans	( 1.353.163 )	0	( 1.353.163 )
Foreign exchange difference	178.709	0	178.709
<b>Allowance for impairment on loans at year end</b>	<u>1.487.763</u>	<u>18.721</u>	<u>1.506.483</u>
<b>2009</b>			
Allowance for impairment on loans at the beginning of the year	1.836.532	88.678	1.925.210
Impairment loss on loans during the year	1.150.539	( 78.958 )	1.071.581
Written- off on loans	( 389.156 )	0	( 389.156 )
Guarantees paid	( 282.513 )	0	( 282.513 )
Foreign exchange difference	175.156	0	175.156
<b>Allowance for impairment on loans at year end</b>	<u>2.490.558</u>	<u>9.721</u>	<u>2.500.278</u>

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

	<b>Gross amount</b>	<b>Specific allowance for impairment</b>	<b>Carrying amount</b>
<b>2010</b>			
Customers:			
Real estate companies	263.021	263.021	0
Holding companies	1.079.299	1.064.550	14.749
Individuals	276.802	160.192	116.610
<b>Total</b>	<b>1.619.122</b>	<b>1.487.763</b>	<b>131.359</b>
<b>2009</b>			
Customers:			
Industry	275.063	275.063	0
Real estate companies	263.214	263.214	0
Holding companies	2.383.930	1.767.764	616.166
Individuals	280.195	184.517	95.678
<b>Total</b>	<b>3.202.403</b>	<b>2.490.558</b>	<b>711.844</b>

The Bank's credit risk is specified as follows in terms of impairment losses:

	<b>Neither past due nor impaired</b>	<b>Past due but not impaired</b>	<b>Individually impaired</b>	<b>Gross amount</b>	<b>Allowance for impairment</b>	<b>Carrying amount</b>
<b>31 December 2010</b>						
Cash and cash equivalents	1.222.505	0	0	1.222.505	0	1.222.505
Loans to financial institutions	2.418.571	34.765	0	2.453.336	0	2.453.336
Loans to customers	648.969	152.859	1.619.122	2.420.950	1.506.483	914.467
Assets held for sale	186.435	0	0	186.435	0	186.435
Other assets	147.355	6.699	0	154.054	0	154.054
	<u>4.623.835</u>	<u>194.323</u>	<u>1.619.122</u>	<u>6.437.280</u>	<u>1.506.483</u>	<u>4.930.796</u>
<b>31 December 2009</b>						
Cash and cash equivalents	1.559.735	0	0	1.559.735	0	1.559.735
Loans to financial institutions	2.047.304	34.765	0	2.082.068	0	2.082.068
Loans to customers	2.210.149	171.775	3.202.403	5.584.326	2.490.558	3.093.768
Other assets	208.741	0	0	208.741	0	208.741
	<u>6.025.929</u>	<u>206.540</u>	<u>3.202.403</u>	<u>9.434.871</u>	<u>2.490.558</u>	<u>6.944.312</u>

The carrying amount of loans in default but not impaired:

	<b>2010</b>	<b>2009</b>
Past due up to 30 days	0	16.178
Past due 31-90 days	3.436	0
Past due 91-180 days	12.300	8.326
Past due 181 - 365 days	137.123	147.271
<b>Remaining balance of loans in default but not impaired</b>	<b>152.859</b>	<b>171.775</b>

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

The total amount in default for loans that are not impaired at year end 2010 amounted to ISK 32 million. (2009: ISK 23 million)

## 9. Liquidity risk control and management

Liquidity risk is the risk of the Bank not being 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:

2010	Due	0 - 3 months	3 - 12 months	1 - 5 years	Over 5 years	Total
<b>Financial assets</b>						
Cash and cash equivalents	0	1.222.505	0	0	0	1.222.505
Loans to financial institutions	34.765	2.418.571	0	0	0	2.453.336
Trading assets	0	3.158.390	0	0	0	3.158.390
Financial assets at fair value	0	0	0	0	149.761	149.761
Assets held for sale	0	0	762.648	0	0	762.648
Loans to customers	69.954	265.786	42.485	440.382	95.860	914.467
Other financial assets	6.699	115.611	0	0	0	122.310
<b>Total financial assets</b>	<b>111.418</b>	<b>7.180.863</b>	<b>805.132</b>	<b>440.382</b>	<b>245.621</b>	<b>8.783.415</b>
<b>Financial liabilities</b>						
Trading liabilities	0	4.575.693	0	0	0	4.575.693
Borrowings	0	1.451.425	1.396.439	0	0	2.847.864
Subordinated loans	0	0	0	684.880	0	684.880
Other financial liabilities	0	161.120	0	0	0	161.120
<b>Total liabilities</b>	<b>0</b>	<b>6.188.238</b>	<b>1.396.439</b>	<b>684.880</b>	<b>0</b>	<b>8.269.556</b>
Net financial assets and liabilities	111.418	992.625	( 591.307 )	( 244.497 )	245.621	513.859

