



KAUPTHING BANK

KAUPTHING BANK HF.

(Incorporated in Iceland as a public limited company)

€150,000,000

Non-cumulative Undated Step-up Capital Notes

Issue Price 100 per cent.

Interest on the €150,000,000 Non-cumulative Undated Step-up Capital Notes (the “**Notes**”) of Kaupthing Bank hf. (the “**Issuer**”) will, subject to Condition 4, be payable, with respect to the period from, and including, 30th June, 2004 to, but excluding, 30th June, 2014, on 30th June in each year at a rate of 5.901 per cent. per annum and thereafter, interest will be payable in arrear on the Interest Payment Dates (as defined in Condition 4) falling in March, June, September and December in each year at a rate of interest equal to 2.45 per cent. above three month EURIBOR (as defined in Condition 4), as more fully described herein.

In making an investment decision, potential investors should carefully consider the merits and risks of an investment in the Notes and carefully review the Terms and Conditions of the Notes. In particular:

- (i) the Notes are undated and deeply subordinated;
- (ii) principal in respect of the Notes may be converted into conditional capital contributions as described in Condition 3;
- (iii) conditional capital contributions may only be reconverted and reinstated as provided in Condition 3;
- (iv) the Issuer shall not pay accrued interest in certain circumstances as provided in Condition 4; and
- (v) the Notes may be redeemed at the option of the Issuer, in whole but not in part (a) on 30th June, 2014 or on any Interest Payment Date thereafter or (b) (subject as provided herein) in the event of certain tax or regulatory changes affecting the Issuer, in each case subject to prior approval of the Financial Supervisory Authority of Iceland and provided that any conditional capital contributions have been reconverted and reinstated as provided in Condition 3, all as further described in Condition 6.

On pages 42 to 43 of this Offering Circular there is reproduced a press release entitled “Kaupthing Bank Acquires the Danish Bank FIH for DKK 7.1 billion (€1.0 billion)”. This acquisition is conditional upon the events described in the press release and is currently expected to be completed in September.

Application has been made for the listing of the Notes on the Luxembourg Stock Exchange.

The Notes will initially be represented by a temporary global Note (the “**Temporary Global Note**”), without interest coupons (“**Coupons**”), to be deposited with a common depository for Euroclear Bank S.A./N.V., as operator of the Euroclear System (“**Euroclear**”), and Clearstream Banking, société anonyme (“**Clearstream, Luxembourg**”) on or about 30th June, 2004 (the “**Closing Date**”). The Temporary Global Note will be exchangeable for interests in a permanent global Note (the “**Permanent Global Note**”), without Coupons, on and after 10th August, 2004 upon certification of non-U.S. beneficial ownership. The Permanent Global Note will be exchangeable for definitive Notes in bearer form, with Coupons attached, only in certain limited circumstances as described in Condition 1.

The Notes have been assigned a “Baa1” rating by Moody’s Investors Service Limited (“**Moody’s**”). A rating is not a recommendation to buy, sell or hold securities and may be subject to suspension, change or withdrawal at any time by the assigning rating agency.

Deutsche Bank

Barclays Capital

Credit Suisse First Boston

The date of this Offering Circular is 28th June, 2004.

Subject as provided below, the Issuer, having made all reasonable enquiries, confirms that this Offering Circular contains or incorporates all information which is material in the context of the issuance and offering of the Notes, that the information contained or incorporated in this Offering Circular is true and accurate in all material respects and is not misleading, that the opinions and intentions expressed in this Offering Circular are honestly held and that there are no other facts the omission of which would make this Offering Circular or any of such information or the expression of any such opinions or intentions misleading. The Issuer accepts responsibility accordingly.

The audited consolidated financial statements in respect of the financial years ended 31st December, 2003 and 2002 of FIH Group and FIH Erhvervsbank A/S and the unaudited financial statements for the period from January to March 2004 and January to March 2003 of FIH Group are set out on pages 44 to 47 of this Offering Circular. These financial statements have been extracted without adjustment or updating from the FIH Group webpage. The Issuer accepts responsibility for accurately reproducing these accounts. No further or other responsibility (express or implied) in respect of these accounts is accepted by the Issuer.

This Offering Circular is to be read in conjunction with all documents which are deemed to be incorporated herein by reference (see “**Incorporation by Reference**” below). This Offering Circular shall be read and construed on the basis that such documents are incorporated in and form part of this Offering Circular.

No person has been authorised to give any information or to make any representations other than those contained in this Offering Circular in connection with the offering or sale of the Notes and, if given or made, such information or representations must not be relied upon as having been authorised by the Issuer or the Managers (as defined under “**Subscription and Sale**”). Neither the delivery of this Offering Circular nor any sale made hereunder shall under any circumstances create any implication or constitute a representation that there has been no change in the affairs of the Issuer since the date hereof. This Offering Circular does not constitute an offer of, or an invitation by or on behalf of the Issuer or the Managers to subscribe for or purchase, any of the Notes.

The distribution of this Offering Circular and the offering of the Notes in certain jurisdictions may be restricted by law. Neither the Issuer nor the Managers represents that this Offering Circular may be lawfully distributed or that the Notes may be lawfully offered, in compliance with any applicable registration or other requirements in any such jurisdiction, or pursuant to an exemption available thereunder, or assumes any responsibility for facilitating any such distribution or offering. In particular, no action has been taken by the Issuer or the Managers which would permit a public offering of the Notes or distribution of this Offering Circular in any jurisdiction where action for that purpose is required. Accordingly, the Notes may not be offered or sold, directly or indirectly, and neither this Offering Circular nor any advertisement or other offering material relating to the Notes may be distributed or published in any jurisdiction, except under circumstances that will result in compliance with any applicable laws and regulations.

The Notes have not been and will not be registered under the United States Securities Act of 1933, as amended (the “**Securities Act**”). The Notes may not be offered or sold within the United States or to, or for the account or benefit of, U.S. persons (as defined in regulation S under the Securities Act (“**Regulation S**”)) except in certain transactions exempt from or not subject to the registration requirements of the Securities Act. This Offering Circular has been prepared by the Issuer solely for use in connection with the offer and sale of the Notes outside the United States to non-U.S. persons pursuant to Regulation S. For a description of these and certain further restrictions on offers and sales of the Notes and distribution of this Offering Circular, see “**Subscription and Sale**”.

Unless otherwise specified or the context requires, references to “**ISK**” are to Icelandic krona and to “**euro**” and “**€**” are to the currency introduced at the start of the third stage of European economic and monetary union pursuant to the Treaty establishing the European Community, as amended.

INCORPORATION BY REFERENCE

The audited financial statements of the Issuer in respect of the financial year ended 31st December, 2003 and of each of Kaupthing Bank hf. and Bunadarbanki Islands hf. in respect of the financial years ended 31st December, 2002 and 2001 shall be deemed to be incorporated in, and form part of, this Offering Circular.

Copies of the above financial statements may be obtained free of charge at the specified office of the Issuer and each of the Paying Agents.

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In connection with the issue and distribution of the Notes, Deutsche Bank AG London or any person acting for it may over-allot or effect transactions with a view to supporting the market price of the Notes at a level higher than that which might otherwise prevail for a limited period. However, there may be no obligation on Deutsche Bank AG London or any agent of its to do this. Such stabilising, if commenced, may be discontinued at any time and must be brought to an end after a limited period. Such stabilising shall be in compliance with all applicable laws, regulations and rules.

TERMS AND CONDITIONS OF THE NOTES

The following are the terms and conditions of the Notes which, subject to completion and amendment, will be incorporated by reference into the Global Notes (as defined below) and which will be endorsed on each Note in definitive form (if issued).

The €150,000,000 Non-cumulative Undated Step-up Capital Notes (the “**Notes**”) of Kaupthing Bank hf. (the “**Issuer**”) are issued subject to and with the benefit of a Fiscal Agency Agreement dated 30th June, 2004 (the “**Agency Agreement**”) made between the Issuer, Deutsche Bank Aktiengesellschaft, Frankfurt am Main (the “**Fiscal Agent**”) and Deutsche Bank Luxembourg S.A. (together with the Fiscal Agent, the “**Paying Agents**”). The statements in these Terms and Conditions include summaries of, and are subject to, the detailed provisions of and definitions in the Agency Agreement. Copies of the Agency Agreement are available for inspection during normal business hours by the holders of the Notes and the holders of the interest coupons appertaining to the Notes (the “**Couponholders**” and the “**Coupons**”, respectively) at the specified office of each of the Paying Agents. Any reference to “**Noteholders**” or “**holders**” in relation to any Notes shall mean the holders of the Notes and shall, in relation to any Notes represented by a Global Note, be construed as provided below. The Noteholders and the Couponholders are entitled to the benefit of, are bound by, and are deemed to have notice of, all the provisions of the Agency Agreement applicable to them. References in these Terms and Conditions to the Fiscal Agent and the Paying Agents shall include any successor appointed under the Agency Agreement.

1. Form, Denomination and Title

- (1) The Notes are initially represented by a temporary global note (the “**Temporary Global Note**”) without Coupons attached which has been deposited with a common depository for both Euroclear Bank S.A./N.V., as operator of the Euroclear System (“**Euroclear**”), and Clearstream Banking, société anonyme, Luxembourg, (“**Clearstream, Luxembourg**”) on 30th June, 2004. Upon deposit of the Temporary Global Note, Euroclear or Clearstream, Luxembourg, as the case may be, credited each subscriber with a principal amount of Notes equal to the principal amount thereof for which such subscriber had subscribed and paid. Payments of principal and interest on the Temporary Global Note will be made only upon certification as to non-U.S. beneficial ownership as provided therein.

The Temporary Global Note is exchangeable in whole or in part as provided therein for a further global Note (the “**Permanent Global Note**” and, together with the Temporary Global Note, the “**Global Notes**” and each a “**Global Note**”) without Coupons attached on and after 10th August, 2004, provided certification as to non-U.S. beneficial ownership has been received. Each Global Note is or will be in bearer form and transferable by delivery. The Permanent Global Note will be exchangeable in whole, but not in part, for definitive Notes with Coupons attached only upon an Exchange Event as described therein.

For these purposes, “**Exchange Event**” means that both Euroclear and Clearstream, Luxembourg have been closed for business for a continuous period of 14 days or more (other than by reason of holiday, statutory or otherwise) or have announced an intention permanently to cease business or have in fact done so and, in any such case, no successor or alternative clearing system is available. The Issuer will promptly give notice to Noteholders in accordance with Condition 11 if an Exchange Event occurs. In the event of the occurrence of an Exchange Event, Euroclear and/or Clearstream, Luxembourg (acting on the instructions of any holder of an interest in the Permanent Global Note) may give notice to the Fiscal Agent requesting exchange. Any such exchange shall occur not later than 45 days after the date of receipt of the first relevant notice by the Fiscal Agent.

The Issuer undertakes that, in the event that any Notes are to be represented by Notes in definitive form, it will make any amendments necessary prior to the issue of such Notes in definitive form to the Notes and the Agency Agreement to permit the issue of Notes in definitive form with talons attached thereto. Any reference herein to “**Coupons**” or “**coupons**” shall, unless the context otherwise requires, be deemed to include a reference to talons.

- (2) The Notes are in bearer form, serially numbered (in the case of the definitive Notes), in the denomination of €1,000. Definitive Notes (if issued) will have Coupons attached.
- (3) Whenever there is any adjustment to the principal amount of any Note pursuant to these Terms and Conditions, upon presentation of such Note to the Fiscal Agent at its specified office, a record of such adjustment shall be endorsed by it on such Note provided that any failure to so present or record shall not in any way affect the decrease or increase pursuant to Condition 3.
- (4) Subject as set out below, title to the Notes and to the Coupons will pass by delivery.
- (5) The Issuer and any Paying Agent may (to the fullest extent permitted by applicable laws) deem and treat the holder of any Note and the holder of any Coupon as the absolute owner for all purposes (whether or not the Note or Coupon shall be overdue and notwithstanding any notice of ownership or writing on the Note or Coupon or any notice of previous loss or theft of the Note or Coupon) but, in the case of a Global Note, without prejudice to the provisions set out in Condition 1(6).
- (6) For so long as any of the Notes is represented by a Global Note held on behalf of Euroclear and/or Clearstream, Luxembourg, each person (other than Euroclear or Clearstream, Luxembourg) who is for the time being shown in the records of Euroclear or of Clearstream, Luxembourg as the holder of a particular principal amount of the Notes (in which regard any certificate or other document issued by Euroclear or Clearstream, Luxembourg as to the principal amount of the Notes standing to the account of any person shall be conclusive and binding for all purposes save in the case of manifest error) shall be treated by the Issuer and the Paying Agents as the holder of such principal amount of the Notes for all purposes (including for the purposes of any quorum requirements of, or the right to demand a poll at, meetings of the Noteholders) other than with respect to the payment of principal or interest on such principal amount of such Notes, for which purpose the bearer of the relevant Global Note shall be treated by the Issuer and the Paying Agents as the holder of such principal amount of such Notes in accordance with and subject to the terms of the relevant Global Note and the expressions “**Noteholder**” and “**holder of Notes**” and related expressions shall be construed accordingly.

Notes which are represented by a Global Note will be transferable only in accordance with the rules and procedures for the time being of Euroclear and Clearstream, Luxembourg, as the case may be.

References to Euroclear and/or Clearstream, Luxembourg shall, whenever the context so permits, be deemed to include a reference to any additional or alternative clearing system approved by the Issuer and the Fiscal Agent.

2. Status and Subordination

The Notes and the Coupons constitute and will constitute unsecured, subordinated debt obligations of the Issuer.

In the event of the voluntary or involuntary liquidation or bankruptcy of the Issuer, the rights of:

- (a) the Noteholders and Couponholders to payments of the principal amount of the Notes and any other amounts including interest due in respect of the Notes; and
- (b) where the whole or any part of the principal amount of the Notes has been converted into conditional capital contributions as described below and such conditional capital contributions have not been reconverted and reinstated as provided below, the providers of such conditional capital contributions, in respect of such conditional capital contributions,

shall rank:

- (i) *pari passu* without any preference among the Noteholders, the Couponholders and such providers;

- (ii) at least *pari passu* with the rights of the holders of any other outstanding Capital Securities whether or not such Capital Securities have been converted in the manner described below and at least *pari passu* with the rights of the holders of any other obligations of the Issuer constituting or eligible (“eligible” to be construed, *mutatis mutandis*, as provided in the definition of Capital Event) as constituting Tier I Capital of the Issuer, in each case in relation to their rights as such holders and to payments in respect thereof;
- (iii) in priority to the rights of holders of all classes of ordinary share capital, preferred share capital and other share capital, of the Issuer and in priority to the rights of holders of any obligation of the Issuer expressed to rank junior to the Notes, in each case in relation to their rights as such holders and to payments in respect thereof; and
- (iv) junior in right of payment to the payment of any present or future claims of (a) depositors of the Issuer, (b) other unsubordinated creditors of the Issuer and (c) subordinated creditors of the Issuer in respect of Subordinated Indebtedness (other than Capital Securities).

