Consolidated Financial Statements 2008

MP Bank hf.
Skipholt 50d
105 Reykjavík
Iceland

Reg. no.: 540599-2469

Contents

Endorsement and Statement by the Board of Directors and the CEO

The consolidated financial statements of MP Bank hf. for the year ended 31 December 2008 have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union and additional disclosure requirements applicable. The consolidated financial statements comprise MP Bank hf. and its subsidiaries (together referred to as the “Bank”).

According to the income statement, profit for the year amounted to ISK 860 million. The Bank's equity at the end of 2008 amounted to ISK 6,624 million. The Bank's capital adequacy ratio, calculated in accordance with the Act on Financial Undertakings, was 22.3% at year-end. As of 31 December 2008 the Bank's total assets amounted to ISK 53,378 million.

During the year, the Bank was granted a commercial banking licence and consequently the name of the Bank was changed from 'MP Investment Bank hf.' to 'MP Bank hf.'.

The year 2008 was an extremely challenging year for the Icelandic financial sector. The three largest banks constituted 80% of the banking system. They were all partly nationalised and in part went into liquidation. Counterparty risk increased enourmously. The Board believes that in the accounts of MP Bank for the year 2008 the effects of this collapse on the bank are fully reflected. Among those effects are very high impairments and disappearance of the Bank's Icelandic hedging counterparties.

The Board of Directors proposes that a dividend of 36% be paid in the year 2009 on 2008 operations and in addition, shareholders be paid dividend in the form of shares in Hraunbjarg ehf. of nominal value 1,470 thousand.

The Bank’s share capital amounted to 1,100 million at the end of 2008. Of that amount, 55 million were own shares. Four shareholders held more than 10.0% of the shares in the Bank at year-end 2008. Their shareholding is specified as follows:

	Ownership
Margeir Pétursson and companies under his control	28.4%
BYR sparisjóður (Savings Bank)	13.1%
Sigurður Gísli Pálmason and company under his control	12.7%
Jón Pálmason and company under his control	12.7%

To the best of our knowledge, the consolidated financial statements of MP Bank hf. for the year 2008 give a true and fair view of the assets, liabilities, financial position and financial performance of the Bank. Further, in our opinion the consolidated financial statements and the endorsement of the Board of Directors and the Chief Executive Officer gives a fair view of the development and performance of the Bank's operations and its position and describes the principal risks and uncertainties faced by the Bank.

The Board of Directors and the CEO of the Bank have today discussed the annual consolidated financial statements of MP Bank hf. for the year 2008 and confirm them by the means of their signatures.

Reykjavik, 20 February 2009.

The Board of Directors:

CEO:

Independent Auditor's Report

To the Board of Directors and Shareholders of MP Bank hf.

We have audited the accompanying consolidated financial statements of MP Bank hf. and its subsidiaries (the "Bank"), which comprise the consolidated balance sheet as at 31 December 2008, and the consolidated income statement, consolidated statement of changes in equity and consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Consolidated Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the consolidated financial position of MP Bank hf. as at 31 December 2008, and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted the EU.

Reykjavík, 20 February 2009.

KPMG hf.

Amounts are in ISK '000

Consolidated Income Statement for the Year 2008

	Notes	2008	2007
Interest income		7,122,641	4,968,499
Interest expense		(5,941,621)	(4,189,400)
Net interest income	6,46	1,181,020	779,099
Fee and commission income		1,073,657	1,600,755
Fee and commission expense		(32,624)	(72,558)
Net fee and commission income	7	1,041,033	1,528,197
Net financial income	8,9,47	1,824,984	158,982
Share in (loss) profit of associates	4,59	(77,499)	686,325
Other income		1,937	7,712
Net operating income		3,971,475	3,160,315
Administrative expenses	48-51	(1,032,477)	(902,147)
Impairment losses on financial assets	22,58	(2,247,655)	(8,467)
Profit before income tax		691,343	2,249,701
Income tax	10,52	168,812	(469,629)
Profit for the year		860,155	1,780,072
Basic and diluted earnings per share		0.81	1.62