2009	Due	0 - 3 months	3 - 12 months	1 - 5 years	Over 5 years	Total
<b>Financial assets</b>						
Cash and cash equivalents	0	1,559,735	0	0	0	1,559,735
Loans to financial institutions	34,765	2,047,303	0	0	0	2,082,068
Trading assets	0	3,741,769	0	0	0	3,741,769
Financial assets at fair value	0	0	0	0	570,481	570,481
Loans to customers	168,908	486,830	472,659	1,769,678	195,693	3,093,768
Other financial assets	0	182,403	0	0	0	182,403
<b>Total financial assets</b>	<b>203,673</b>	<b>8,018,040</b>	<b>472,659</b>	<b>1,769,678</b>	<b>766,174</b>	<b>11,230,224</b>
<b>Financial liabilities</b>						
Trading liabilities	0	4,252,552	0	0	0	4,252,552
Borrowings	0	3,717,829	222,348	0	0	3,940,177
Subordinated loans	0	0	0	0	1,624,463	1,624,463
Other financial liabilities	0	80,358	0	0	0	80,358
<b>Total liabilities</b>	<b>0</b>	<b>8,050,739</b>	<b>222,348</b>	<b>0</b>	<b>1,624,463</b>	<b>9,897,550</b>
Net financial assets and liabilities	203,673	( 32,699 )	250,311	1,769,678	( 858,289 )	1,332,673

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 is stated therein, it is for example not taken into account that on demand loans from financial institutions will be paid in full in the period stated in the previous analysis.

## 10. Market risk control and management

The Bank's risk management monitors closely the Bank's market risk and ensures that limits set by the Board are not exceeded. Market risk is managed by setting limits on assessments and risk benchmarks, which are 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 and stocks with low turnover is specifically monitored. Furthermore 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.

## 11. Interest rate risk

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 and 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. Risk management also optimises 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 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.

<b>Sensitivity analysis of effects of interest rate changes in net interest income compared to equal interest rate shift of 1 percent (100 basis points):</b>	<b>100 bp equal increase</b>	<b>100 bp equal decrease</b>
<b>2010</b>		
Year end .....	10.587	( 10.587 )
Average balance during the year .....	17.628	( 17.628 )
Highest balance during the year .....	22.826	( 22.826 )
Lowest balance during the year .....	10.587	( 10.587 )
<b>2009</b>		
Year end .....	22.465	( 22.465 )
Average balance during the year .....	32.889	( 32.889 )
Highest balance during the year .....	43.497	( 43.497 )
Lowest balance during the year .....	21.212	( 21.212 )

## 12. Indexation risk

The balance of the amount of indexed and unindexed assets and liabilities is systematically managed. It shall be taken into account that indexed assets are in general higher than indexed liabilities. 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.

	<b>2010</b>	<b>2009</b>
Indexed assets	1.087.125	3.171.949
Indexed liabilities	698.801	1.624.463
<b>Total indexation exposure</b>	<b>388.324</b>	<b>1.547.486</b>

## 13. Price risk

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.

## 14. Currency risk

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.

Breakdown of financial assets and liabilities by currencies at year end 2010:

2010	CHF	EUR	USD	NOK	Other currencies
<b>Financial assets</b>					
Cash and cash equivalents	4	66	20.353	17.721	14.935
Financial assets at fair value	0	0	0	0	37.287
Assets held for sale	56.383	0	0	706.265	0
Loans to customers	216.376	67.396	0	0	185.923
<b>Total assets</b>	<b>272.763</b>	<b>67.462</b>	<b>20.353</b>	<b>723.986</b>	<b>238.145</b>
<b>Financial liabilities</b>					
Borrowings	0	0	42.533	0	0
Other liabilities	0	0	2.202	0	0
<b>Total liabilities</b>	<b>0</b>	<b>0</b>	<b>44.735</b>	<b>0</b>	<b>0</b>
Net balance in the balance sheet	272.763	67.462	( 24.383 )	723.986	238.145
<b>2009</b>					
	<b>CHF</b>	<b>EUR</b>	<b>USD</b>	<b>DKK</b>	<b>Other currencies</b>
<b>Financial assets</b>					
Cash and cash equivalents	4	76	61	22.986	126
Trading assets	0	0	0	23.831	0
Financial assets designated at fair value	0	0	0	2.838	442.572
Loans to customers	592.606	310.595	29.744	0	847.978
Other assets	0	0	0	40.217	0
<b>Total assets</b>	<b>592.610</b>	<b>310.671</b>	<b>29.805</b>	<b>89.872</b>	<b>1.290.676</b>
<b>Financial liabilities</b>					
Trading liabilities	0	0	0	4.158	0
Borrowings	0	1.571	21.740	91.536	0
Other liabilities	0	0	0	28.439	0
<b>Total liabilities</b>	<b>0</b>	<b>1.571</b>	<b>21.740</b>	<b>124.133</b>	<b>0</b>
Net balance in the balance sheet	592.610	309.100	8.065	( 34.261 )	1.290.676