No Noteholder or Couponholder or provider of any conditional capital contribution who shall in the event of the liquidation or bankruptcy of the Issuer be indebted to the Issuer shall be entitled to exercise any right of set-off or counterclaim against moneys owed by the Issuer in respect of the Notes or conditional capital contributions held or provided by such Noteholder, Couponholder or provider, as the case may be.

The Issuer reserves the right to issue other Capital Securities in the future or other obligations constituting or eligible as constituting Tier I Capital of the Issuer, provided, however, that any such obligations may not in the event of voluntary or involuntary liquidation or bankruptcy of the Issuer rank in priority to the Notes.

3. Utilisation and Conversion

To the extent that it may be required to avoid the Issuer no longer meeting the requirements with respect to minimum own funds (“**Minimum Own Funds**”) as set out in The Act on Financial Undertaking (161/2002), as amended, the Board of Directors of the Issuer, by resolution passed at a board meeting, may decide that the principal amount (or part thereof, as the case may be) of each Note will be utilised by writing down the part or whole of any principal amount to the extent and by the amount required to avoid falling below the required Minimum Own Funds and converting such aggregate amount (the “**Converted Amount**”) into a conditional capital contribution. The rights of the Noteholders and the Couponholders in respect of the Converted Amount will thereupon be converted into rights of providers of conditional capital contributions as set out herein.

Upon utilisation of the Converted Amount as above the Issuer shall give notice to the Noteholders in accordance with Condition 11.

Utilisation of the Converted Amount for the purpose of avoiding falling below the required Minimum Own Funds shall be made prior to the utilisation for the same purpose of outstanding perpetual/undated subordinated debt issued by the Issuer (other than other Capital Securities) and shall be made following the utilisation for the same purpose of the principal amount of Capital Securities and any other securities ranking junior to the Notes and outstanding at the time of such utilisation and *pro rata* to the principal amount of Capital Securities ranking *pari passu* with the Notes and outstanding at the time of such utilisation.

Where, pursuant to this Condition 3, writing down and conversion applies to part only of the principal amount of the Notes, the part of the principal amount of each Note to be subject to such writing down and conversion shall bear the same proportion to the total amount of the principal amount in respect of such Note as the aggregate amount of the principal amount of all the Notes to be subject to such writing down and conversion bears to the aggregate outstanding principal amount of all the Notes respectively. Any reconversion and reinstatement as provided below will be made on the same basis.

Utilisation of the Converted Amount as aforesaid may only be made provided:

- (a) that the Fiscal Agent has received prior to such utilisation a certificate signed by two Directors of the Issuer confirming that, following such conversion to a Converted Amount, the rights of the providers thereof in respect of such amounts will rank as provided in Condition 2 (copies of such certificate will be available for inspection at the specified office of the Fiscal Agent);
- (b) that the Financial Supervisory Authority of Iceland (*Fjármálaeftirlitid*) or any successor (the “FSA”) shall have given its approval thereto; and
- (c) that the Fiscal Agent has received prior to such utilisation a certificate signed by two Directors of the Issuer confirming that following such conversion to a Converted Amount, such amount will be a conditional capital contribution and will be accounted for as such in the balance sheet of the Issuer (copies of such certificate will be available for inspection at the specified office of the Fiscal Agent).

If the Issuer’s own funds exceed the required Minimum Own Funds allowing for reconversion and reinstatement (in whole or in part) as debt of amounts converted in respect of subordinated indebtedness in the form of Capital Securities and/or perpetual/undated subordinated securities and/or any other securities, the Board of Directors of the Issuer shall subsequently decide that such reconversion and reinstatement shall be made with due observance taken to the prescribed ranking between the relevant instruments to the extent such replenishment does not result in the Issuer’s own funds falling below the required Minimum Own Funds.

Utilisation as described above of the principal amount of the Notes shall not constitute an Event of Default under Condition 9.

If and to the extent that any Converted Amount has been reconverted and reinstated as an obligation in respect of such Note in the balance sheet of the Issuer, such amount shall be reinstated as principal and shall be added to the principal amount of such Note for all purposes thereafter (and references to “principal” and “principal amount” shall be construed accordingly) and interest shall start to accrue on such amount and become payable in accordance with the terms of the Notes as from the date of such reinstatement.

Reconversion and Reinstatement

Reconversion and reinstatement (in whole or in part) as debt of the Converted Amount may only be made out of Unallocated Distributable Profits of the Issuer and subject to a resolution of the Board of Directors of the Issuer. Reconversion and reinstatement shall first be made in respect of perpetual/undated subordinated debt (other than Capital Securities) issued by the Issuer that may have been converted into conditional capital contributions.

Reconversion and reinstatement as debt of the Converted Amount shall be made *pro rata* with any amounts converted in respect of other Capital Securities of the Issuer ranking *pari passu* with the Notes. For the avoidance of doubt, amounts converted in respect of Capital Securities and any other securities expressed to rank junior to the Notes shall be reconverted and reinstated as debt only after the Converted Amount (and any other amounts converted in respect of other Capital Securities of the Issuer expressed to rank *pari passu* with the Notes) have been so reconverted and reinstated.

Upon reconversion and reinstatement as debt of the Converted Amount as described above the Issuer shall give notice to Noteholders in accordance with Condition 11.

The principal amount of the Notes may be utilised and converted as described above on one or more occasions.

4. Interest

Rate of Interest

- (1) (i) From and including 30th June, 2004 (the “**Interest Commencement Date**”) to, but excluding, 30th June, 2014, the Notes bear interest at the rate of 5.901 per cent. per annum (the “**Fixed Rate of Interest**”) payable, subject as provided below, annually in arrear on 30th June in each year, commencing on 30th June, 2005.

From and including 30th June, 2014, the Notes bear interest at the applicable Floating Rate of Interest payable, subject as provided below, quarterly in arrear on 30th March, 30th June, 30th September and 30th December in each year, commencing on 30th September, 2014.

Each date on which interest is payable in accordance with this Condition 4(1) is referred to as an “**Interest Payment Date**”. The period from, and including, 30th June, 2004 to, but excluding, the first Interest Payment Date and each successive period from, and including, an Interest Payment Date to, but excluding, the next Interest Payment Date is referred to as an “**Interest Period**”.

If any Interest Payment Date falling after 30th June, 2014 would otherwise fall on a day which is not a TARGET Settlement Day, it shall be postponed to the next day which is a TARGET Settlement Day unless it would thereby fall into the next calendar month in which event such Interest Payment Date shall be brought forward to the immediately preceding TARGET Settlement Day.

- (ii) Whenever it is necessary to compute an amount of interest in respect of the Notes for a period other than an Interest Period and such period ends prior to 30th June, 2014 or on, but excluding, 30th June, 2014, such interest shall be calculated by applying the Fixed Rate of Interest (a) while the Notes are represented by a Global Note, to the aggregate principal amount of the Notes (taking into account any adjustment to such amount during such Interest Period), multiplying such sum by the Fixed Day Count Fraction and rounding the resultant figure to the nearest cent, half a cent being rounded upwards or otherwise in accordance with applicable market convention, and (b) upon delivery of definitive Notes, to the principal amount of such Note (taking into account any adjustment to such amount during such period), multiplying such sum by the Fixed Day Count Fraction and rounding the resultant figure to the nearest cent, half a cent being rounded upwards or otherwise in accordance with applicable market convention.
- (iii) Whenever it is necessary to calculate an amount of interest in respect of the Notes for a period other than an Interest Period and such period begins on or after 30th June, 2014, such interest shall be calculated on the basis of the actual number of days in the relevant period divided by 360 and otherwise in accordance with sub-clause (v) below.
- (iv) The rate of interest payable in respect of the Notes for any Interest Period commencing on 30th June, 2014 or any date thereafter (the “**Floating Rate of Interest**”) shall be three month EURIBOR plus a margin of 2.45 per cent., as determined by the Fiscal Agent.

For the purposes of these Terms and Conditions:

“**three month EURIBOR**” means, in relation to an Interest Period, the rate for deposits in euro for a period of three months which appears on the Relevant Screen Page as of 11.00 a.m. Brussels time (or such other time as may be customary for the daily reset of such rate) on the relevant Interest Determination Date.

If such rate does not appear on the Relevant Screen Page on the Interest Determination Date for an Interest Period, then three month EURIBOR for the Interest Period will be determined on the basis of the rates at which deposits in euro are offered by the Reference Banks at approximately 11.00 a.m., Brussels time, on the Interest Determination Date in question to prime banks in the euro-zone

interbank market for a period of three months commencing on the first day of such Interest Period and in a Representative Amount. The Fiscal Agent shall request the principal London office of each of the Reference Banks to provide a quotation of its rate. If at least two quotations are provided, three month EURIBOR for such Interest Period shall be the arithmetic mean of such quotations.

If fewer than two quotations are provided as requested, three month EURIBOR for such Interest Period shall be the arithmetic mean of the rates quoted by major banks in the euro-zone selected by the Fiscal Agent, at approximately 11.00 a.m., Brussels time, on the first day of the relevant Interest Period for loans in euro to leading European banks for a period of three months commencing on the first day of such Interest Period and in a Representative Amount, except that, if the banks so selected by the Fiscal Agent are not quoting as mentioned above, the Floating Rate of Interest for such Interest Period shall be either (i) the Floating Rate of Interest in effect for the last preceding Interest Period to which one of the preceding paragraphs of this definition of three month EURIBOR shall have applied or (ii) if none, the Fixed Rate of Interest plus a margin of one per cent.

(v) Determination of Floating Rate of Interest and calculation of Interest Amounts

The Fiscal Agent will at or as soon as practicable after each time at which the Floating Rate of Interest is to be determined, determine the Floating Rate of Interest for the relevant Interest Period.

In respect of each such Interest Period, the Fiscal Agent will calculate the amount of interest (each an “**Interest Amount**”) payable subject to Condition 4(3) in respect of the principal amount of Notes outstanding from time to time. Each Interest Amount shall be calculated by applying the Floating Rate of Interest (a) while the Notes are represented by a Global Note, to the aggregate principal amount of the Notes (taking into account any adjustment to such amount during such Interest Period), multiplying such sum by the actual number of days in the Interest Period concerned divided by 360, and rounding the resultant figure to the nearest cent, half a cent being rounded upwards or otherwise in accordance with applicable market convention, and (b) upon delivery of definitive Notes, to the principal amount of each Note (taking into account any adjustment to such amount during such Interest Period), multiplying such sum by the actual number of days in the Interest Period concerned divided by 360, and rounding the resultant figure to the nearest cent, half a cent being rounded upwards or otherwise in accordance with applicable market convention.

(vi) Notification of Floating Rate of Interest and Interest Amounts

The Fiscal Agent will cause the Floating Rate of Interest and each Interest Amount for each applicable Interest Period and the relevant Interest Payment Date to be notified to the Issuer and, for so long as the Notes are listed on the Luxembourg Stock Exchange, to the Luxembourg Stock Exchange by no later than the first day of the following Interest Period and notice thereof to be given to the Noteholders in accordance with Condition 11 as soon as possible after their determination but in no event later than the fourth Frankfurt Business Day thereafter. Each Interest Amount and Interest Payment Date so notified may subsequently be amended (or appropriate alternative arrangements made by way of adjustment) without prior notice in the event of an extension or shortening of the Interest Period. Any such amendment will be promptly notified to the Noteholders in accordance with Condition 11.

(vii) Certificates to be final

All certificates, communications, opinions, determinations, calculations, quotations and decisions given, expressed, made or obtained for the purposes of the provisions of this Condition 4(1) by the Fiscal Agent, shall (in the absence of wilful default, bad faith or manifest error) be binding on the Issuer, the other Paying Agent and all Noteholders and

Couponholders and (in the absence as aforesaid) no liability to the Issuer, the Noteholders or the Couponholders shall attach to the Fiscal Agent in connection with the exercise or non-exercise by it of its powers, duties and discretions pursuant to such provisions.

Interest accruing after the due date for redemption in certain circumstances

- (2) Each Note will cease to bear interest from the due date for final redemption unless, upon due presentation, payment of principal is improperly withheld or refused, in which case it will continue to bear interest at such rate until whichever is the earlier of (a) the day on which all sums due in respect of such Note up to that day are received by or on behalf of the relevant Noteholder and (b) the day which is seven days after the Fiscal Agent has notified the Noteholders that it has received all sums due in respect of the Notes up to such seventh day.

Sufficiency of Available Distributable Funds

- (3) (a) Payments of interest on any Interest Payment Date may not exceed, taking into account all payments previously made in that fiscal year in respect of the Notes, other Capital Securities ranking *pari passu* with the Notes and Other Tier I Securities, the Available Distributable Funds. To the extent that, on any Interest Payment Date, Available Distributable Funds are insufficient to pay or provide for payment in full of all accrued but unpaid interest under the Notes, other Capital Securities ranking *pari passu* with the Notes and Other Tier I Securities (in each case falling due on that Interest Payment Date), the Issuer will make partial payment of all accrued but unpaid interest under the Notes, such other Capital Securities and Other Tier I Securities *pro rata* to the extent of such Available Distributable Funds. If, and to the extent that Available Distributable Funds are insufficient or non-existent and the Issuer makes partial payment of, or does not pay, accrued but unpaid interest, the right of the Noteholders to receive accrued but unpaid interest in respect of the relevant Interest Period will be deferred until the Deferral End Date. At the Deferral End Date the Issuer will make full or partial payment of all deferred but unpaid interest under these Notes and such other Capital Securities *pro rata* to the extent the Issuer has accrued any Unallocated Distributable Profits, as determined by the Board of Directors of the Issuer after consultation with the Issuer's auditors, in such fiscal year. If, and to the extent that, any deferred payments remain unpaid after the applicable Deferral End Date, the right of the Noteholders to receive such deferred payments will be lost. The Issuer will have no obligation to make such payments of unpaid deferred interest or to pay interest thereon, whether or not payments of interest in respect of subsequent Interest Periods are made, and such unpaid deferred interest will not be deemed to have "accrued" or been earned for any purpose.

Notwithstanding anything to the contrary herein, the Issuer will not make any payments of interest if the Issuer, following payment of such interest, would no longer meet the requirements with respect to Minimum Own Funds.

- (b) The Issuer covenants that, so long as any Note is outstanding, if the most recent scheduled payments on the Notes have not been made in full:
- (i) subject to sub-clause (a) above, its Board of Directors shall not propose to its general meeting of shareholders to declare, pay or distribute, a dividend or any other amount on, or in respect of, any of its ordinary share capital;
 - (ii) it shall not declare, pay or distribute interest, a dividend or any other amount on, or in respect of, any of its preference share capital, any Other Tier I Securities, any Junior Securities or make any payment on a Tier I Guarantee (except, in the case of Capital Securities ranking *pari passu* with the Notes, any payments made on a *pro rata* basis as contemplated above);
 - (iii) subject to sub-clause (a) above, it shall not redeem, purchase or otherwise acquire any of its ordinary shares, its preference shares, any Other Tier I Securities or Junior Securities or purchase or otherwise acquire any security benefiting from a Tier I

Guarantee (save where those shares or securities being redeemed, purchased or acquired are replaced contemporaneously by an issue of shares or securities of the same aggregate principal amount and the same ranking in a voluntary or involuntary liquidation or bankruptcy of the Issuer to those shares or securities being redeemed, purchased or acquired); and

- (iv) it will procure that no payment is made, or any redemption, purchase or acquisition is effected, by any Subsidiary on any security (however named or designated) benefiting from a Tier I Guarantee,

in each case until, if all such scheduled payments are paid on the Deferral End Date applicable to such payment, such Deferral End Date or otherwise for a period of 12 months following the applicable Interest Payment Date or until an amount equal to any Converted Amount has been reconverted and reinstated as debt in full in the balance sheet of the Issuer, or such amount has been redeemed (such redemption having been approved by the FSA).