The notes on pages 9 to 40 are an integral part of these consolidated financial statements

Amounts are in ISK '000

Consolidated Balance Sheet as at 31 December 2008

	Notes	31.12.2008	31.12.2007
Assets			
Cash and cash equivalents	16,53	15,524,332	7,241,857
Loans to Central Bank	54	5,011,885	0
Derivatives	17	1,419,923	1,380,422
Fixed income securities	18,55	9,626,049	17,205,899
Shares and other variable income securities	19,56	640,825	3,453,562
Securities used for hedging	20,57	7,337,259	10,418,582
Loans to customers	21,37,58	10,310,113	9,599,516
Investments in associates	4,59	1,328,125	1,205,627
Property and equipment	23,60	653,626	415,937
Other assets	61	1,525,676	1,627,276
Total assets		53,377,813	52,548,678
Liabilities			
Short positions in listed securities	24,62	15,825,079	5,709,533
Securities used for hedging	20,63	5,212,949	0
Derivatives	17	30,127	273,988
Deposits	25	8,575,692	0
Borrowings	26,64	13,624,594	37,288,541
Subordinated liabilities	27,65	29,411	43,846
Current tax liabilities	28,66	11,435	187,594
Deferred tax liabilities	28,66	17,895	193,863
Other liabilities	29,67	3,426,625	2,664,227
Total liabilities		46,753,807	46,361,592
Equity			
Share capital	32,69	1,045,339	1,063,776
Share premium		813,368	942,368
Reserves		6,986	(39,419)
Retained earnings		4,758,313	4,220,361
Total equity		6,624,006	6,187,086
Total liabilities and equity		53,377,813	52,548,678

The notes on pages 9 to 40 are an integral part of these consolidated financial statements

Amounts are in ISK '000

Consolidated Statement of Changes in Equity for the Year 2008

			Reserves				
2007	Share Capital	Share Premium	Translation Reserve	Option Reserve	Fair value reserve	Retained Earnings	Total
Equity at 1.1.2007	1,064,000	1,164,875	0	(158,323)	94,338	2,603,433	4,768,323
Translation of foreign operations			(1,923)				(1,923)
Fair value reserve transferred to P&L					(94,338)		(94,338)
Profit for the year						1,780,072	1,780,072
Total recognised income and expense			(1,923)	0	(94,338)	1,780,072	1,683,811
Share-based payments				120,827		29,431	150,258
Own shares, change	(30,224)	(284,007)					(314,231)
Paid in new capital	30,000	61,500					91,500
Dividends paid						(192,575)	(192,575)
Equity at 31.12.2007	1,063,776	942,368	(1,923)	(37,496)	0	4,220,361	6,187,086
2008							
Equity at 1.1.2008	1,063,776	942,368	(1,923)	(37,496)	0	4,220,361	6,187,086
Translation of foreign operations			66,670				66,670
Profit for the year						860,155	860,155
Total recognised income and expense			66,670			860,155	926,825
Share-based payments				(20,265)			(20,265)
Own shares, change	(18,437)	(129,000)					(147,437)
Dividends paid						(322,203)	(322,203)
Equity at 31.12.2008	1,045,339	813,368	64,747	(57,761)	0	4,758,313	6,624,006

The notes on pages 9 to 40 are an integral part of these consolidated financial statements