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 profit / loss before tax:**

	<b>30% Equal strengthening of the ISK</b>	<b>30% Equal weakening of the ISK</b>
<b>2010</b>		
Year end .....	( 384.001 )	384.001
Average balance .....	( 580.557 )	580.557
Highest balance during the year .....	( 757.105 )	757.105
Lowest balance during the year .....	( 384.001 )	384.001
<b>2009</b>		
Year end .....	( 415.790 )	415.790
Average balance .....	( 1.574.679 )	1.574.679
Highest balance during the year .....	( 2.450.486 )	2.450.486
Lowest balance during the year .....	( 415.790 )	415.790

**15. Fair value evaluation methods:**

The following table shows financial instruments recognised at fair value classified by evaluation method. The methods are defined as follows:

**Level 1:** Quoted price in an active market for identical assets and liabilities.

**Level 2:** Presumptions are based on other variables than nominal prices in an active market (level 1), which may be obtained for assets and liabilities, directly (for example, prices) or indirectly (derived from prices).

**Level 3:** The fair value of assets and liabilities are not based on data obtainable in the market.

	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
<b>2010</b>				
Trading assets	3.135.188	23.202	0	3.158.390
Financial assets designated at fair value	0	0	149.761	149.761
Assets held for sale		538.364	224.284	762.648
Trading liabilities	( 4.575.693 )	0	0	( 4.575.693 )
	<u>( 1.440.506 )</u>	<u>561.566</u>	<u>374.044</u>	<u>( 504.896 )</u>
<b>2009</b>				
Trading assets	3.739.315	2.454	0	3.741.769
Financial assets designated at fair value	0	427.143	143.337	570.481
Trading liabilities	( 4.252.552 )	0	0	( 4.252.552 )
	<u>( 513.238 )</u>	<u>429.597</u>	<u>143.337</u>	<u>59.697</u>

## 16. Operating risk

Operating risk is the risk arising from direct or indirect losses due to various reasons related to the Bank's development, operating 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 operating 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 department. Management relies upon the Bank's general benchmarks developed for risk management for each of the following items:

- requirements on appropriate work department;
- reporting on policies and operating 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 of 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 management 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 department.

## 17. Fair value of financial instruments

The fair value of a financial instrument is the receivable amount 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 is used in the assessment of monetary assets and liabilities, when it is available. 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 then 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

### 18. Net interest income

Interest income and expenses are specified as follows:

	Interest income	Interest expenses	Net interest income
<b>Year 2010</b>			
Cash and cash equivalents	26.686	0	26.686
Loans to customers	323.883	0	323.883
Trading assets and liabilities	275.740	210.940	64.800
Borrowings	0	436.254	( 436.254 )
Other	618	715	( 97 )
<b>Interest income and expenses</b>	<b>626.927</b>	<b>647.909</b>	<b>( 20.982 )</b>
Interest income on financial assets and liabilities at fair value	275.740	210.940	64.800
Interest income on financial assets and liabilities not measured at fair value through profit and loss	351.187	436.969	( 85.782 )
<b>Interest income and expenses</b>	<b>626.927</b>	<b>647.909</b>	<b>( 20.982 )</b>

### Year 2009

Cash and cash equivalents	63.856	0	63.856
Loans to customers	566.600	0	566.600
Trading assets and liabilities	504.408	2.186	502.222
Financial assets and liabilities at fair value	133.774	0	133.774
Borrowings	0	576.765	( 576.765 )
Other	0	15.630	( 15.630 )
<b>Interest income and expenses</b>	<b>1.268.638</b>	<b>594.581</b>	<b>674.057</b>
Interest income on financial assets and liabilities at fair value	638.182	2.186	635.996
Interest income on financial assets and liabilities not measured at fair value through profit and loss	630.456	592.395	38.061
<b>Interest income and expenses</b>	<b>1.268.638</b>	<b>594.581</b>	<b>674.057</b>