If the Issuer deems that it does not have sufficient Available Distributable Funds to pay accrued interest on the Notes on the next Interest Payment Date, the Issuer shall, if reasonably practicable and if so permitted by the applicable regulations of any stock exchange upon which the Issuer's equity or debt is then listed, give not more than 14 nor less than five days' prior notice to the Noteholders in accordance with Condition 11.

The Issuer shall also give not more than 14 nor less than five days' prior notice to the Noteholders in accordance with Condition 11 in case of a deferred payment of interest out of Unallocated Distributable Profits.

The Issuer is responsible for determining whether it has Available Distributable Funds or Unallocated Distributable Profits and, on any occasion when it determines it has insufficient Available Distributable Funds to pay accrued interest on the next Interest Payment Date or Unallocated Distributable Profits to make a full or partial payment of accrued interest on any deferred Interest Payment Date prior to the Deferral End Date, it will procure that its auditors certify this to be the case and a copy of such certificate will be available for inspection at the specified office of each Paying Agent.

5. Payments

(1) *Method of payment*

Subject as provided below, payments will be made by credit or transfer to an account in euro maintained by or on behalf of the payee.

Payments will be subject in all cases to any fiscal or other laws and regulations applicable thereto in the place of payment, but without prejudice to the provisions of Condition 7.

(2) *Presentation of definitive Notes and Coupons*

Payments of principal in respect of definitive Notes will (subject as provided below) be made in the manner provided in paragraph (1) above only against presentation and surrender (or, in the case of part payment of any sum due, endorsement) of definitive Notes, and payments of interest (if any) in respect of definitive Notes will (subject as provided below) be made as aforesaid only against presentation and surrender (or, in the case of part payment of any sum due, endorsement) of Coupons, in each case at the specified office or any Paying Agent outside the United States (which expression, as used herein, means the United States of America (including the States and the District of Columbia, its territories, its possessions and other areas subject to its jurisdiction)).

Upon the date on which any Note in definitive form becomes due and repayable, unmatured Coupons shall become void and no payment or, as the case may be, exchange for further Coupons shall be made in respect thereof.

If the due date for redemption of any definitive Note is not an Interest Payment Date, interest (if any) accrued and payable in respect of such Note from, and including, the preceding Interest Payment Date shall be payable only against surrender of the relevant definitive Note.

(3) *Payments in respect of Global Notes*

Payments of principal and interest (if any) in respect of the Temporary Global Note will be made only upon certification as to non-U.S. beneficial ownership as provided therein. On and after 10th August, 2004 no payment will be made on the Temporary Global Note unless exchange for an interest in the Permanent Global Note is improperly withheld or refused.

Payments of principal and interest (if any) in respect of Notes represented by a Global Note will (subject as provided below) be made in the manner specified in paragraph (1) above and otherwise in the manner specified in the relevant Global Note against presentation or surrender, as the case may be, of such Global Note at the specified office of any Paying Agent outside the United States. A record of each payment made against presentation or surrender of any Global Note, distinguishing between any payment of principal and any payment of interest, will be made on such Global Note by the Paying Agent to which it was presented and such record shall be *prima facie* evidence that the payment in question has been made.

The holder of a Global Note shall be the only person entitled to receive payments in respect of Notes represented by such Global Note and the Issuer will be discharged by payment to, or to the order of, the holder of such Global Note in respect of each amount so paid. Each of the persons shown in the records of Euroclear or Clearstream, Luxembourg as the beneficial holder of a particular principal amount of Notes represented by such Global Note must look solely to Euroclear or Clearstream, Luxembourg, as the case may be, for his share of each payment so made by the Issuer to, or to the order of, the holder of such Global Note.

- (4) A holder shall be entitled to present a Note or Coupon for payment only on a Presentation Date and shall not be entitled to any further interest or other payment if a Presentation Date is after the due date.
- (5) The names of the initial Paying Agents and their initial specified offices are set out at the end of these Terms and Conditions. The Issuer reserves the right at any time to vary or terminate the appointment of any Paying Agent and to appoint additional or other Paying Agents provided that:
- (a) there will at all times be a Fiscal Agent;
 - (b) there will at all times be at least one Paying Agent (which may be the Fiscal Agent) having its specified office in a European city which so long as the Notes are listed on the Luxembourg Stock Exchange shall be Luxembourg;
 - (c) the Issuer undertakes that it will ensure that it maintains a paying agent in a Member State of the European Union that is not obliged to withhold or deduct tax pursuant to European Council Directive 2003/48/EC or any other Directive implementing the conclusions of the ECOFIN Council meeting of 26th-27th November, 2000 or any law implementing or complying with, or introduced in order to conform to, such Directive; and
 - (d) there will at all times be a Paying Agent in a jurisdiction within continental Europe.

Notice of any termination or appointment and of any changes in specified offices given to the Noteholders promptly by the Issuer in accordance with Condition 11.

6. Redemption and Purchase

- (1) Subject to paragraph (7) below, on 30th June, 2014 or on any Interest Payment Date thereafter the Issuer may, subject to prior approval of the FSA and having given not less than ten TARGET Settlement Day's notice to the Noteholders in accordance with Condition 11 (which notice shall be irrevocable), redeem all (but not some only) of the Notes at a redemption price determined as provided in paragraph (6) below.

- (2) Subject to paragraph (7) below, if:
- (a) as a result of any change in, or amendment to, the laws or regulations of Iceland or any political subdivision of, or any authority in, or of, Iceland having power to tax, or any change in the application or official interpretation of such laws or regulations, which change or amendment becomes effective after 28th June, 2004, on the occasion of the next payment due in respect of the Notes the Issuer would be required to pay additional amounts as provided or referred to in Condition 7; and
 - (b) the requirement cannot be avoided by the Issuer taking reasonable measures available to it,

the Issuer may, subject to the prior approval of the FSA and provided that such approval can validly be given in accordance with applicable rules, regulations and policies of the FSA, and after having given not less than 30 nor more than 60 days' notice to the Noteholders in accordance with Condition 11 (which notice shall be irrevocable), redeem all (but not some only) of the Notes at a redemption price determined as provided in paragraph (6) below, such redemption to occur at any time if on or prior to 30th June, 2014 or only on an Interest Payment Date if thereafter, provided that no notice of redemption shall be given earlier than 90 days before the earliest date on which the Issuer would be required to pay the additional amounts were a payment in respect of the Notes then due.

Prior to the publication of any notice of redemption pursuant to this paragraph, the Issuer shall deliver to the Fiscal Agent a certificate signed by two Directors of the Issuer stating that the requirement referred to in (a) above will apply on the occasion of the next payment due in respect of the Notes and cannot be avoided by the Issuer taking reasonable measures available to it and an opinion of an independent Icelandic law firm of recognised standing to the effect that the Issuer has or will become obliged to pay such additional amounts as a result of the change or amendment.

- (3) Subject as provided in paragraph (7) below, upon the occurrence of a Special Event, the Issuer may, subject to the prior approval of the FSA and provided that such approval can validly be given in accordance with applicable rules, regulations and policies of the FSA, at its option, having given not less than 30 days nor more than 60 days' notice to the Noteholders in accordance with Condition 11 (which notice shall be irrevocable), redeem all (but not some only) of the Notes at any time prior to 30th June, 2014 at a redemption price determined as provided in paragraph (6) below.
- (4) The Issuer or any of its Subsidiaries may (subject to the prior approval of the FSA) at any time purchase Notes (provided that, in the case of definitive Notes, all unmatured Coupons appertaining to the Notes are purchased with the Notes) in any manner and at any price. Notes purchased by the Issuer or any of its Subsidiaries shall be cancelled.
- (5) All Notes which are redeemed will forthwith be cancelled, together, in the case of definitive Notes, with all relative unmatured Coupons and accordingly may not be reissued or resold.
- (6) Upon the expiry of any notice referred to in paragraph (1), (2) or (3) above, the Issuer shall be bound to redeem the Notes as follows:
 - (i) in the case of a redemption in accordance with paragraph (1) and (2) above, at an amount equal to the principal amount of the Notes, together with interest (if any) on the principal amount accrued to, but excluding, the due date for redemption (provided that the Issuer is obliged to make payment of interest in accordance with Condition 4(3)) (the "**Redemption Amount**"); and
 - (ii) in the case of a redemption in accordance with paragraph (3) above at an amount equal to the greater of Redemption Amount and the Make-Whole Amount (as determined by the Fiscal Agent).

- (7) Save as provided in Condition 9, where any principal amount has been converted into Converted Amounts as described in Condition 3, the Issuer shall not redeem the Notes until all Converted Amounts have been reconverted and reinstated as debt in full.

7. Taxation

All payments of principal and interest in respect of the Notes by the Issuer will be made without withholding or deduction for or on account of any present or future taxes or duties of whatever nature imposed or levied by or on behalf of any Tax Jurisdiction unless such withholding or deduction is required by law. In such event, the Issuer will pay such additional amounts as shall be necessary in order that the net amounts received by the Noteholders and Couponholders after such withholding or deduction shall equal the respective amounts of principal and interest which would otherwise have been receivable in respect of the Notes or Coupons in the absence of such withholding or deduction; except that no such additional amounts shall be payable with respect to any Note or Coupon presented for payment:

- (i) by or on behalf of a holder who is liable for such taxes or duties in respect of such Note or Coupon by reason of his having some connection with a Tax Jurisdiction other than the mere holding of such Note or Coupon;
- (ii) more than 30 days after the Relevant Date except to the extent that the holder thereof would have been entitled to an additional amount on presenting the same for payment on such thirtieth day assuming that day to have been a Presentation Date;
- (iii) where such withholding or deduction is imposed on a payment to an individual and is required to be made pursuant to European Council Directive 2003/48/EC or any other Directive implementing the conclusions of the ECOFIN Council meeting of 26th-27th November, 2000 on the taxation of savings income or any law implementing or complying with, or introduced in order to conform to, such Directive; or
- (iv) by or on behalf of a holder who would have been able to avoid such withholding or deduction by presenting such Note to another Paying Agent in a Member State of the European Union.

8. Prescription

Claims against the Issuer in respect of principal and interest on the Notes while the Notes are represented by a Global Note will become void unless the Global Note is presented for payment within a period of 10 years (in the case of principal) and five years (in the case of interest) after the Relevant Date therefor.

Claims against the Issuer in respect of definitive Notes and Coupons will become void unless presented for payment within a period of 10 years (in the case of principal) and five years (in the case of interest) after the Relevant Date therefor.

9. Events of Default

- (1) The following events or circumstances (each an “**Event of Default**”) shall be an event of default in relation to the Notes:
- (i) the Issuer shall default in the payment of principal for a period of 3 days in respect of any Note which has become due and payable in accordance with these Terms and Conditions; or
 - (ii) the Issuer shall, to the extent that it is obliged to pay interest under Condition 4(3), default for a period of 7 days in the payment of interest due on any Note in accordance with these Terms and Conditions; or
 - (iii) a court or agency or supervisory authority in Iceland (having jurisdiction in respect of the same) shall have instituted a proceeding or entered a decree or order for the appointment of a receiver or liquidator in any insolvency, rehabilitation, readjustment of debt,

marshalling of assets and liabilities or similar arrangements involving the Issuer or all or substantially all of its property and such proceedings, decree or order shall not have been vacated or shall have remained in force undischarged or unstayed for a period of 14 days; or

- (iv) the Issuer shall file a petition to take advantage of any insolvency statute or shall voluntarily suspend payment of its obligations.
- (2) If any Event of Default shall have occurred and shall be continuing, any Noteholder may give notice to the Issuer that the Note is, and it shall accordingly, subject to this Condition 9, forthwith become, immediately due and repayable whether or not the whole or any part of any Converted Amount has been reconverted and reinstated as debt at an amount equal to the principal amount (construed as provided above) of the Notes, together with interest (if any) on the principal amount accrued to, but excluding, the due date for redemption (provided that the Issuer is obliged to make such payment of interest in accordance with Condition 4(3)).
- (3) If a Note has been declared due and payable under this Condition 9, the Noteholder may claim payment in respect of the Notes only in the bankruptcy or liquidation of the Issuer and may therefore institute such steps, including the obtaining of a judgment against the Issuer for any amount due in respect of the Notes, as it thinks desirable with a view to having the Issuer declared bankrupt or put into liquidation.
- (4) A Noteholder may institute such proceedings against the Issuer as it may think fit to enforce any obligation, condition, undertaking or provision binding on the Issuer under the Notes (other than, without prejudice to sub-paragraphs (2) and (3) above, any obligation for the payment of any principal or interest in respect of the Notes) provided that the Issuer shall not by virtue of the institution of any such proceedings be obliged to pay any sum or sums sooner than the same would otherwise have been payable by it.

A provider of any Converted Amount may institute such proceedings against the Issuer as it may think fit to enforce any obligation, condition, undertaking or provision binding on the Issuer under Condition 2 or 3 provided that the Issuer shall not by virtue of the institution of such proceedings be obliged to pay any sum or sums sooner than the same would otherwise have been payable by it.

- (5) No remedy against the Issuer, other than as provided in sub-paragraphs (2), (3) and (4) above, or proving or claiming in the liquidation or bankruptcy of the Issuer in Iceland or elsewhere, shall be available to the Noteholders, whether for the recovery of amounts owing in respect of the Notes or in respect of any breach by the Issuer of any of its obligations or undertakings with respect to the Notes.

10. Replacement of Notes and Coupons

If any Note or Coupon is lost, stolen, mutilated, defaced or destroyed, it may be replaced at the specified office of the Paying Agent in Luxembourg subject to all applicable laws and market practice upon payment by the claimant of the expenses incurred in connection with the replacement and on such terms as to evidence and indemnity as the Issuer may require. Mutilated or defaced Notes or Coupons must be surrendered before replacements will be issued.

11. Notices

- (1) All notices regarding the Notes will be deemed to be validly given if published in English in a daily newspaper published in Luxembourg. It is expected that such publication will be made in the *Luxemburger Wort* or the *Tageblatt*. Any such notice will be deemed to have been given on the date of the first publication or, where required to be published in more than one newspaper, on the date of the first publication in all required newspapers. Couponholders will be deemed for all purposes to have notice of the contents of any notice given to the Noteholders in accordance with this Condition 11.

Until such time as any definitive Notes are issued, there may, subject to the rules of any stock exchange on which the Notes may be listed and so long as any Global Notes representing the Notes are held in their entirety on behalf of Euroclear and/or Clearstream, Luxembourg, be substituted for such publication in such newspaper(s) the delivery of the relevant notice to Euroclear and/or Clearstream, Luxembourg for communication by them to the Noteholders. Any such notice shall be deemed to have been given to the Noteholders on the day on which the said notice was given to Euroclear and/or Clearstream, Luxembourg.