Amounts are in ISK '000

Consolidated Statement of Cash Flows for the Year 2008

	Notes	2008	2007
Cash flows from operating activities:			
Profit for the year		860,155	1,780,072
Adjustments for:			
Indexation and exchange rate difference		(1,420,441)	240,321
Effects of associates	59	175,499	(686,325)
Depreciation	60	33,077	16,898
Impairment on loans		1,353,136	8,467
Deferred income tax, change		(175,968)	(176,819)
		825,458	1,182,614
Change in operating assets and liabilities		404,478	(47,694)
Net cash from operating activities		1,229,936	1,134,920
Cash flows from investing activities:			
Loans to customers, change		1,172,783	(1,812,801)
Other financial assets, change		12,457,011	(2,269,530)
Investment in shares in associated companies		(174,455)	(233,326)
Investment in property, plant and equipment		(108,211)	(264,731)
Net cash provided by (used in) investing activities		13,347,128	(4,580,388)
Cash flows from financing activities:			
Deposits from customers, change		8,575,692	0
Borrowings and debt issued, change		(29,743,242)	6,671,217
Other financial liabilities, change		15,328,495	2,287,753
Subordinated liabilities, change		(14,435)	(14,591)
Dividends paid		(322,203)	(192,575)
Share capital purchased and sold		(147,437)	(222,731)
Cash flows (used in) from financing activities		(6,323,130)	8,529,073
Net increase in cash and cash equivalents		8,253,934	5,083,605
Effects of exchange rate fluctuations on cash held		28,541	528
Cash and cash equivalents at the beginning of the year		7,241,857	2,157,724
Cash and cash equivalents at the end of the year	16,53	15,524,332	7,241,857

The notes on pages 9 to 40 are an integral part of these consolidated financial statements

Notes

General Information

1. **Reporting Entity**

MP Bank hf. is a company incorporated and domiciled in Iceland. The consolidated financial statements as at and for the year ended 31 December 2008 comprise MP Bank hf. (the Parent) and its subsidiaries (together referred to as the "Bank") and the Bank's interest in associates. The address of the Bank is Skipholt 50d in Reykjavík.

MP Bank's main purpose is to offer banking services to individuals, corporates, and institutional investors. The Bank offers services in areas of lending, deposit taking, brokerage services, capital market services, asset management services and fund management.

2. **Basis of preparation**

a. Statement of compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs), as adopted by the European Union.

The consolidated financial statements were approved by the Board of Directors and the CEO on 20 February 2009.

b. Basis of measurement

The consolidated financial statements have been prepared on the historical cost basis except for the following:

- derivative financial instruments are measured at fair value
- financial instruments at fair value through profit or loss are measured at fair value
- securities used for hedging are measured at fair value

c. Functional and presentation currency

These consolidated financial statements are prepared and presented in Icelandic króna (ISK), which is the parent company's functional currency. Except as indicated, financial information has been rounded to the nearest thousand.

Items included in the financial statements of each of the Bank's entities are measured using the functional currency of the respective entity.

d. Use of estimates and judgements

The preparation of the consolidated financial statements in conformity with IFRSs requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities, income and expenses. The estimates and underlying assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying amounts of assets and liabilities that are not readily apparent from other sources, actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

Information about significant areas of estimation uncertainty and critical judgements made by management in applying accounting policies that have the most significant effect on the amounts recognised in the consolidated financial statements is provided in note 34.

Notes

Significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements, and have been applied consistently by the Bank's entities.

3. **Basis of consolidation**

a. Subsidiaries

Subsidiaries are entities controlled by the Bank. Control exists when the Bank has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Control usually exists when the Bank holds more than 50% of the voting power of the subsidiary. In assessing control, potential voting rights that are presently exercisable or convertible, if any, are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

The purchase method of accounting is used to account for the acquisition of subsidiaries by the Bank. The cost of an acquisition is measured as the fair value, at the date of exchange, of the assets given, liabilities incurred or assumed and equity instruments issued, plus cost directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Bank's share of the identifiable net assets acquired is recognised as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised immediately in the income statement.

b. Funds management

The Bank manages and administers assets held in mutual funds on behalf of investors. The financial statements of these funds are not included in these consolidated financial statements.

c. Transactions eliminated on consolidation

Intra-bank balances, income and expenses, and unrealised gains and losses arising from intra-bank transactions, are eliminated in preparing the consolidated financial statements. Unrealised gains arising from transactions with associates are eliminated against the investment to the extent of the Bank's interest in the associate. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

4. **Associates**

Associates are those entities in which the Bank has significant influence, but not control, over the financial and operating policies. Significant influence generally exists when the Bank holds between 20% and 50% of the voting power, including potential voting rights, if any. Investments in associates are initially recognised at cost.