### 19. Net fee income

Fee income and expenses are specified as follows:

	2010	2009
Fee on securities transactions	168.226	363.938
Asset management fee	47.506	0
Other fee income	166.125	144.254
<b>Fee income</b>	<b>381.857</b>	<b>508.192</b>
Fee on securities transactions	39.528	106.071
Other fee expenses	39.647	24.057
<b>Fee expenses</b>	<b>79.175</b>	<b>130.129</b>
<b>Net fee income</b>	<b>302.683</b>	<b>378.063</b>

2010

2009

**20. Net income on financial assets and liabilities**

Net income (expenses) on financial assets and liabilities are specified as follows:

a. Dividends	12,455	2,063
Net income (expenses) on trading assets and liabilities	234,835	( 1,735,186 )
Net (expenses) income on financial assets designated at fair value	( 103,809 )	1,648,107
Net foreign exchange difference	( 43,671 )	3,315
<b>Net income (expenses) on financial assets and liabilities</b>	<b>99,810</b>	<b>( 81,701 )</b>
b. Net income (expenses) on trading assets and liabilities are specified as follows:		
Shares and related derivatives	1,861	( 1,962,371 )
Bonds and related derivatives	232,974	227,185
<b>Net income (expenses) on trading assets and liabilities</b>	<b>234,835</b>	<b>( 1,735,186 )</b>
c. Net (expenses) income on financial assets designated at fair value are specified as follows:		
Shares and related derivatives	( 53,809 )	1,838,387
Bonds and related derivatives	( 50,000 )	( 190,280 )
<b>Net (expenses) income on financial assets designated at fair value</b>	<b>( 103,809 )</b>	<b>1,648,107</b>

**21. Personnel**

Total number of employees is specified as follows:

Average number of full-time employment positions during the year	34	31
Number of full-time employment positions at year-end	37	32

Salaries and salary related expenses are specified as follows:

Salaries	372,502	320,169
Contribution to pension fund	49,327	49,992
Other salary related expenses	64,317	53,219
Expensed due to share options	0	13,816
<b>Salaries and salary related expenses</b>	<b>486,146</b>	<b>437,196</b>

**22. Management's salaries**

Year 2010

	<b>Salaries</b>	<b>Benefits</b>	<b>Share capital *</b>	<b>Share of fin. rel. parties</b>
<b>CEO:</b>				
Porvaldur Lúðvík Sigurjónsson	20.907	1.785	7.100	0
<b>Board of Directors:</b>				
Halldór Jóhannsson, Chairman	2.038	0	0	9.130
Eggert Árni Gíslason	550	0	0	10.000
Guðmundur Örn Þórðarson	168	0	0	0
Gunnar Þór Guðmannsson	1.300	0	350	0
Gunnar Þór Gíslason	875	0	1.000	10.000
Jón Ármann Guðjónsson	875	0	0	10.250
Karl Friðriksson	63	0	35	0
Svanhildur Nanna Vigfúsdóttir	1.130	0	0	0
Sindri Sindrason	425	0	0	0
Stefán Héðinn Gunnlaugsson	210	0	100	0
Managing Directors (8)	146.582	12.771	350	0
	<u>175.122</u>	<u>14.556</u>	<u>8.935</u>	<u>39.380</u>

\* The above shares are in Hilda hf. and Saga Eignarhaldsfélag hf., which are the sole shareholders of the bank.

Porvaldur Lúðvík Sigurjónsson, former CEO, resigned from his position on 15 February 2011. The resignation took effect immediately and in accordance with his employment agreement with the bank he gets paid salary during his six months resignation period.

Year 2009	<b>Salaries</b>	<b>Benefits</b>	<b>Share capital</b>	<b>Share of fin. rel. parties</b>
<b>CEO:</b>				
Porvaldur Lúðvík Sigurjónsson	23.000	1.891	710.000	213.500
<b>Board of Directors:</b>				
Halldór Jóhannsson, Chairman	1.643	0	0	1.126.543
Eggert Árni Gíslason	595	0	0	1.000.000
Gunnar Þór Guðmannsson	595	0	35.000	0
Sindri Sindrason	1.095	0	0	0
Stefán Héðinn Gunnlaugsson	85	0	10.000	0
Kristján Eldjárn Jóhannesson, reserve director	0	0	20.000	0
Gunnar Þór Gíslason, former board member	500	0	100.000	1.000.000
Jóhann Antonsson, former board member	1.095	0	60.000	513.500
Managing Directors (7)	112.893	12.018	35.000	0
	<u>141.501</u>	<u>13.909</u>	<u>970.000</u>	<u>3.853.543</u>