- (2) Notices to be given by any Noteholder shall be in writing and given by lodging the same, together (in the case of any Note in definitive form) with the relative Note or Notes, with the Fiscal Agent. Whilst any of the Notes are represented by a Global Note, such notice may be given by any Noteholder to the Fiscal Agent through Euroclear and/or Clearstream, Luxembourg, as the case may be, in such manner as the Fiscal Agent and Euroclear and/or Clearstream, Luxembourg, as the case may be, may approve for this purpose.

12. Meetings of Noteholders and Modification

- (1) The Agency Agreement contains provisions which are binding on the Issuer for convening meetings of the Noteholders to consider any matter affecting their interests, including the modification of these Terms and Conditions or the provisions of the Agency Agreement although any modification cannot be made without the prior approval of the FSA.
- (2) The quorum at any meeting for passing an Extraordinary Resolution will be one or more persons present holding or representing a clear majority in principal amount of the Notes for the time being outstanding or at any adjourned meeting one or more persons present whatever the principal amount of the Notes held or represented by him or them, except that at any meeting, the business of which includes the modification of certain of these Terms and Conditions the necessary quorum for passing an Extraordinary Resolution will be one or more persons present holding or representing not less than two-thirds, or at any adjourned meeting not less than one-third, of the principal amount of the Notes for the time being outstanding.
- (3) The Fiscal Agent may agree, without the consent of the Noteholders or Couponholders, to any modification of any of the provisions of the Agency Agreement which is not materially prejudicial to the interests of the Noteholders or to any modification which is of a formal, minor or technical nature or to correct a manifest error.
- (4) Any modification shall be binding on the Noteholders and the Couponholders and, unless the Fiscal Agent agrees otherwise, any modification shall be notified by the Issuer to the Noteholders as soon as practicable thereafter in accordance with Condition 11.

13. Further Issues

The Issuer may from time to time, without the consent of the Noteholders, create and issue further securities having the same terms and conditions as the Notes in all respects (or in all respects except for the first payment of interest on them) so as to form a single series with the Notes.

14. Third Party Rights

Except as provided herein in relation to providers of any Converted Amount, no person shall have any right to enforce any term or condition of the Notes under the Contracts (Rights of Third Parties) Act 1999.

15. Governing Law and Submission to Jurisdiction

- (1) The Agency Agreement, the Notes and the Coupons are governed by, and will be construed in accordance with, English law except that the provisions of Conditions 2, 3 and 4(3) shall be governed by the laws of Iceland.

- (2) The Issuer irrevocably agrees for the benefit of the Noteholders that the courts of England shall have jurisdiction to hear and determine any suit, action or proceedings, and to settle any disputes, which may arise out of or in connection with the Notes (respectively, “**Proceedings**” and “**Disputes**”) and, for such purposes, irrevocably submits to the jurisdiction of such courts.

The Issuer hereby irrevocably waives any objection which it may have now or hereafter to the laying of the venue of any such Proceedings in any such court and any claim that any such Proceedings have been brought in an inconvenient forum and hereby further irrevocably agrees that a judgment in any such Proceedings brought in the English courts shall be conclusive and binding upon it and may be enforced in the courts of any other jurisdiction.

Nothing contained in this Condition shall limit any right to take Proceedings against the Issuer in any other court of competent jurisdiction, nor shall the taking of Proceedings in one or more jurisdictions preclude the taking of Proceedings in any other jurisdiction, whether concurrently or not.

- (3) *Appointment of Process Agent*

The Issuer appoints Kaupthing Limited of 89 New Bond Street, 5th Floor, London W1S 1DA, England as its agent for service of process, and undertakes that, in the event of it ceasing so to act or ceasing to be registered in England, it will appoint another person as its agent for service of process in England in respect of any Proceedings. Nothing herein shall affect the right to serve proceedings in any other manner permitted by law.

16. Definitions

For the purposes of these Terms and Conditions:

“**Available Distributable Funds**” means, in respect of each fiscal year of the Issuer, the aggregate amount, as calculated as of the end of the immediately preceding fiscal year in the individual financial statements of the Issuer, of accumulated retained earnings and any other reserves and surpluses capable under Icelandic law of being available for distribution as cash dividends to holders of Bank Share Capital, but before deduction of the amount of any dividend or other distribution declared on Bank Share Capital in respect of such prior fiscal year.

“**Bank Share Capital**” means the ordinary shares of the Issuer, together with all other securities of the Issuer, ranking *pari passu* with the ordinary shares of the Issuer as to participation in a liquidation surplus.

A “**Capital Event**” means the determination by the Issuer (such determination to be evidenced by a certificate signed by two Directors of the Issuer and to be binding on the Noteholders without further investigation (copies of such certificate to be available for inspection at the specified office of the Fiscal Agent)), having received confirmation or similar proof thereof from the FSA, that the Notes are no longer eligible for inclusion in Tier I Capital (*Eiginfjárháttur A*) of the Issuer and for these purposes the Notes shall be deemed to be so “eligible” notwithstanding that any limits in respect of obligations which can be included in determining such eligibility would be exceeded by including in such determination all or any part of the Notes and accordingly for these purposes any such limits shall be disregarded.

“**Capital Securities**” means any subordinated and undated debt instruments of the Issuer which are recognised as “*Eiginfjárháttur A*” from time to time by the FSA and including, where the context so requires, the Notes.

“**Deferral End Date**” means the earlier of (i) the date on which the Issuer accrues enough Unallocated Distributable Profits during the fiscal year of the Issuer in which such interest payments were otherwise due, as determined by the Board of Directors of the Issuer after consultation with the Issuer’s auditors, to pay the entire deferred payment due under these Notes and under other Capital Securities ranking *pari passu* with the Notes and Other Tier I Securities, and makes such payments or (ii) 31st December of the fiscal year of the Issuer in which such payments were otherwise due.

“Fixed Day Count Fraction” means (i) the actual number of days in the period from and including the date from which interest begins to accrue for the relevant period of calculation (the **“Accrual Date”**) to but excluding the date on which it falls due divided by (ii) the actual number of days from and including the Accrual Date to but excluding the next following Interest Payment Date.

“Frankfurt Business Day” means a day (other than a Saturday or a Sunday) on which banks and foreign exchange markets are open for general business in Frankfurt am Main.

“Interest Determination Date” means, in relation to each Interest Period for which a Floating Rate of Interest is to be calculated, the second TARGET Settlement Day before the commencement of the Interest Period.

“Junior Securities” means (i) ordinary shares of the Issuer, (ii) each class of preference shares of the Issuer ranking junior to these Notes, if any, and any other instrument of the Issuer ranking *pari passu* herewith or junior hereto, and (iii) preference shares or any other instrument of any Subsidiary of the Issuer subject to any guarantee or support agreement of the Issuer ranking junior to the obligations of the Issuer under these Notes.

The **“Make-Whole Amount”** will be calculated by the Fiscal Agent, and will equal the sum of the Present Values on the date of redemption of (i) the principal amount of the Notes and (ii) the remaining scheduled payments of interest on the Notes to but excluding 30th June, 2014.

The **“Adjusted Comparable Yield”** will be the yield at the date of redemption on the euro benchmark security selected by the Fiscal Agent as having a maturity comparable to the remaining term of the Notes to 30th June, 2014 that would be utilised, at the time of selection and in accordance with customary financial practice, in pricing new issues of corporate debt securities of comparable maturity to 30th June, 2014.

The **“Present Values”** will be calculated by the Fiscal Agent by discounting the principal amount of the Notes and the remaining interest payments to 30th June, 2014 on an annual basis, applying the Fixed Day Count Fraction and using the Adjusted Comparable Yield plus 0.6 per cent.

“Other Tier I Securities” means any securities which are Tier I Capital of the Issuer and which rank on a voluntary or involuntary liquidation or bankruptcy of the Issuer *pari passu* with the Notes.

“Presentation Date” means a day which (subject to Condition 8):

- (a) is a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in the relevant place of presentation and Frankfurt am Main; and
- (b) is a day on which the TARGET System is open.

“Rate of Interest” means the Fixed Rate of Interest or the Floating Rate of Interest, as the case may be.

“Reference Banks” means four major banks in the euro-zone interbank market as selected by the Fiscal Agent.

“Relevant Date” means the date on which such payment first becomes due, except that, if the full amount of the moneys payable has not been duly received by the Fiscal Agent on or prior to such due date, it means the date on which, the full amount of such moneys having been so received, notice to that effect is duly given to the Noteholders in accordance with Condition 11.

“Relevant Screen Page” means Telerate Screen page 248 or such replacement page on that service, or such other service as may be nominated as the information vendor, for the purpose of displaying rates or prices comparable to three month EURIBOR.

“Representative Amount” means an amount that is representative for a single transaction in the relevant market at the relevant time.

A **“Special Event”** means the occurrence of any of a Tax Event or a Capital Event.

“Subordinated Indebtedness” means any obligation, whether dated or undated, of the Issuer which by its terms is, or is expressed to be, subordinated in the event of liquidation or bankruptcy of the Issuer to the claims of depositors and all other unsubordinated creditors of the Issuer but not otherwise.

Subsidiary means, in relation to the Issuer, any company (i) in which the Issuer holds a majority of the voting rights or (ii) of which the Issuer is a member and has the right to appoint or remove a majority of the board of directors or (iii) of which the Issuer is a member and controls a majority of the voting rights, and includes any company which is a Subsidiary of a Subsidiary of the Issuer.

“TARGET Settlement Day” means a day on which the Trans-European Automated Real-Time Gross Settlement Express Transfer (TARGET) System is open.

“three month EURIBOR” has the meaning given to it in Condition 4.

A **“Tax Event”** means the receipt by the Issuer of an opinion of counsel in Iceland (experienced in such matters) to the effect that, as a result of (i) any amendment to, clarification of, or change (including any announced prospective change) in, the laws or treaties (or any regulations thereunder) of Iceland or any political subdivision or taxing authority thereof or therein affecting taxation, (ii) any governmental action or (iii) any amendment to, clarification of, or change in the official position or the interpretation of such governmental action or any interpretation or pronouncement that provides for a position with respect to such governmental action that differs from the theretofore generally accepted position, in each case, by any legislative body, court, governmental authority or regulatory body, irrespective of the manner in which such amendment, clarification or change is made known, which amendment, clarification or change is effective or such pronouncement or decision is announced on or after the date of issuance of the Notes, there is more than an insubstantial risk that the Issuer is, or will be, subject to more than a *de minimis* amount of other taxes, duties or other governmental charges or civil liabilities with respect to the Notes or any amount payable in respect of the Notes.

“Tax Jurisdiction” means Iceland or any political subdivision or any authority thereof or therein having power to tax or any other jurisdiction or any political subdivision or any authority thereof or therein having power to tax to which the Issuer becomes subject in respect of payments made by it of principal and/or interest on the Notes.

“Tier I Capital” means capital which is treated as issued tier I capital by the FSA either on a solo or on a consolidated basis.

“Tier I Guarantee” means any guarantee, indemnity or other contractual support arrangement entered into by the Issuer in respect of securities (regardless of name or designation) issued by a Subsidiary which constitutes Tier I Capital of the Issuer.

“Unallocated Distributable Profits” means, in respect of each fiscal year of the Issuer, the aggregate amount, as calculated during the course of such fiscal year in the individual financial statements of the Issuer, of accumulated retained earnings and any other reserves, surpluses, including current operating profits, capable under Icelandic law of being available for distribution as cash dividends to holders of Bank Share Capital in the following fiscal year.

USE OF PROCEEDS

The net proceeds amount from the issue of the Notes is €148,500,000, which will be applied by the Issuer for the purpose of improving the Issuer's capital structure.

CAPITALISATION

Capitalisation of the Issuer

The following table sets forth the capitalisation of the Issuer as at 31st March, 2004.

	<u>31/3/2004</u> <i>(ISK millions)</i>
Equity	
Share capital	4,388
Other equity	42,937
Borrowing	
Issued Bonds	151,205
Loans	87,603
Deposits	185,995
Subordinated Loans	
Tier I.. .. .	1,177
Tier II.. .. .	11,251
Total capitalisation	<u><u>484,556</u></u>

Notes:

- (1) Since 31st March, 2004 the Issuer has issued a senior EMTN issue amounting to EUR 600,000,000.
- (2) On the Closing Date the Issuer shall issue a Tier II EMTN issue amounting to EUR 300,000,000.
- (3) Save as disclosed above, there has been no material change in the capitalisation of the Issuer since 31st March, 2004.
- (4) As at 31st March, 2004, the authorised and issued share capital of the Issuer was ISK 4,405,485,120 at nominal value, was fully paid up and comprised 440,548,512 ordinary shares.

KAUPTHING BANK HF.

INTRODUCTION

The Issuer is an Icelandic bank offering comprehensive retail and investment banking services to individuals, companies and institutional investors. It is the largest bank in Iceland and a leading player in all key areas of the Icelandic financial market. It has the highest market capitalisation on the Iceland Stock Exchange. The activities of the Issuer and its subsidiaries (together, the “Group”) in Iceland are divided into retail banking and investment banking but internationally its focus is on investment banking. The Issuer is one of the ten largest banks in the Nordic countries and aims to be one of the leading investment banks in the region.

The Issuer was created in its present form by the merger of two of Iceland’s foremost banks, Kaupthing Bank and Bunadarbanki Islands hf., both of which enjoyed a strong market position in Iceland. Bunadarbanki Islands dates back to 1929, when the Icelandic parliament, the Althing, passed a law on the founding of Bunadarbanki Islands. At the beginning of 1998 Bunadarbanki Islands hf. became a limited liability company, and the government began to sell its holdings in the bank. The bank was privatised in stages and this process was completed at the beginning of 2003. Bunadarbanki Islands hf. was listed on the Main List of the Iceland Stock Exchange hf. on 17th December, 1998.

Kaupthing hf. was established by eight Icelanders in 1982, at the same time as the free capital market was launched in Iceland. Kaupthing hf. later became an investment bank and changed its name to Kaupthing Bank hf. in 2002. In September 2000, Kaupthing Bank hf. was listed on the Iceland Stock Exchange and, in December 2002, Kaupthing Bank hf. was listed on the Stockholm Stock Exchange (Stockholmsbörsen).

In May 2003, Kaupthing Bank hf. and Bunadarbanki Islands hf. merged under the name Kaupthing Bank hf. Kaupthing Bank hf. took over the assets and liabilities of Bunadarbanki Islands hf. and shareholders in Bunadarbanki Islands hf. received 48.23 per cent. of the total share capital in Kaupthing Bank hf. in exchange for their shares. The merger was effective as of 1st January, 2003.

In recent years, the Issuer has strengthened its position abroad by acquiring financial companies and establishing subsidiaries. The most important development was the acquisition of the Swedish bank, JP Nordiska AB (now Kaupthing Bank Sverige AB), in 2002 which significantly strengthened the Issuer’s position in the Nordic countries, an area which the Bank defines as its home market.

The Issuer has six core business areas: Retail Banking; Corporate Banking; Asset Management and Private Banking; Corporate Finance; Capital Markets and Treasury. It also has ancillary divisions such as Risk Management, IT, Finance, and Sales and Marketing.