The consolidated financial statements include the Bank's share of the total recognised gains and losses of associates on an equity accounted basis, from the date the significant influence commences until the date it ceases. When the Bank's share of loss exceeds its interest in an associate, the Bank's carrying amount is reduced to zero and recognition of further losses is discontinued except to the extent that the Bank has incurred legal or constructive obligations or made payments on behalf of the associate. If the associate subsequently reports profits, the investor resumes recognising its share of those profits only after its share of the profits equals the share of losses not recognised.

Notes

5. **Foreign currency**

a. Foreign currency transactions

Transactions in foreign currencies are translated into the respective functional currency of the operation at the spot exchange rate ruling on the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated to Icelandic krona (ISK) at the foreign exchange rate ruling at the reporting date. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated at spot exchange rate ruling at the date the fair value was determined.

b. Foreign operations

The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on acquisition, are translated into the presentation currency, Icelandic króna, at spot exchange rate current at the reporting date. The income and expenses of foreign operations are translated into Icelandic krona at the spot exchange rates at the dates of the transactions.

6. **Interest income and expense**

Interest income and expense are recognised in the income statement using the effective interest method. The effective interest rate is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial asset or liability (or, where appropriate, a shorter period) to the carrying amount of the financial asset or liability. When calculating the effective interest rate, the Bank estimates future cash flows considering all contractual terms of the financial instruments but not future credit losses.

The calculation of the effective interest rate includes all fees and points paid or received that are an integral part of the effective interest rate. Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial asset or liability.

Interest income and expense presented in the income statement include:

• Interest on financial assets and liabilities at amortised cost calculated on an effective interest basis
• Interest income and expense on financial assets and liabilities at fair value through profit or loss
• Interest income and expense on derivatives

7. **Fee and commission income and expense**

The Bank provides various services to its clients and earns income from them, such as income from transactions on behalf of third parties, commission from customers for equity and bond transactions and other services.

Fees and commission and expenses that are integral to the effective interest rate on a financial asset or liability are included in the measurement of the effective interest rate.

Other fee and commission income is recognised in the income statement as the services are provided. Fees that are performance-linked are recognised when the performance criteria is fulfilled.

Fee and commission expense relates mainly to transaction and service fees, which are expensed as the services are received.

Notes

8. **Net financial income**

Net financial income is comprised of the following:
- Realised and unrealised gains/losses from price changes of fixed income securities carried at fair value, excluding interest income
- Realised and unrealised gains/losses from price changes of variable income securities
- Dividends, excluding dividends from associates and subsidiaries
- Foreign exchange difference

9. **Dividend income**

Dividend income is recognised when the right to receive income is established. Usually this is the ex-dividend date for equity securities. Dividends are reflected as components of net financial income.

10. **Income tax expense**

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

The deferred income tax liability has been calculated and recognised in the balance sheet. The calculation is based on the difference between balance sheet items as presented in the tax return on one hand, and in the consolidated financial statements on the other, taking into consideration tax losses carried forward. This difference is due to the fact that the tax assessment is based on premises that differ from those governing the consolidated financial statements, mostly due to temporary differences arising from the recognition of revenues and expenses in the tax returns and in the consolidated financial statements.

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

11. **Financial assets measured at fair value**

The Bank classifies certain financial assets upon their initial recognition as financial assets held at fair value with fair value changes recognised in profit or loss if doing so results in more relevant information.

12. **Fair value measurement of financial assets and financial liabilities**

The determination of fair value of financial assets and financial liabilities that are quoted in an active market is based on quoted prices. A market is considered active if quoted prices are readily and regularly available and those prices represent actual and regularly occurring market transactions on an arm's length basis. For all other financial instruments fair value is determined by using valuation techniques.