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

**23. Auditors' fees**

Auditors' fees are specified as follows:

	<b>2010</b>	<b>2009</b>
Audit of financial statements	7.703	14.941
Internal audit	16.006	3.567
Review of interim financial statements	3.223	3.550
Other services	3.409	8.162
<b>Auditors' fees</b>	<u>30.341</u>	<u>30.219</u>

## NOTES TO THE BALANCE SHEET

### 24. Financial assets and liabilities

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 appertain and their basis of measurement are specified as follows:

- trading assets and liabilities - recognised at fair value through profit or loss;
- financial assets and liabilities designated at fair value - recognised at fair value through profit or loss;
- loans and receivables - recognised at amortised cost;
- other financial liabilities - recognised at amortised cost.

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	Fin. assets and liabilities at fair value	Other on amortised cost value	Carrying amount	Fair value
<b>2010</b>						
Cash and cash equivalents	0	0	0	0	1,222,505	1,222,505
Loans to financial institutions	0	0	0	0	2,453,336	2,453,336
Trading assets	3,158,390	0	0	0	3,158,390	3,158,390
Financial assets at fair value	0	149,761	149,761	0	149,761	149,761
Assets held for sale		576,212	576,212		762,647	762,647
Loans to customers	0	0	0	0	914,467	916,176
Other financial assets	0	0	0	0	122,310	122,310
	<u>3,158,390</u>	<u>725,972</u>	<u>725,972</u>	<u>0</u>	<u>8,783,415</u>	<u>8,785,124</u>
Trading liabilities	4,575,693	0	0	0	4,575,693	4,575,693
Borrowings	0	0	0	2,847,864	2,847,864	2,847,864
Subordinated loans	0	0	0	684,880	684,880	725,214
Other financial liabilities	0	0	0	161,120	161,120	161,120
	<u>4,575,693</u>	<u>0</u>	<u>0</u>	<u>3,693,863</u>	<u>8,269,556</u>	<u>8,309,891</u>
<b>2009</b>						
Cash and cash equivalents	0	0	0	0	1,559,735	1,559,735
Loans to financial institutions	0	0	0	0	2,082,068	2,082,068
Trading assets	3,741,769	0	0	0	3,741,769	3,741,769
Financial assets at fair value	0	570,481	570,481	0	570,481	570,481
Loans to customers	0	0	0	0	3,093,768	3,159,177
Other financial assets	0	0	0	0	205,464	205,464
	<u>3,741,769</u>	<u>570,481</u>	<u>570,481</u>	<u>0</u>	<u>11,253,285</u>	<u>11,318,694</u>
Trading liabilities	4,252,552	0	0	0	4,252,552	4,252,552
Borrowings	0	0	0	3,940,177	3,940,177	3,940,177
Subordinated loans	0	0	0	1,624,463	1,624,463	1,624,463
Other financial liabilities	0	0	0	80,358	80,358	80,358
	<u>4,252,552</u>	<u>0</u>	<u>0</u>	<u>5,644,998</u>	<u>9,897,550</u>	<u>9,897,550</u>

**25. Loans to financial institutions****2010****2009**

Receivables from financial institutions are specified as follows:

Bank accounts	23,494	2,852
Other loans to financial institutions	2,429,842	2,079,216
<b>Loans to financial institutions</b>	<b>2,453,336</b>	<b>2,082,068</b>

Loans to financial institutions are specified as follows by maturities:

On demand loans	34,765	34,765
Up to 3 months	2,418,571	2,047,304
<b>Loans to financial institutions</b>	<b>2,453,336</b>	<b>2,082,068</b>

**26. Trading assets**

Trading assets are specified as follows:

Bonds	2,998,238	3,712,145
Shares	160,152	29,624
<b>Trading assets</b>	<b>3,158,390</b>	<b>3,741,769</b>

**27. Financial assets designated at fair value**

Financial assets designated at fair value as specified as follows:

Shares	99,761	470,481
Bonds	50,000	100,000
<b>Financial assets designated at fair value</b>	<b>149,761</b>	<b>570,481</b>

**28. Assets held for sale**

Assets held for sale are specified as follows:

Loans to customers	186,436	0
Shares	576,212	0
<b>Assets held for sale</b>	<b>762,648</b>	<b>0</b>

**29. Loans to customers**

Loans to customers are specified as follows by loan type:

Loan agreements	23,434	448,771
Bonds	2,397,516	5,145,276
Allowance account for loans	( 1,506,483 )	( 2,500,279 )
<b>Loans to customers</b>	<b>914,467</b>	<b>3,093,768</b>

Allowance account for loans as proportion of loans	62,3%	44,7%
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Loans to customers are specified as follows by borrowers:

	2010	2009
Industry	15,8%	2,9%
Construction industry	32,2%	19,0%
Trade	4,0%	2,0%
Services	23,0%	5,5%
Real estate companies	0,0%	25,7%
Holding companies	1,4%	34,4%
Individuals	23,5%	10,4%
<b>Loans to customers</b>	<b>100,0%</b>	<b>100,0%</b>

Loans to customers are specified as follows by maturities:

On demand loans	69.954	168.908
Up to 3 months	265.786	486.830
3 months to 1 year	42.485	472.659
1 to 5 years	440.382	1.769.678
Over 5 years	95.860	195.693
<b>Loans to customers</b>	<b>914.467</b>	<b>3.093.768</b>

### 30. Intangible assets

Intangible assets are specified as follows:

	2010	2009	2010	2009
	Goodwill		Software	
Intangible assets at the beginning of the year	0	0	35.025	33.908
Additions during the year	21.600	0	0	27.863
Amortisation during the year	0	0	( 22.454 )	( 26.746 )
<b>Intangible assets at year end</b>	<b>21.600</b>	<b>0</b>	<b>12.571</b>	<b>35.025</b>

### 31. Property and equipment

Property and equipment is specified as follows:

	Fixtures, vehicles, and equipment	
Total value at the beginning of the year	68.684	70.109
Additions during the year	70.600	29.930
Sold and disposed of during the year	( 157 )	( 4.347 )
Depreciated during the year	( 26.429 )	( 27.008 )
<b>Carrying amount of property and equipment at year end</b>	<b>112.699</b>	<b>68.684</b>

### 32. Tax asset

Tax asset is specified as follows:

	2010	2009
Tax asset at the beginning of the year	1.250.567	2.037.506
Recognised income tax due to discontinued operation	0	176.046
Current tax	( 1.025.567 )	( 962.985 )
<b>Tax asset at year end</b>	<b>225.000</b>	<b>1.250.567</b>

Effective tax rate:		2010		2009
Loss before taxes		( 751.458 )		( 1.053.773 )
Income tax based on current tax rate	18,0%	( 135.262 )	15,0%	( 158.066 )
Effect of change in tax rate	3,0%	( 22.500 )	23,3%	( 245.094 )
Discontinued operation	0,0%	0	-16,7%	176.045
Non-deductible cost	-0,1%	584	-83,7%	882.214
Tax exempt income	0,0%	0	0,0%	( 309 )
Expensed due to share options	0,0%	0		0
Effect of discontinued operation	0,0%	0	16,7%	( 176.045 )
Adjustments from previous years	0,0%	0	-11,6%	122.498
Write down of tax asset	-154,7%	1.162.202	-20,9%	220.000
Other changes	-2,7%	20.543	-13,5%	141.743
Effective income tax	-136,5%	1.025.567	-91,4%	962.985

The Bank's tax asset is specified as follows:

	2010	2009
Property and equipment	1.527	1.375
Impairment of financial assets designated at fair value	( 12.567 )	0
Foreign exchange difference	3.198	11.724
Carry forward loss	( 217.158 )	( 1.263.666 )
<b>Total</b>	<b>( 225.000 )</b>	<b>( 1.250.567 )</b>

Carry forward loss can be utilised over 10 years from when it is incurred.

Carry forward loss of the year 2008, utilisable until year 2018	8.188.925
Carry forward loss of the year 2010, utilisable until year 2020	575.542
<b>Total carry forward loss at year end</b>	<b>8.764.467</b>

Tax asset is calculated due to carry forward loss, which is believed to be mostly utilised against taxable future profit. At year end 2010, tax asset due to carry forward loss amounts to ISK 1,753 million, but only 217 million are capitalised as the management believes that it is unlikely that it will be utilised against taxable profit. The evaluation of the tax asset is based on the management's approved future income budgets and on their estimation of how much of it will be utilised.

### 33. Other assets

Other assets are specified as follows:

	2010	2009
Unsettled securities transactions	10.952	56.863
Various assets	116.748	130.546
Prepaid expenses	26.354	21.332
<b>Other assets</b>	<b>154.054</b>	<b>208.741</b>

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

**34. Trading liabilities****2010****2009**

Trading liabilities are specified as follows:

Short positions in listed bonds	4,575.693	4,252.552
<b>Trading liabilities</b>	<u>4,575.693</u>	<u>4,252.552</u>

Short positions are in listed government bonds. As a primary dealer the bank has access to securities lending facilities provided by the Central Bank and the Housing Financing fund. Majority of the short positions have a maturity of less than a one month.