At the end of 2003, the Issuer had operations in ten countries, including all of the Nordic countries and two of the world’s main business centres, London and New York. Its main subsidiaries are Kaupthing Bank Sverige in Sweden, Kaupthing Bank Luxembourg, Kaupthing Sofi Oyj and Norvestia in Finland, Kaupthing Bank A/S in Denmark, Kaupthing Føroyar in the Faroe Islands, Kaupthing New York, Handsal Asset Management in Switzerland, Kaupthing Ltd in the United Kingdom, Kaupthing Norge in Norway, Lysing and Althjóða líftryggingafélagid in Iceland. At the end of 2003, the number of the Group’s full-time equivalent staff was 1,237.

The Issuer and its subsidiaries are members of seven stock exchanges in Europe and the United States. Trading in their shares accounted for a combined total of 4.05 per cent. of the equities turnover in the Nordic stock exchanges in 2003. As at 31st December, 2003, the Group’s assets under management totalled ISK 405 billion, and its assets in custody amounted to ISK 607 billion.

Legal Status and Legislative Background

The Issuer is a public limited company incorporated in Iceland and operating under Icelandic law. It is registered with the registrar of companies in Iceland and its registration number is 560882-0419. The registered office of the Issuer is at Borgartún 19, 105 Reykjavík, Iceland. The operations of the Issuer are subject to the provisions of Act no. 2/1995 on Public Limited Companies and Act no. 161/2002 on

Financial Undertakings. The Issuer is subject to the supervision of the Icelandic Financial Supervisory Authority.

Under the Issuer's constitutional documents, it has two legal names, Kaupthing Bunadarbanki hf. and Kaupthing Bank hf. Prior to the date of this Offering Circular, the Issuer issued Notes under its €4,000,000,000 Euro Medium Term Note Programme (the "**Programme**") using the legal name Kaupthing Bunadarbanki hf. As from 28th April, 2004, the Issuer has used the legal name Kaupthing Bank hf. for all purposes under the Programme, since it is now the policy of the Issuer to use the legal name Kaupthing Bank hf. abroad instead of the English spelling of the Icelandic legal name, Kaupthing Bunadarbanki hf.

SOURCES OF FUNDS

The Issuer's principal sources of funding are customer deposits and foreign borrowing. Other sources of funding include capital markets and financial institutions. Core funding as a percentage of total funding at the end of 2003 was 44.7 per cent. while borrowing as a percentage of total funding was 37.7 per cent.

The table below provides a breakdown of the Group's sources of funds as at 31st December in each of the years stated:

	<u>2003</u>	<u>2002</u>
	<i>(ISK millions)</i>	
Equity	45,929	33,379
Minority interest in subsidiaries' equity	10,603	1,114
Subordinated Loans	10,704	11,010
Deposits	182,497	164,570
Core funding	<u>249,733</u>	<u>210,073</u>
Borrowings	210,645	102,029
Credit institutions	79,267	109,865
Other liabilities	17,278	10,034
Provision for tax liabilities	1,646	411
Finance in the market	<u>308,836</u>	<u>222,339</u>
Total funds	<u><u>558,569</u></u>	<u><u>432,412</u></u>

The composition of the Group's funding has changed significantly in recent years as the Issuer's business has moved from primarily serving individuals, small businesses and clients in the agricultural sector to serving larger corporations in the domestic and Nordic markets. As a result, intermediation of foreign funds has grown rapidly which in turn has led to an increased share of borrowing as a source of funds.

Available Distributable Funds

	<u>2003</u>	<u>2002</u>
	<i>(ISK millions)</i>	
Retained earnings for previous year	11,649	7,000
Dividend paid.. .. .	(1,244)	(704)
Net earnings	7,520	5,363
Retained earnings	<u><u>17,925</u></u>	<u><u>11,659</u></u>

Equity

As of 31st March, 2004, the equity of the Issuer was ISK 47,325 million.

The table below sets out the 15 largest shareholders of the Issuer as of 31st March, 2004:

		<i>Shares</i>	<i>%</i>
1	Meidur ehf.	74,135,700	16.83%
2	Egla hf.	47,504,915	10.78%
3	Lífeyrissjóður verslunarmanna	19,450,199	4.41%
4	Vátryggingafélag Íslands hf	19,270,441	4.37%
5	Eignarhaldsfélagid Sveipur ehf	18,441,615	4.19%
6	Lífeyrissjódir Bankastræti 7	13,246,724	3.01%
7	Lífeyrissjóður sjómanna	8,328,548	1.89%
8	Samvinnulífeyrissjóðurinn	7,809,987	1.77%
9	Lífeyrissjóðurinn Framsýn	7,644,504	1.74%
10	Länsförsäkringar AB (Publ)	6,642,957	1.51%
11	Everest Equities Ltd.	6,300,000	1.43%
12	Fjárfestingafélagid Freyr ehf	5,811,592	1.32%
13	Eignarhaldsf Samvinnutrygg svf	5,589,813	1.27%
14	Eyrir fjárfestingafélag ehf	5,544,195	1.26%
15	Ferradis Holdings S.A.	5,363,014	1.22%

Subordinated Loans

The Issuer has issued Tier I and Tier II subordinated loans in both the domestic and international markets. The Issuer's capital adequacy ratio at 31st December, 2003 was 14.2 per cent. The Issuer's Tier I ratio at 31st December, 2003 was 12.2 per cent.

The breakdown of subordinated loans issued by the Issuer and the Group as at 31st December, 2003 is as follows:

	<i>Tier</i>	<i>Currency</i>	<i>Interest at start</i>	<i>Interest changes</i>	<i>Interest after change</i>	<i>Payment date</i>	<i>Book value 31/12 2003</i>
<i>(ISK millions)</i>							
Issued 1998	II	ISK	6.30%			2004	190
Issued 1999	II	ISK	5.50%	2004	7.00%	2009	1,580
Issued 2000	II	ISK	6.00%	2005	7.50%	2010	1,307
Issued 2000	II	ISK	6.00%	2005	7.50%	2010	239
Issued 2000	II	ISK	7.00%	2007	9.00%	2012	2,028
Issued 2001	II	ISK	6.00%	2006	7.50%	2011	116
Issued 2001	I	ISK	8.65%	2011		Perpetual	1,151
Issued 2001	II	ISK	8.00%	2006	10.00%	2011	1,364
Issued 2002	II	ISK	6.00%	2007	7.50%	2012	865
Issued 2002	II	EUR	3.30%	2007	5.79%	2012	448
Issued 2002	II	ISK	7.50%	2009	10.00%	2014	1,230
Subordinated loans parent							10,518
Subordinated loans of subsidiaries							186
Subordinated loans consolidated							10,704

Capital Adequacy

According to the provisions of Art. 84 and 85 of the Law no. 161/2002 on Financial Undertakings, a bank's subordinated loans and equity capital, after subtraction of the book value of shares held in other

financial institutions, may not at any time fall below 8.0 per cent. of its risk-weighted asset base, as defined by law. The risk-weighted asset base of a bank is comprised of total assets as well as guarantees issued and calculated risk factors after the deduction of various figures in the balance sheet, according to the rules of the Financial Supervisory Authority. At 31st December, 2003, the Issuer complies with all statutory ratios in accordance with the provisions of Art. 28 and 83 of the Act on Financial Undertakings. Together with subordinated loans, total capital and reserves amounted to ISK 58,672 million as at 31st December, 2003 of which ISK 50,337 million consisted of Tier I capital. It is the Issuer's policy to seek to maintain a 10.0 per cent. capital ratio for the Group with a minimum Tier I ratio of 8.0 per cent.

The table below sets out information in relation to the Issuer's capital and capital adequacy ratio as at 31st December in each of the years stated, calculated according to Icelandic law:

	<u>2003</u>	<u>2002</u>
	<i>(ISK millions)</i>	
Tier I: Capital recorded in the Financial Statements	50,337	31,868
Tier II: Subordinated Loans	9,532	9,765
Deductions according to Art. 85 of Act No. 161/2002	(1,197)	(597)
Total	<u>58,672</u>	<u>41,036</u>
Risk-weighted asset base	414,355	329,204
Capital Adequacy Ratio	14.2%	12.5%

Deposits

As at 31st December, 2003, the Issuer had approximately 260,000 deposit accounts, including current accounts, savings accounts and currency accounts. As at the same date, the Issuer's total deposits amounted to 25 per cent. of the total deposits in all of Iceland's commercial banks and savings banks. The deposits from customers are well diversified, with a majority of the customers having relatively low deposits. Deposit accounts bear interest at a floating rate.

The table below sets out a breakdown of the Issuer's deposits as at 31st December in each of the years indicated:

	<u>2003</u>	<u>2002</u>
	<i>(ISK millions)</i>	
Deposits on demand	103,432	80,270
Time deposits	79,065	84,300
Total	<u>182,497</u>	<u>164,570</u>
Savings deposits by maturity		
Up to 3 months	36,274	59,556
Over 3 months and up to 1 year	20,999	11,520
Over 1 year and up to 5 years	16,797	11,476
Over 5 years	4,995	1,748
Total	<u>79,065</u>	<u>84,300</u>

Other Funding

Both the Icelandic domestic money market and the Icelandic interbank market (Reibor Market) have evolved in recent years with the interbank market becoming the most important market for the Issuer's short-term treasury operations. In 2001, a new forward (SWAP) inter-bank market was established, thereby giving Icelandic banks additional products for use in their treasury operations.

The total outstanding bonds and notes issued by the Group amounted to ISK 150,424 million at 31st December, 2003.

The following table sets out a breakdown of the Issuer's borrowings from bonds and notes issued, as well as borrowings from other credit institutions, as at 31st December in each of the years indicated. The Group's borrowings in foreign currency, international syndicated loans and private placements generally have maturities from two to four years.

	<u>2003</u>	<u>2002</u>
	<i>(ISK millions)</i>	
Bonds issued	150,424	31,026
Loans	60,221	71,003
Total	<u>210,645</u>	<u>102,029</u>

USES OF FUNDS

The table below sets out a breakdown of the Issuer's uses of funds as at 31st December in each of the years indicated:

	<u>2003</u>	<u>2002</u>
	<i>(ISK millions)</i>	
Cash, treasury bills and amounts due from credit institutions.. .. .	50,545	38,519
Loans to customers	327,019	250,278
Mortgages foreclosed	1,962	2,030
Lease contracts	22,014	17,025
Bonds and other fixed-income securities	80,832	69,298
Shares and other variable-income securities	50,327	32,882
Shares in associated and affiliated companies	2,926	3,528
Other assets	22,944	18,852
Total assets	<u>558,569</u>	<u>432,412</u>

The predominant lending activity of the Issuer is making loans to private individuals and an extensive range of corporate customers.

Securities held by the Issuer consist of trading securities and investment securities. Investment securities are marketable securities which the Issuer's management has made a formal decision to hold for more than one year. Trading securities include all other securities.

Marketable securities and corporate shares were ISK 134 billion at 31st December, 2003 (market value). Of this amount, bonds were ISK 80.8 billion, shares ISK 50.3 billion and shares in associated and affiliated companies were ISK 2.9 billion. The Issuer has entered into derivative agreements with a nominal amount of ISK 56.6 billion relating to these bonds and ISK 7.8 billion relating to these shares.

The Issuer provides services to all sectors of the economy and has sought to establish a diversified portfolio of marketable securities and loans in order to minimise its lending risks. The Issuer believes that its portfolio of loans and marketable securities is well distributed between economic sectors. As at 31st December, 2003, loans to individuals accounted for 25.2 per cent. of the Issuer's total lending and marketable securities. Loans to the services sector accounted for 43.7 per cent. of the total loans, with loans to industry accounting for a further 13.2 per cent., loans to the fishery sector 2.6 per cent. and

loans to the agriculture sector 1.0 per cent. Credit facilities for government institutions at 31st December, 2003 accounted for 1.3 per cent. of total loans.

The table below sets out the breakdown of the Issuer's total loans and marketable securities by customer categories as at 31st December in each of the years indicated:

	<u>2003</u>	<u>2002</u>
	<i>(ISK millions)</i>	
Government and municipalities	1.3%	1.6%
Agriculture	1.0%	3.5%
Fishing industry	2.6%	8.5%
Commerce	13.0%	11.7%
Industry	13.2%	13.0%
Services	43.7%	32.7%
Individuals	25.2%	29.0%
	<u>100.0%</u>	<u>100.0%</u>

The table below sets out a breakdown by remaining maturity of the Group's loans to customers and leasing agreements amounting in aggregate to ISK 349,033 million:

	<u>2003</u>	<u>2002</u>
	<i>(ISK millions)</i>	
On demand	21,177	22,139
Up to 3 months	122,160	81,960
Over 3 months and up to 1 year	58,196	48,502
Over 1 year and up to 5 years	117,105	89,576
Over 5 years	30,395	25,126
	<u>349,033</u>	<u>267,303</u>

RISK MANAGEMENT

The Issuer faces various types of risks related to its business as a financial institution, which arise from its day to day operations. The most significant of these risks are listed below. Management devotes a significant portion of its time to the management of risk. Effective risk management involves the identification of the significant risks, the quantification of the Issuer's exposure to these risks and taking appropriate action to limit these risks including constantly monitoring them. Among other risk management techniques, the Issuer has established a range of limits, has sought to ensure that these limits are complied with and has sought to quantify its exposures to different risks. It is management's responsibility to identify where established limits have been exceeded and to take the appropriate action. The Issuer has documented these responsibilities and limits.

Approval and Revision of Risk Policy

The Issuer's Risk Policy has been adopted and approved by its Board of Directors. It is reviewed and revised at least annually. Amendments or minor changes can be made more frequently but each change needs the approval of the Issuer's chief executive officers (CEOs) before it is effective and then needs to be approved by the Board of the Issuer as soon as practicable thereafter.

Credit Risk and Collateral Management

Credit risk is managed on a Group-wide level by the Group Credit Committee and the Group Credit Manager (or Head of Credit Risk). The role of the Credit Manager is to manage the process and make sure all the requirements set out by the Credit Committee such as requirements on documentation and collateral are satisfied. The Credit Manager monitors collateral quality on a daily basis and reacts to any deficiencies identified. Collateral is valued based on haircuts, which are different for each asset class

depending on its estimated liquidation quality. The collateral system integrates loan, foreign exchange and derivative information with custody data and the values of pledged securities in the clients' portfolios and calculates the collateral value daily.

Credit and collateral risk is managed on a local level in the Issuer's subsidiaries according to the same rules and in accordance with any further requirements of local regulation. The local credit committees and credit managers receive their credit limits from the Group Credit Committee and all larger credits require approval from the Group Credit Committee.

Monitoring

At least twice a year the risk management department submits to the Board of Directors an overview of at least the 10 largest credits of the Issuer. The overview includes long- and short-term obligations, stock holdings, collateral and major financial information. At least twice a year a list of the largest credits in doubt is also presented to the Board of Directors.

Market Risk Management

Market Risk Limits

Position limits and any changes to them are proposed by the Issuer's Head of Trading and accepted by the Issuer's Head of Risk Management (Head of Risk) and reviewed by the CEOs. Each position limit size is based on, among other things, underlying liquidity, the Issuer's risk appetite as well as legal limitations on individual positions stipulated by relevant authorities. The Head of Risk maintains a document detailing current limits and a journal of changes to them. Final approval of all position limits is required from the CEOs. All trades outside of position limits are prohibited and the penalty will be decided by Head of Risk and paid by the relevant Trading Department from its profit and loss account. The penalty amount is, in general, based on the profit or loss generated by the unauthorised trades and is twice that amount or 1 per cent. per day of the limit overrun, whichever is larger. Disputes on breaches of position limits or amounts can be referred to the CEOs. All violations of this risk policy need to be documented in the journal maintained by Head of Risk and made available to the CEOs.

Risk Monitoring

The Issuer monitors the different risks incurred carefully. The different types of risks (excluding credit risk) are specified below. The overall responsibility of complying with the established limits lies with the Board of Directors. Management is, however, responsible for the day-to-day routines aimed at controlling the different risk parameters. The positions are continuously monitored against the limits where possible and otherwise daily.

Risk Models

Risk models employed are position based (risk limits), volatility based (i.e. based on the volatility of market variables and their related co-variance) and scenario based (i.e. based on a prescribed scenario which is likely to cause severe drawdown in profits).

Risk measures are generated by proprietary systems that utilise counterparty and market data and trade databases generated and used by the Issuer's trade systems. Additionally the risk management systems are augmented by a number of third party solutions.

Risk Reporting

Intra-Day Reports

All trades and intra-day profit or loss is reported continuously to the Head of Risk through a position monitoring system. The Head of Risk appoints a person and a backup person whose responsibility it is to monitor the intra-day positions and alert the Head of Risk to any deviations or exceptions observed.

Daily Reports

The Issuer's Risk Management sends a daily report on profit and loss and turnover to the Head of Risk, Head of Trading and the CEOs.

Monthly Reports

The Risk Management department sends a monthly risk assessment report to the Head of Trading, the CEOs and the Board of Directors detailing volatility based and scenario based measures such as Value-at-Risk, Earnings-at-Risk and stress tests based on current position limits.

Quarterly Reports

The Head of Trading sends a quarterly report to the Head of Risk and the CEOs on activities, profit and loss and general observations on the market and his view on future prospects for the trading operations.

Types of Risks

Security market risk

Trading departments are only permitted to trade certain listed stocks on certain exchanges within prescribed limits and in some cases on an intra-day basis only.

Currency risk

Currency risk is the risk associated with fluctuations in assets and liabilities denominated in different currencies due to movements in exchange rates. Currency risk is controlled by the Issuer's Treasury, is subject to limits and is estimated using the risk models described above.

Interest rate risk

Interest rate risk arises due to the maturity or interest rate reset periods of assets and liabilities not coinciding. Fluctuations in market interest rates cause fluctuations in interest income. Short to medium term interest risk is controlled by the Issuer's Treasury using limits on mismatch in expected in- and outgoing payments as well as limits on interest rate sensitivity of overall interest bearing assets and liabilities. The Issuer's Trading Department is responsible for positions in long term bonds and interest rate risk is further controlled using position limits and estimated using various risk models as described above.

Liquidity risk

The Issuer is subject to the risk of being unable to repay its depositors on demand, or as and when due, through holding insufficient cash or near-cash assets. This risk is measured by constant monitoring of liquidity ratios. The Issuer's Treasury is responsible for maintaining liquidity by maintaining a sufficiently high ratio of liquid assets and available funding to near term liabilities and possible payment outflows. The liquidity measures are calculated at the end of each trading day and monitored by the Head of Risk and reported to the CEOs.

Operational risk

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, human and system error, or from external events that affect the Issuer's operations. These operational risks are monitored through a system of internal control set up at different levels in the Group (including daily controls, supervisory controls and management controls).

PROVISIONS AND NON-PERFORMING LOANS

The Issuer evaluates non-performing loans according to the rules of the Financial Supervisory Authority, which are based on EU Directive no. 554/1994 regarding rules on the annual accounts of commercial banks. Non-performing loans amounted to ISK 6,584 million at 31st December, 2003. The table below sets out a breakdown of the Group's non-performing loans as at 31st December in each of the years indicated:

	<u>2003</u>	<u>2002</u>
	<i>(ISK millions)</i>	
Loans with specific provision for losses	7,149	5,340
Specific provision for losses	(5,465)	(3,633)
Total	<u>1,684</u>	<u>1,707</u>
Other non-performing loans	4,900	2,761
Total non-performing loans	<u><u>6,584</u></u>	<u><u>4,468</u></u>

Coverage for the Group's non-performing assets as at 31st December in each of the years indicated is as follows:

	<u>2003</u>	<u>2002</u>
	<i>(ISK millions)</i>	
Total non-performing loans	6,584	4,468
Specific provisions for losses	5,465	3,633
Mortgages foreclosed	1,962	2,030
Total non-performing assets	<u>14,011</u>	<u>10,131</u>
Specific provision for losses	5,465	3,633
General provisions	2,836	2,131
Mortgages foreclosed	1,962	2,030
Total provision	<u>10,263</u>	<u>7,794</u>
Total provision/Total non-performing assets	<u><u>73.2%</u></u>	<u><u>76.9%</u></u>

Provisions for losses on the loan portfolio have been made each year by the Issuer to meet the estimated risk attached to these assets. These provisions do not represent a final write-off. Certain risk factors are evaluated in addition to a regular contribution for this purpose. The Issuer uses specific provisions as well as general provisions to meet the general risk of lending operations.

The table below sets out changes in the Issuer's provisions as at 31st December in each of the years indicated.

The changes in provisions are as follows:

	<u>2003</u>	<u>2002</u>
	<i>(ISK millions)</i>	
Balance on 1 January	5,764	4,311
Provision for losses during the year	3,894	2,794
Exchange rate difference on the translation of foreign subsidiaries	25	(14)
Actual losses during the year	(1,402)	(1,294)
Paid-in previously written off	20	17
Disposals during the year		(50)
Balance on 31 December	<u>8,301</u>	<u>5,764</u>
Provision for losses on loan portfolio as a percentage of loans and guarantees issued	<u>2.4%</u>	<u>2.1%</u>

BOARD OF DIRECTORS OF THE ISSUER

The Issuer's Board of Directors consists of nine members and nine alternates.

Board

Sigurður Einarsson – Born 1960 • Executive Chairman of Kaupthing Bank • Cand. Polit from the University of Copenhagen • Joined Kaupthing Bank in 1994.

Hjörleifur Thór Jakobsson – Born 1957 • Vice Chairman of the Board • Elected 2003 • CEO of Olúfélagid ehf.

Ásgeir Thoroddsen – Born 1942 • Elected 2003 • Attorney to the Supreme Court.

Bjarnfredur H. Ólafsson – Born 1967 • Elected 2003 • Attorney to the District Court.

Brynja Halldórsdóttir – Born 1957 • Elected 2004 • CFO of BYKO.

Finnur Ingólfsson – Born 1954 • Elected 2003 • CEO of Vátryggingafélag Íslands hf.

Gunnar Páll Pálsson – Born 1961 • Elected 2001 • CEO of Commercial Workers' Union of Reykjavík (VR).

Peter Gatti – Born 1947 • Elected 2003 • Managing Director of Hauck & Aufhäuser Privatbankiers KGaA.

Tommy Persson – Born 1948 • Elected 2002 • CEO of Länsförsäkringar AB • Other directorships: Chairman of the Swedish Insurance Federation and the Swedish Insurance Employers' Association. • Chairman of EurAPCO AG. • Board member of Eureko BV.

Senior Management

The Issuer has two Chief Executive Officers each of which is appointed by the Board of Directors.

Hreidar Már Sigurdsson

Born 1970 • CEO • Business Studies graduate from University of Iceland • Joined Kaupthing Bank in 1994.

Sólón R. Sigurdsson.

Born 1942 • CEO • Joined Búnadarbanki Íslands hf. in 1983.

Managing Directors of the Issuer

Armann Thorvaldsson – Managing Director of Corporate Finance.

Born 1968, a History graduate with an MBA from Boston University. He has been with Kaupthing Bank since 1994.

Bjarki H. Diego – Managing Director of Corporate Banking.

Born 1968, Graduated in Law from the University of Iceland in 1993, LL.M from University of London in 1999 • He has been with Kaupthing Bank since 2000.

Fridrik Halldorsson – Managing Director of Retail Banking.

Born 1959, BA in Business Administration. He was with the bank 1992-1999 and joined the bank again in 2002.

Gudny Arna Sveinsdóttir – Managing Director of Finance and Accounting.

Born 1966, a Business Studies graduate with an MS from the University of Uppsala in Sweden. She has been with Kaupthing Bank since 2001.

Hafliði Kristjánsson – Managing Director of Marketing and Sales.

Born 1962, a Psychology graduate with an MIBS from the University of South Carolina. He has been with Kaupthing Bank since 1997.

Ingi Örn Geirsson – Managing Director of Information Technology.

Born 1951, a Business Administration and Computer Science graduate from the University of Lund. He has been with Búnadarbanki since 1985.

Ingolfur Helgason – Managing Director of Capital Markets.

Born 1967, a Business Studies graduate from the University of Iceland. He has been with Kaupthing Bank since 1993.

Kristin Petursdóttir – Managing Director of Treasury.

Born 1965, a Business Studies graduate with an MS in International Business from the Norwegian School of Management in Bergen. She has been with Kaupthing Bank since 1997.

Kristján Arason – Managing Director of Private Banking.

Born 1961, a Business Studies graduate from University of Iceland. He has been with Kaupthing Bank since 2001.

Dr. Steingrímur P. Karason – Managing Director of Risk Management.

Born 1968, an Engineering graduate with an ScD in Mechanical Engineering from MIT in Boston. He has been with Kaupthing Bank since 1997.

Thórarinn Sveinsson – Managing Director of Asset Management.

Born 1967, an MSc in Engineering from Massachusetts Institute of Technology (MIT). He has been with Kaupthing Bank since 1999.

AUDITORS' REPORT

To the Board of Directors and Shareholders of Kaupthing Bunadarbanki hf.

We have audited the accompanying Balance Sheet and Consolidated Balance Sheet of Kaupthing Bunadarbanki hf. as of 31st December, 2003 and the related Profit and Loss Account, Statement of Cash Flows for the year then ended and a five-year summary. These Annual Accounts are the responsibility of the Bank's management. Our responsibility is to express an opinion on these Annual Accounts based on our audit. We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the Annual Accounts are free of material misstatements.

An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the Annual Accounts. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the Annual Accounts. We believe that our audit provides a reasonable basis for our opinion. In our opinion the Annual Accounts give a true and fair view of the financial position of Kaupthing Bunadarbanki hf. as of 31st December, 2003, and the results of its operations and its cash flows for the year then ended, in accordance with the law and generally accepted accounting principles in Iceland.

Reykjavik, 12th February, 2004.

Sigurdur Jonsson
Hildur Arnadottir
KPMG Endurskodun hf.

Profit and Loss Account – The Group

	31/12 2003	31/12 2002
	(ISK millions)	
Financial income		
Interest from credit institutions	2,173	2,093
Interest on loans	22,245	18,781
Interest on bonds	1,861	2,598
Other interest income	3,369	2,713
	<u>29,648</u>	<u>26,185</u>
Financial expenses		
Interest to credit institutions	5,724	6,139
Interest on deposits	7,221	6,811
Interest on borrowings	5,435	5,242
Interest on subordinated loans.. .. .	938	807
Other interest expenses	206	188
	<u>19,524</u>	<u>19,187</u>
Net interest income	10,124	6,998
Other operating income		
Dividends from shares and other holdings	1,101	507
Fees, commissions and other service charges	11,125	7,089
Expenses in respect of commissions and other service charges	(1,442)	(865)
Trading gains	10,044	5,900
Other operating income	828	1,783
	<u>21,656</u>	<u>14,414</u>
Net operating income	31,780	21,412
Other operating expenses		
Salaries and salary related expenses	10,110	6,505
Other operating expenses	7,028	5,193
Depreciation	1,355	757
	<u>18,493</u>	<u>12,455</u>
Provision for losses	(3,894)	(2,794)
Pre-tax profit	9,393	6,163
Income tax	(1,486)	(764)
Minority interest	(387)	(36)
Net earnings	<u><u>7,520</u></u>	<u><u>5,363</u></u>

Balance Sheet – The Group

	31/12 2003	31/12 2002
	<i>(ISK millions)</i>	
Assets		
Cash, treasury bills and amounts due from credit institutions		
Demand deposits with the Central Bank	771	763
Treasury bills eligible for refinancing with the Central Bank	0	802
Amounts due from other credit institutions		
Required deposits with the Central Bank	2,717	5,832
Amounts due from other credit institutions	47,057	31,122
	<u>50,545</u>	<u>38,519</u>
Loans		
Loans to customers	327,019	250,278
Mortgages foreclosed	1,962	2,030
Lease contracts	22,014	17,025
	<u>350,995</u>	<u>269,333</u>
Bonds and shares in other companies		
Bonds and other fixed-income securities	80,832	69,298
Shares and other variable-yield securities	50,327	32,882
Shares in associated and affiliated companies	2,926	3,528
	<u>134,085</u>	<u>105,708</u>
Other assets		
Goodwill	5,948	3,002
Fixed assets	5,441	5,279
Other assets	8,638	5,580
Deferred tax asset	831	741
Prepaid expenses and accrued income	2,086	4,250
	<u>22,944</u>	<u>18,852</u>
Total assets	<u>558,569</u>	<u>432,412</u>

	31/12 2003	31/12 2002
	(ISK millions)	
Liabilities and equity		
Amounts owed to credit institutions	79,267	109,865
Savings deposits		
Demand deposits	103,432	80,270
Time deposits	79,065	84,300
	<u>182,497</u>	<u>164,570</u>
Borrowings	210,645	102,029
Other liabilities		
Sundry liabilities	13,701	5,925
Accrued expenses	3,577	4,109
	<u>17,278</u>	<u>10,034</u>
Deferred tax liability	1,646	411
Total liabilities	<u>491,333</u>	<u>386,909</u>
Subordinated loans	10,704	11,010
Minority interest in subsidiaries' equity	10,603	1,114
Equity		
Share capital	4,384	4,092
Share premium	23,304	17,508
Accrued stock options	316	130
Retained earnings	17,925	11,649
	<u>45,929</u>	<u>33,379</u>
Total liabilities and equity	<u><u>558,569</u></u>	<u><u>432,412</u></u>

RECENT DEVELOPMENTS

The following information on pages 37 to 40 of this Offering Circular relates to developments to the end of the first quarter of 2004 and is extracted without material adjustment from the Issuer's results announcement for the first quarter of 2004.

Kaupthing Bank's Q1 2004 results

Kaupthing Bank posted an after-tax profit of ISK 2,650 million (EUR 30 million) during the first quarter of 2004, which represents an increase of 92.6 per cent. from the same period in 2003.

Earnings per share amounted to ISK 6.1 (EUR 0.07) during the first quarter, compared with ISK 3.4 (EUR 0.04) during the same period in the previous year. Return on equity after tax was 24.4 per cent., compared with 17.5 per cent. during the first quarter of 2003.