**35. Borrowings**

Borrowings are specified as follows:

Loans from financial institutions	2,127,357	3,108,696
Other loans	720,506	831,481
<b>Borrowings</b>	<u>2,847,864</u>	<u>3,940,177</u>

Borrowings are specified as follows by maturities:

Up to 1 month	1,429,079	3,217,142
1 to 3 months	22,346	500,687
3 months to 1 year	1,396,439	222,348
<b>Borrowings</b>	<u>2,847,864</u>	<u>3,940,177</u>

The bank has entered in to securities lending transactions and borrowed securities amounting to ISK 1,000 million which have been pledged for a loan from financial institutions. The bank has an obliged to return the securities on a specific maturity day.

**36. Subordinated loan**

In the event of the winding-up the Bank, this liability will be subordinated to the claims of all other creditors. The subordinated loan is denominated in ISK and bears 13% fixed interest p.a. The loan is CPI-indexed and is due in 2015, with yearly interest payments. The Bank has not defaulted on any principal, interest or other conditions of the subordinated loan since it was issued.

**37. Other liabilities****2010****2009**

Other liabilities are specified as follows:

Unsettled securities transactions	77,628	34,685
Accounts payable	79,741	34,177
Various liabilities	98,435	102,311
<b>Other liabilities</b>	<u>255,803</u>	<u>171,174</u>

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

### 38. Reduction of share capital

On 4 March 2010 a shareholders meeting approved The Board of Directors recommendation to reduce the share capital by ISK 4,529 million and share premium of ISK 2,457 million, by reduction of accumulated deficit of ISK 6,986 million. At the year-end 2010 the bank's authorized share capital amounted to 2,960 million and the bank's Treasury shares amounted to ISK 59 million at the year-end 2010.

### 39. Equity

Equity at year end amounted to ISK 823 million or around 8.96 % of the results in the balance sheet. Capital ratio, which is calculated according to Article 84 of the Act on Financial Undertakings is 19.7 % and may not be lower than 8.0%.

The ratio is calculated as follows:

	2010	2009
Tier 1 capital	563.618	2.587.447
Tier 2 capital	281.809	1.293.724
Tier 3 capital	92.395	0
<b>Total capital base</b>	<u>937.821</u>	<u>3.881.171</u>

Total capital requirement is specified as follows:

Credit risk	176.585	535.040
Market risk	153.991	296.453
Operational risk	49.928	23.489
<b>Capital requirement</b>	<u>380.504</u>	<u>854.982</u>

Capital base in excess of capital requirement	557.317	3.026.189
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Capital ratio	19,7%	36,3%
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### 40. Related parties

The Bank's related parties are its Board, CEO, Managing Directors and parties that have considerable influence as major shareholders in the Bank. Information on related parties are the following.

	2010	2009
Loans to the CEO and Managing Directors, and companies related to them	167.498	229.786
Loans to large shareholders and companies related to them	359.196	0
<b>Total loans to related parties</b>	<u>526.694</u>	<u>229.786</u>

Saga Eignarhaldsfélag hf. and Hilda hf. are related parties. At the year-end 2010 Hilda owns 9.99% of shares issued by the Bank and Saga Eignarhaldsfélag owns 90.01%. Hilda hf. and Saga Eignarhaldsfélag are considered by the Financial Supervisory Authority to be in cooperation regarding the ownership of the Bank. Furthermore Hilda owns a subordinated bond issued by the Bank of original principal ISK 1,560 million issued on 31 October 2009.

Saga and Hilda have signed an operating agreement under which the Bank is responsible for the asset management of Hilda's assets. The total asset management fee paid by Hilda to the Bank in 2010 amounted to ISK 47 million. In addition, Hilda paid a total of ISK 12,1 million in brokerage fees to the Bank.

In 2010 the Bank sold six loan agreements to three borrowers, of total value ISK 1,044 million, to Hilda for which Hilda paid by reduction in the subordinated loan to the Bank. During the year 2010 Saga paid a total of ISK 1,130 million in principal, interests and indexation payments of the subordinated loan to Hilda, of which ISK 1,044 million were paid with the aforementioned loan agreements and ISK 87 million in interest and indexation payments on the interest payment date 31 October 2010. Principal payments amounted in total ISK 919 million, interest payments ISK 163 million and indexation payments ISK 48 million.

During the year 2010 the Bank had money market loans from Hilda in ISK, DKK and USD. At year end, the Bank had two money market loans from Hilda, amounting to ISK 409 million and USD 165 thousand, for a total value of ISK 428 million. The total interest payments of money market loans from the Bank to Hilda amounted to ISK 30,9 million, DKK 28,7 thousand, and less than USD 100.