Net operating income during the first quarter totalled ISK 9,571 million (EUR 110 million), increasing by 41.0 per cent. between years. Operating expenses during the first quarter totalled ISK 5,071 million (EUR 58 million) and increased by 15.6 per cent. between years and the cost ratio decreased from 64.6 per cent. to 53.0 per cent.

Total assets amounted to ISK 601 billion (EUR 6.9 billion) at the end of the first quarter, increasing by 7.6 per cent. from the beginning of the year.

The Norwegian securities company A. Sundvall ASA was acquired. The purpose of the acquisition was to strengthen the Bank's activities in Norway.

The Bank achieved a complete turnaround in operations in Sweden.

Approximately 56 per cent. of the Bank's net operating income during the first quarter of 2004 was generated outside Iceland.

Income statement – Key figures

	<u>Q1 2004</u>	<u>Q4 2003</u>	<u>Q3 2003</u>	<u>Q2 2003</u>	<u>Q1 2003</u>
	<i>(ISK millions)</i>				
Net Interest Income	3,501	3,018	2,505	2,203	2,398
Net Commission Income	3,212	3,086	2,338	2,250	2,009
Trading Gains	1,862	3,097	3,038	1,879	2,030
Other Income	996	280	228	1,072	349
Net Operating Income	9,571	9,481	8,109	7,404	6,786
Salaries and Related Expenses	-2,622	-2,795	-2,367	-2,612	-2,336
Other Administrative Expenses	-2,449	-2,285	-1,969	-2,079	-2,050
Other Operating Expenses					
Total	-5,071	-5,080	-4,336	-4,691	-4,386
Provisions for Losses	-1,150	-1,172	-1,344	-751	-627
Profit Before Taxes	3,350	3,229	2,429	1,962	1,773
Taxes	-558	-401	-415	-273	-397
Minority Interest	-142	-387	-	-	-
Net Earnings	2,650	2,441	2,014	1,689	1,376

Balance sheet – Key figures

	<u>31/3/04</u>	<u>31/12/03</u>		<u>31/3/04</u>	<u>31/12/03</u>
	<i>(ISK Billions)</i>			<i>(ISK Billions)</i>	
Amounts due from			Amounts owed to		
Credit Inst.	39.8	50.5	Credit Inst.	80.3	79.3
Loans to Customers	371.2	351.0	Deposits	186.0	182.5
Bonds & Fixed Income					
Securities	85.4	80.8	Borrowings	238.8	210.6
Shares	69.6	50.3	Other Liabilities	36.3	29.5
Subsidiaries & Associated ..	3.0	2.9	Subordinated Loans ..	12.5	10.7
Other Assets	32.2	22.9	Equity	47.3	45.9
			Total Liabilities and		
Total Assets	601.3	558.6	Equity	601.3	558.6

Provisions and non-performing loans

The Issuer evaluates non-performing loans according to the rules of the Financial Supervisory Authority, which are based on EU Directive no. 554/1994 regarding rules on the annual accounts of commercial banks. The table below sets out a breakdown of the Group's non-performing loans as at 31st March, 2004:

	<u>31/3/2004</u>
	<i>(ISK millions)</i>
Loans with specific provision for losses	9,463
Specific provision for losses.. .. .	(6,152)
Total	3,311
Other non-performing loans	2,835
Total non-performing loans.	6,146

Coverage for the Group's non-performing assets as at 31st March in 2004:

	<u>31/3/2004</u>
	<i>(ISK millions)</i>
Total non-performing loans	6,146
Specific provisions for losses.	6,152
Mortgages foreclosed	1,996
Total non-performing assets	14,294
Specific provision for losses	6,152
General provisions	2,995
Mortgages foreclosed	1,996
Total provision	11,143
Total provision/Total non-performing assets	78.0%

Provisions for losses on the loan portfolio have been made each year by the Issuer to meet the estimated risk attached to these assets. These provisions do not represent a final write-off. Certain risk factors are evaluated in addition to a regular contribution for this purpose. The Issuer uses specific provisions as well as general provisions to meet the general risk of lending operations.

The table below sets out changes in the Issuer's provisions as at 31st March, 2004:

The changes in provisions are as follows:

	<u>31/3/2004</u>
	<i>(ISK millions)</i>
Balance on 1 January	8,301
Provision for losses during the year	1,150
Exchange rate difference on the translation of foreign subsidiaries	2
Actual losses during the year	(354)
Paid-in previously written off	48
Balance at end of period	<u>9,147</u>
Provision for losses on loan portfolio as a percentage of loans and guarantees issued ..	2.5%

Highlights of the first quarter

Acquisition of Norwegian securities company A. Sundvall ASA

In February 2004 Kaupthing Bank acquired the Norwegian securities company A. Sundvall ASA. The company is one of the smaller but also oldest securities companies in Oslo. It operates in the fields of securities brokerage, corporate finance and research. A. Sundvall ASA employs 25 people. Net operating income in 2003 amounted to NOK 30 million and the company's pre-tax profit was NOK 4 million. Equity at year end 2003 totalled NOK 25 million. Prior to this acquisition, Kaupthing Bank had activities in Norway via its subsidiary Kaupthing Norge A.S. (previously Tyren Group), which specialises in asset management.

The purpose of this latest acquisition was to strengthen the Bank's activities in Norway and to bring the Bank closer to its objective of being one of the leading investment banks in the Nordic countries.

The Issuer has stated that it intends to continue a prudent growth strategy which could also entail further acquisitions in the Nordic region (including the United Kingdom and Benelux), however, such growth should not be at the expense of profitability.

Changes in the Bank's senior management

Sólon R. Sigurdsson, one of Kaupthing Bank's two chief executive officers, announced at the Bank's AGM on 27th March, 2004 that he intended to retire as CEO at the end of 2004. In the same month Gudbjörn Maronsson left his position as Managing Director of Asset Management and Private Banking. He was succeeded by Thórarinn Sveinsson, who will direct Asset Management and Kristján Arason, who will direct Private Banking. At the Bank's AGM on 27th March, 2004, Brynja Halldórsdóttir was elected on to the board of directors, replacing Jón Helgi Guðmundsson.

Singer and Friedlander

In February 2004 Kaupthing Bank purchased approximately 19.4 million shares in the British investment bank Singer and Friedlander Group Plc., which corresponds to 10.00 per cent. of issued share capital. Kaupthing Bank therefore owns approximately 37.9 million shares in the Bank following this acquisition, which represents 19.53 per cent. of issued share capital. On 31st March, 2004 Kaupthing Bank was the largest single shareholder in the Bank.

Pro forma five year summary

	<i>Q1-2004</i>	<i>2003</i>	<i>2002</i>	<i>2001</i>	<i>2000</i>	<i>1999</i>
	<i>(ISK millions)</i>					
Profit and Loss						
Net interest income	3,501	10,124	6,998	5,811	4,089	3,361
Other operating income ..	6,070	21,656	14,414	8,039	5,112	5,379
Net operating Income ..	9,571	31,780	21,412	13,850	9,201	8,740
Other operating expenses	-5,071	-18,493	-12,455	-10,565	-7,030	-5,352
Provision for losses	-1,150	-3,894	-2,794	-1,691	-815	-846
Income taxes	-558	-1,486	-764	321	-343	-732
Minority interest	-142	-387	-36	-	-	-
Net earnings	2,650	7,520	5,363	1,915	1,013	1,810
Balance Sheet						
	<i>Q1-2004</i>	<i>2003</i>	<i>2002</i>	<i>2001</i>	<i>2000</i>	<i>1999</i>
Assets						
Amounts due from credit institutions	39,828	50,546	38,519	17,696	19,553	17,952
Loans	371,227	350,994	269,333	204,552	126,823	85,846
Bonds and other fixed income securities	85,437	80,832	69,298	44,264	28,575	17,602
Shares and other variable yield securities	69,595	50,327	32,882	35,343	19,115	13,445
Subsidiaries	3,014	2,926	3,528	1,997	2,646	1,585
Other assets	32,172	22,944	18,852	13,711	10,909	4,909
Total assets	601,273	558,569	432,412	317,563	207,621	141,339
Liabilities and equity						
Amounts owed to credit institutions	80,321	79,267	109,865	88,166	47,731	18,177
Deposits	185,996	182,497	164,570	83,473	67,369	61,003
Borrowings	238,808	210,645	102,029	109,750	66,828	45,623
Other liabilities	36,337	29,528	11,559	5,656	6,889	4,768
Subordinated loans	12,487	10,704	11,010	8,364	6,187	2,761
Equity.. .. .	47,325	45,928	33,379	22,154	12,616	9,007
Total liabilities and equity	601,273	558,569	432,412	317,563	207,621	141,339
KEY RATIOS						
Cost/income ratio	53.0%	58.2%	58.2%	76.3%	76.4%	68.3%
Return on equity	23.3%	23.0%	18.7%	-	-	-
Provisions for losses during the year	0.2%	1.1%	1.0%	0.8%	0.6%	0.9%
Provisions for losses at year-end	2.5%	2.4%	2.1%	2.0%	1.7%	2.0%

Trading between Kaupthing Bank and Búnadarbanki Íslands was an insignificant part of the banks' trading during the years 1999-2002 and should therefore not have a significant impact when the operations of the merged bank are compared with the summed-up (pro forma) operations of both banks between 1999-2002.

Further recent developments

FI-Holding

In June 2004 Kaupthing Bank issued a press release entitled “Kaupthing Bank Acquires the Danish Bank FIH for DKK 7.1 billion (€1.0 billion)”.

An extract from this press release and the audited financial statements in respect of the financial years ended 31st December, 2003 and 2002 of FIH Group and FIH Erhvervsbank A/S and the unaudited financial statements for the period from January to March 2004 and January to March 2003 appear below.

A copy of the full Annual Report 2003 for FIH Group and FIH Interim Report January-March 2004 is available at the specified office of the Paying Agent for the time being in Luxembourg.

**Kaupthing Bank Acquires the Danish Bank FIH
for DKK 7.1 billion (€ 1.0 billion)**

Kaupthing Bank has signed an agreement with FöreningsSparbanken (Swedbank) to acquire all issued shares in FI-Holding ("FIH"), the holding company of the Danish bank FIH for DKK 7.1 billion (€1.0 billion), in addition interest will accrue from 31 March until the deal is closed. FIH represents an excellent strategic fit with Kaupthing Bank. This acquisition will double the size of Kaupthing Bank and will give the bank a leading position in the Danish corporate banking sector.

The acquisition will be funded through a combination of a subordinated bond issue and a rights issue. Excess capital and cash reserves in FIH amounting to DKK 2.4 billion (€ 320 million) will be distributed to the seller prior to closing. Shareholders with 52% ownership in Kaupthing Bank have expressed support for the acquisition and will fully participate in the rights issue. The board is expected to propose an issue price in line with current market price.

FIH provides medium and long term financing to the full spectrum of Danish corporations. Through the strength and experience of its management team, FIH has built up a 17% share of the Danish corporate banking market. With around 5,000 clients, the bank has the widest range of large corporate and small and medium-sized enterprises in Denmark. FIH also has a strong capital structure and a proven track record in minimizing losses in its credit portfolio.

Kaupthing Bank is a fast growing Nordic bank with a strong track record of both organic and acquired growth. Its acquisition of FIH is a continuation of its strategy to grow its corporate banking capabilities and expand its presence in the Nordic region.

The combined entity will provide a platform for growth in corporate finance, acquisition finance and private equity investments. The cross-selling opportunities arising from this acquisition will enable FIH's wide range of clients to benefit from Kaupthing Bank's broader product portfolio. The management team of FIH and the strong local brand will remain unchanged and there will be no need for a reorganisation of the FIH business.

On a proforma basis this acquisition will increase Kaupthing Bank's total assets from ISK 601 billion (€ 6.9 billion) to ISK 1,470 billion (€15.9 billion). Net earnings for 2003 and Q1 2004 will increase from ISK 7,520 million (€ 86.4 million) to ISK 14,163 million (€ 162.8 million) and ISK 2,650 million (€30.5 million) to ISK 4,816 million (€55.4 million) respectively. The acquisition will have a significantly positive impact on earnings per share. The target for the combined group would be to keep the Capital Adequacy Directive ("CAD") ratio in excess of 11.0% and the Tier 1 Capital ratio at 8.0% or higher.

Sigurður Einarsson, Kaupthing Bank's Executive Chairman, commented:

"This is major strategic milestone for Kaupthing and is wholly in line with our strategy. FIH is a strong force in Danish corporate banking and the acquisition brings us closer to our goal of becoming a leading investment bank in the Nordic region. We believe that the existing senior management team has been key to FIH's success and we intend to retain them to develop the business going forward."

Lars Johansen, CEO of FIH, said:

"We look forward to becoming part of Kaupthing Bank, which has in recent years shown impressive commitment and zeal to its goal of becoming a leading Nordic investment bank – without moving from its tradition of putting the client first. I am confident that our clients and employees will find our new setting as stimulating as I do."

Conditions

The acquisition is conditional upon:

- Approval at an Extraordinary General Meeting of Kaupthing Bank.
- Consent by the by the Danish Financial Supervisory Authority under the Danish Financial Business Act ("Lov om Finansiell Virksomhed"), and
- Consent by the Icelandic Financial Supervisory Authority as stipulated in article 39 in the Icelandic Act on Financial Undertakings, No 161/2002.

The transaction is expected to be completed in September.

Advisors

Kaupthing Investment Banking is acting as financial advisor to Kaupthing Bank.

FIH

FIH was founded in November 1958 as Finance for Danish Industry by the Danish Central Bank, Danish Bankers Association, Danish Insurance Association and Confederation of Danish Industries. FIH made an IPO in November 1988 on the Copenhagen Stock Exchange and was de-listed in 2000.

FIH focuses primarily on providing medium and long term financing to the full spectrum of Danish corporations ranging from leading multinationals to small and medium-sized enterprises. FIH reports low credit losses and good profitability. FIH employs 174 people with the majority working from the head office in Copenhagen, and 39 people in the regional sales offices in Fredericia, Aarhus, Aalborg and Herning.

FIH ANNUAL REPORT 2003

Income Statement 2003

	<i>FIH Group</i>		<i>FIH Erhvervsbank A/S</i>	
	<i>2003</i>	<i>2002</i>	<i>2003</i>	<i>2002</i>
	<i>(DKK '000)</i>			
Interest income	2,778,787	3,198,232	2,453,785	2,778,175
Interest expense	1,680,097	2,178,722	1,455,427	1,903,833
Net interest income	1,098,690	1,019,510	998,358	874,342
Dividends from investments	203	3,300	172	3,279
Fee and commission income	49,690	60,360	60,129	72,804
Fees and commissions paid	1,821	2,525	13,769	15,904
Net interest and fee income	1,146,762	1,080,645	1,044,890	934,521
Market value adjustments	(143,750)	(7,680)	(149,679)	(9,543)
Other operating income	9,947	14,914	17,796	16,946
Staff costs and administration expenses	204,475	184,132	193,788	172,886
Depreciation and write-downs of intangible and tangible assets	12,911	15,739	12,616	15,298
Other operating expenses	0	28	0	5
Loan losses and loan loss provisions	68,238	85,694	88,517	78,814
Profit from investments in group enterprises and associates	69,664	59,241	145,666	150,519
Profit on ordinary operations before taxation	796,999	861,527	763,752	825,440
Taxation	229,730	234,891	196,483	198,804
Net profit for the year	567,269	626,636	567,269	626,636
Allocation of profits				
Net profit for the year			567,269	626,636
Total amount to be allocated			567,269	626,636
Dividend			154,072	154,072
Transferred to equity			413,197	472,564
Total allocation			567,269	626,636

FIH ANNUAL REPORT 2003

Balance Sheet 31st December, 2003

	<i>FIH Group</i>		<i>FIH Erhvervsbank A/S</i>	
	<i>2003</i>	<i>2002</i>	<i>2003</i>	<i>2002</i>
	<i>(DKK '000)</i>			
ASSETS				
Cash in hand and demand deposits with				
central banks	101,523	32,484	101,523	32,480
Due from credit institutions and central banks	2,991,371	3,314,297	2,748,552	3,081,481
Loans to customers	55,734,736	56,858,617	51,904,747	51,858,534
Bonds	6,125,518	4,808,148	5,430,420	3,805,000
Shares, etc.	171,686	190,523	39,753	88,757
Investments in associates, etc.	427,318	407,365	64,095	130,435
Investments in group enterprises	0	0	1,958,095	2,566,518
Intangible assets	8,304	0	8,304	0
Tangible assets	21,982	31,018	21,982	22,976
Other assets	864,411	1,656,008	1,103,118	1,868,690
Prepayments and accrued income	16,113	7,920	15,875	7,572
Total assets	66,462,962	67,306,380	63,396,464	63,462,443
LIABILITIES				
Due to credit institutions and central banks	5,756,678	5,888,073	6,100,842	6,740,650
Deposits	690,295	379,012	690,295	379,012
Bonds issued	47,316,342	49,983,583	43,163,944	44,535,953
Other liabilities	4,306,802	2,874,700	5,091,190	3,672,025
Accruals and deferred income	59,421	87,999	59,421	87,816
Provisions for commitments	450,917	397,089	408,265	351,063
Subordinated debt	1,831,230	2,057,811	1,831,230	2,057,811
Equity				
Share capital	513,572	513,572	513,572	513,572
Share premium account	157,093	157,093	157,093	157,093
Reserves	62,243	59,448	161,666	1,205,108
Brought forward from previous years	4,974,836	4,492,245	4,951,685	3,438,886
Appropriated from net profit for the year	343,533	415,755	267,261	323,454
Total equity	6,051,277	5,638,113	6,051,277	5,638,113
Total liabilities	66,462,962	67,306,380	63,396,464	63,462,443
Off-balance-sheet items				
Guarantees, etc.	1,741,383	2,877,013	3,162,803	4,764,209
Other commitments	3,136,488	4,433,138	3,015,859	4,678,782
Total off-balance-sheet items	4,877,871	7,310,151	6,178,662	9,442,991

Derivative financial instruments are specified in the supplementary notes.

FIH INTERIM REPORT JANUARY-MARCH 2004

Income statement for the FIH group

	<i>31/3</i> <i>2004</i>	<i>31/3</i> <i>2003</i>	<i>Hele året</i> <i>2003</i>
	<i>DKKm</i>		
Interest income	642.1	726.1	2,778.8
Interest expense	400.8	455.7	1,680.1
Net interest income	241.3	270.4	1,098.7
Dividends from holdings	0.2	0.1	0.2
Fee and commission income	10.9	13.2	49.7
Fees and commissions paid	0.2	0.1	1.8
Net interest and fee income	252.2	283.6	1,146.8
Market value adjustments	38.6	2.6	(143.8)
Other operating income	2.1	1.8	9.9
Staff costs and administration expenses	49.9	46.5	204.5
Depreciation and write-downs of intangible and tangible assets	3.2	4.9	12.9
Other operating expenses	0.0	0.0	0.0
Loan losses and loan loss provisions	17.7	32.0	68.2
Profit from investments in group enterprises and associates	29.2	0.5	69.7
Profit on ordinary operations	251.3	205.1	797.0
Taxation	66.5	61.9	229.7
Net profit	184.8	143.2	567.3

FIH INTERIM REPORT JANUARY-MARCH 2004

Balance sheet for the FIH group

	<i>31/3</i> <i>2004</i>	<i>31/3</i> <i>2003</i>	<i>31/12</i> <i>2003</i>
	<i>DKKm</i>		
ASSETS			
Cash in hand and demand deposits with central banks	97.3	43.4	101.5
Due from credit institutions and central banks	1,248.7	3,299.6	2,991.4
Loans to customers	54,545.6	57,399.0	55,734.7
Bonds	7,153.8	5,874.4	6,125.5
Shares, etc.	181.0	191.8	171.7
Investments in associates, etc.	467.4	403.0	427.3
Investments in group enterprises	0.0	0.0	0.0
Intangible	8.8	0.0	8.3
Tangible assets	28.3	29.9	22.0
Own shares	7.8	0.0	0.0
Other assets	1,670.7	1,710.1	864.5
Prepayments and accrued income	10.4	9.3	16.1
Total assets	65,419.8	68,960.5	66,463.0
Due to credit institutions and central banks	7,469.6	7,076.2	5,756.8
Deposits	644.0	489.0	690.3
Bonds issued	45,464.5	50,001.4	47,316.3
Other liabilities	3,248.6	3,111.8	4,306.8
Accruals and deferred income	56.7	79.8	59.4
Provisions for commitments	450.9	397.1	450.9
Subordinated debt	1,849.4	2,023.9	1,831.2
Equity.. .. .	6,236.1	5,781.3	6,051.3
Total liabilities	65,419.8	68,960.5	66,463.0
Off-balance-sheet items			
Guarantees, etc.	1,267.8	2,210.6	1,741.4
Other commitments	3,940.3	3,504.0	3,136.5
Total off-balance-sheet items	5,208.1	5,714.6	4,877.9

TAXATION

Taxation of Notes

The comments below are of a general nature based on the Issuer's understanding of current law and practice in Iceland. They relate only to the position of persons who are the absolute beneficial owners of the Notes and/or Coupons. They may not apply to certain classes of person such as dealers. Prospective holders of the Notes who are in any doubt as to their personal tax position or who may be subject to tax in any other jurisdiction, should consult their professional advisers.

1. There are no taxes or other governmental charges payable under the laws of Iceland or any authority of, or in, Iceland in respect of the principal or interest on the Notes by a holder who is not a resident of Iceland, or in respect of any amount payable under the Subscription Agreement or the Fiscal Agency Agreement.
2. There are no estate or inheritance taxes, succession duties, gift taxes or capital gains taxes imposed by Iceland or any authority of, or in, Iceland in respect of the Notes if, at the time of the death of the holder or the transfer of the Notes, such holder or transferor is not a resident of Iceland.
3. The Issuer is not required by the current laws of Iceland to make any deductions or withholding from any payment of principal or interest due or to become due under the Notes or from any amount payable under the Subscription Agreement or the Fiscal Agency Agreement, if the recipient is not a resident of Iceland.

EU Savings Directive

On 3rd June, 2003, the European Council of Economics and Finance Ministers adopted a Directive on the taxation of savings income under which Member States will be required, from a date not earlier than 1st January, 2005, to provide to the tax authorities of another Member State details of payments of interest (or similar income) paid by a person within its jurisdiction to an individual resident in that other Member State, except that, for a transitional period, Belgium, Luxembourg and Austria will instead be required (unless during that period they elect otherwise) to operate a withholding system in relation to such payments (the ending of such transitional period being dependent upon the conclusion of certain other agreements relating to information exchange with certain other countries).

SUBSCRIPTION AND SALE

Under a Subscription Agreement (the “**Subscription Agreement**”) dated 28th June, 2004 Deutsche Bank AG London, Barclays Bank PLC and Credit Suisse First Boston (Europe) Limited (the “**Managers**”) have agreed to subscribe for the Notes at 100 per cent. of their principal amount less a combined selling, management and underwriting commission of 1.00 per cent. of such principal amount. The Managers are entitled to terminate the Subscription Agreement in certain circumstances prior to payment being made to the Issuer.

The United States of America

The Notes have not been and will not be registered under the Securities Act and may not be offered, sold or delivered within the United States or to, or for the account or benefit of, U.S. persons, except in certain transactions exempt from the registration requirements of the Securities Act. Terms used in this paragraph have the meanings given to them by Regulation S under the Securities Act.

The Notes are in bearer form and subject to U.S. tax law requirements and may not be offered, sold or delivered within the United States or its possessions or to a United States person, except in certain transactions permitted by U.S. tax regulations. Terms used in this paragraph have the meaning given to them by the United States Internal Revenue Code and regulations thereunder.

Each Manager has represented and agreed that, except as permitted by the Subscription Agreement, it has not offered and sold, and will not offer, sell or deliver the Notes (i) as part of their distribution at any time and (ii) otherwise until 40 days after the later of the commencement of the offering and the Closing Date within the United States or to, or for the account or benefit of, U.S. persons, and that it will have sent to each dealer to which it sells Notes during the distribution compliance period a confirmation or other notice setting forth the restrictions on offers and sales of the Notes within the United States or to, or for the account or benefit of, U.S. persons.

In addition, until 40 days after the commencement of the offering of the Notes, an offer or sale of the Notes within the United States by any dealer (whether or not participating in the offering of such Securities) may violate the registration requirements of the Securities Act.

The United Kingdom

Each Manager has represented and agreed that, except as permitted by the Subscription Agreement:

- (i) it has not offered or sold and, prior to the expiry of the period of six months from the Closing Date, will not offer or sell any Notes to persons in the United Kingdom except to persons whose ordinary activities involve them in acquiring, holding, managing or disposing of investments (as principal or agent) for the purposes of their businesses or otherwise in circumstances which have not resulted and will not result in an offer to the public in the United Kingdom within the meaning of the Public Offers of Securities Regulations 1995 (as amended);
- (ii) it has only communicated or caused to be communicated and will only communicate or cause to be communicated an invitation or inducement to engage in investment activity (within the meaning of Section 21 of the FSMA) received by it in connection with the issue of the Notes in circumstances in which Section 21(1) of the FSMA does not apply to the Issuer; and
- (iii) it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to the Notes in, from or otherwise involving the United Kingdom.

Republic of Italy

The offering of the Notes has not been cleared by CONSOB (the Italian Securities Exchange Commission) pursuant to Italian securities legislation and, accordingly, no Notes may be offered, sold or delivered, nor may copies of this Offering Circular or of any other document relating to the Notes be distributed in the Republic of Italy, except:

- i. to professional investors (“*operatori qualificati*”), as defined in Article 31, second paragraph, of CONSOB Regulation No. 11522 of 1st July, 1998, as amended; or
- ii. in circumstances which are exempted from the rules on solicitation of investments pursuant to Article 100 of Legislative Decree No. 58 of 24th February, 1998 (the “**Financial Services Act**”) and Article 33, first paragraph, of CONSOB Regulation No. 11971 of 14th May, 1999, as amended.

Any offer, sale or delivery of the Notes or distribution of copies of this Offering Circular or any other document relating to the Notes in the Republic of Italy under (i) or (ii) above must be:

- a. made by an investment firm, bank or financial intermediary permitted to conduct such activities in the Republic of Italy in accordance with the Financial Services Act and Legislative Decree No. 385 of 1st September, 1993 (the “**Banking Act**”), as amended; and
- b. in compliance with Article 129 of the Banking Act and the implementing guidelines of the Bank of Italy pursuant to which the issue or the offer of securities in the Republic of Italy may need to be preceded and followed by an appropriate notice to be filed with the Bank of Italy depending, *inter alia*, on the aggregate value of the securities issued or offered in the Republic of Italy and their characteristics; and
- c. in accordance with any other applicable laws and regulations.

Iceland

Each Manager has agreed that it will not offer the Notes to the public in Iceland, except in compliance with the Icelandic Act on Securities Transaction (No. 33/2003) and any applicable laws or regulations of Iceland.

General

Each Manager has agreed with the Issuer that it will obtain any consent, approval or permission which is, to the best of its knowledge and belief, required for the offer, purchase or sale by it of Notes under the laws and regulations in force in any jurisdiction to which it is subject or in which it makes such offers, purchases or sales and that it will, to the best of its knowledge and belief, comply with all such laws and regulations.

GENERAL INFORMATION

1. The issue of the Notes was authorised by a resolution of the Board of Directors of the Issuer dated 21st June, 2004.
2. Application has been made to list the Notes on the Luxembourg Stock Exchange. A legal notice relating to the issue of the Notes and the constitutional documents of the Issuer are being lodged with the Luxembourg trade and companies register (*Registre de commerce et des sociétés, Luxembourg*) where such documents may be examined and copies obtained.
3. So long as any Note remains outstanding, copies of the following documents will, when published, be available free of charge from the registered office of the Issuer and from the specified office of the Paying Agent for the time being in Luxembourg:
 - (i) the articles of association (with an English translation thereof) of the Issuer;
 - (ii) the audited financial statements of the Issuer in respect of the financial year ended 31st December, 2003 and of each of Kaupthing Bank hf. and Bunadarbanki Islands hf. in respect of the financial years ended 31st December, 2002 and 2001;
 - (iii) the most recently published audited annual financial statements of the Issuer and the most recently published unaudited interim financial statements (if any) of the Issuer (with an English translation thereof);
 - (iv) the audited financial statements of FIH Group in respect of the financial year ended 31st December, 2003 and the FIH Interim Report January-March 2004;
 - (v) the Subscription Agreement and the Agency Agreement; and
 - (vi) any certificate referred to in Condition 3(a).
4. Save as disclosed in this Offering Circular, there has been no significant change in the financial or trading position of the Issuer or the Issuer and its subsidiaries, taken as a whole and there has been no material adverse change in the financial position or prospects of the Issuer or the Issuer and its subsidiaries, taken as a whole, since 31st December, 2003.
5. Neither the Issuer nor any of its subsidiaries is or has been involved in any legal or arbitration proceedings (including any proceedings which are pending or threatened of which the Issuer is aware) which may have or have had in the 12 months preceding the date of this document a significant effect on the financial position of the Issuer or the Group.
6. The Notes have been accepted for clearance through the Euroclear and Clearstream, Luxembourg systems with a Common Code of 019485927. The ISIN is XS0194859277 and the WKN is A0BD1K.
7. All consents and authorisations required by Icelandic law have been given for the issue of the Notes and for the Issuer to perform its obligations thereunder, under the Subscription Agreement and under the Fiscal Agency Agreement.
8. The auditors of the Issuer are KPMG Endurskodun hf., who have audited the Issuer's accounts, without qualification, in accordance with generally accepted auditing standards in Iceland for the financial year ended on 31st December, 2003.

The auditors of Bunadarbanki Islands hf. were Deloitte & Touche hf., who audited Bunadarbanki Islands hf.'s accounts, without qualification, in accordance with generally accepted auditing standards in Iceland for each of the three financial years ended on 31st December, 2002 and 2001.

The auditors of Kaupthing hf. were KPMG Endurskodun hf., who audited Kaupthing hf.'s accounts, without qualification, in accordance with generally accepted auditing standards in Iceland for each of the three financial years ended on 31st December, 2002 and 2001.

THE ISSUER

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