At the end of the year 2009 Hilda borrowed ISK 380 million from the Bank to pay interest on its loan from the Treasury. Hilda paid the loan in February 2010 and paid a total of ISK 7,9 million in interest. In addition, the Bank provided short term loans to Hilda in DKK to settle security transactions, and the total interest payments of those loans amounted to DKK 2,9 thousand in 2010.

No unusual transactions have taken place with related parties in the year 2010. Transactions with related parties have been made on an arm's length basis.

## OFF BALANCE SHEET ITEMS

41. On 31 December 2010, the Bank was bound by non-cancellable operation lease contracts on real estates and vehicles. The real estates lease agreements are in accordance with general terms on a rental market. Lease payments change in accordance with price indices. Contract terms due to vehicles are for up maximum of three years.

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:

	2010	2009
0 to 1 year	49.753	41.645
1 to 5 years	186.978	127.589
Over 5 years	44.375	0
<b>Minimum lease payments during the contractual term</b>	<b>281.105</b>	<b>169.234</b>

## 42. Pledged assets

The Bank has entered into security lending transactions with The Central Bank and Housing Financing Fund where the bank has borrowed listed bonds. The bank has at the year-end 2010 pledged financial assets as collaterals for these short positions for a total amount of ISK 4,837 millions which are specified as follows: Loans to financial institutions ISK 2,395 million, trading assets ISK 2,419 million and loans to customers ISK 23 million.

In addition, the Bank has pledged as collateral its shareholding in a real estate company, to secure the borrowings of that company. The shares are classified as assets held for sale in the Balance Sheet. The carrying amount is ISK 352 million.

### 43. Events after the balance sheet date

No events have taken place after the reporting date that require any adjustments and corrections to the financial statements for the year 2010.

#### a. Legal issues

##### (i) Off-setting against a bankrupt commercial bank

The balance sheet is prepared assuming that the Bank has netted its bond claim on one of the bankrupt Icelandic commercial banks against its borrowings from the same bank. The face value of the bond is USD 2 million and the borrowing ISK 250 million. After the bankruptcy of the commercial banks, the Bank declared its claim against the relevant commercial bank would be settled against the borrowings (set-off). The winding up committee of the commercial bank acknowledges the Bank as a beneficial owner of the bond but disputes its right to settle it against borrowings, due to technical issues relating to the bond. However, according to Icelandic laws, provided that certain conditions are met, the Bank can net its claim against the bond and the Bank believes that all conditions according to Icelandic Laws are fully met and will fully protect its interest. It is likely that the matter will be solved through an Icelandic court before the end of 2011.

##### (ii) Settlement of derivatives contracts with a bankrupt commercial bank

In October 2008 the Bank had a few derivatives agreements with an Icelandic commercial bank that went bankrupt. The Bank declared settlement of the contracts with the commercial bank a few days after the bankruptcy, and subsequently declared the same settlement against the estate before the deadline for filing claims on 30 December 2009. The net effect of the declared settlement was that the Bank had a claim of ISK 22 million against the commercial bank. The claim was booked at zero value in the annual accounts of 2008 and 2009. At the end of 2010 the resolution committee of the commercial bank declared a different settlement of the derivatives contracts, whereby the commercial bank had a substantial claim against the Bank. After negotiations, the resolution committee has offered a settlement whereby

the commercial bank has a claim on the Bank in the amount of ISK 40 million. The Bank is considering approving this settlement if it can set-off a claim it has on the commercial bank so the net effect on the Bank's equity would be ISK 12 million.

##### (iii) Loans in foreign currencies

In the year 2010 the Supreme Court ruled that certain types of FX loans should be considered as ISK loans indexed to foreign currencies, which is illegal according to the law on interests (38/2001). The Supreme Court subsequently ruled that the lowest interest rates offered by Icelandic credit institutions, as published monthly by the Central Bank, should be applied to these loans instead of the contractual interest rates. Following that ruling, the law on interests (38/2001) was amended parallel thereto. There is still substantial uncertainty as to which foreign currency loans will be deemed to be illegally linked to foreign currencies and the wording of the individual contract forms could be the deciding factor. It is the Bank's opinion that none of the Supreme Court rulings applies to the Bank's contract forms. However, the Bank has made an assessment that the possible financial impact would be net ISK 34 million, should all foreign currency denominated loans where there is any doubt of legitimacy be deemed illegal and the aforementioned interest rates applied. The total effect on the outstanding loans is a reduction in book value of ISK 86 million, and the effect of loans already paid up is 77 million, for a total of ISK 163 million. On the other hand the bank has a corresponding claim of ISK 129 million which would make the net effect 34 million.