Valuation techniques include recent arm's length transactions between knowledgeable, willing parties, if available, reference to the current fair value of other instruments that are substantially the same, the discounted cash flow analysis and option pricing models. Valuation techniques incorporate all factors that market participants would consider in setting a price and are consistent with accepted methodologies for pricing financial instruments. Periodically, the Bank calibrates the valuation technique and tests it for validity using prices from any observable current market transactions in the same instrument, without modification or repackaging, or based on any available observable market data.

Notes

For more complex instruments, the Bank uses proprietary models, which are usually developed from recognised valuation models. Some or all of the inputs into these models may not be market observable, and are derived from market prices or rates or are estimated based on assumptions. When entering into a transaction, the financial instrument is recognised initially at the transaction price, which is the best indicator of fair value, although the value obtained from the valuation model may differ from the transaction price. This initial difference, usually an increase in fair value, indicated by valuation techniques is recognised in income depending upon the individual facts and circumstances of each transaction and not later than when the market data becomes observable.

The value produced by a model or other valuation technique is adjusted to allow for a number of factors as appropriate, because valuation techniques cannot appropriately reflect all factors market participants take into account when entering into a transaction. Valuation adjustments are recorded to allow for model risks, bid-ask spreads, liquidity risks, as well as other factors. Management believes that these valuation adjustments are necessary and appropriate to fairly state financial instruments carried at fair value on the balance sheet.

13. **Recognition and derecognition of financial assets and liabilities**

a. Recognition

The Bank initially recognises loans, deposits, debt securities issued and subordinated liabilities on the date that they are originated. All other financial assets and liabilities (including assets and liabilities designated at fair value through profit or loss) are initially recognised on the trade date at which the Bank becomes a party to the contractual provisions of the instrument.

b. Derecognition

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

Financial liabilities are recognised when the Bank becomes a party to the contractual provisions of the liability instrument. Financial liabilities are derecognised when the obligation of the Bank is discharged or cancelled or expires.

14. **Offsetting financial assets and liabilities**

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

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

15. **Amortised cost measurement of financial assets and financial liabilities**

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

16. **Cash and cash equivalents**

Cash and cash equivalents consist of cash, balances with banks and unrestricted balances with Central Bank.

Notes

17. **Derivatives**

Derivative is a financial instrument or other contract within the scope of IAS 39, the value of which changes in response to a change in an underlying variable such as share, commodity or bond prices, an index value or an exchange or interest rate, which requires no initial net investment or initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors and which is settled at a future date.

The Bank uses derivatives for trading purposes and to hedge its exposure to market price risk, foreign exchange risk and interest risk arising from operating, financing and investing activities.

Derivative assets and liabilities are initially recognised and subsequently measured at fair value in the balance sheet. Fair value changes of derivatives are split into interest income and net income from financial instruments at fair value and presented in the corresponding line items in the income statement.

18. **Fixed income securities**

Fixed income securities consist of bonds, which are initially and subsequently measured at fair value with fair value changes recognised in the income statement as financial income. Interests on fixed income securities are recognised as interest income in the income statement. Fixed income securities are either classified as held-for-trading or designated at fair value through profit or loss.

19. **Shares and other variable income securities**

Shares and other variable income securities consist of equity investments and unit shares in mutual funds. These investments are initially and subsequently recognised at fair value with price changes recognised in the income statement. Price changes and dividends received are recognised as financial income in the income statement.

20. **Securities used for hedging**

Securities used for hedging consist of non-derivative financial assets that are used to hedge the Bank's risk exposure arising from derivative contracts with customers.

21. **Loans**

Loans are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and advances include loans provided by the Bank to its customers, participation in loans from other lenders and purchased loans that are not quoted in an active market and which the Bank has no intention of selling immediately or in the near future.

When the Bank purchases a financial asset and simultaneously enters into an agreement to resell the asset (or a substantially similar asset) at a fixed price on a future date (“reverse repo or stock borrowing”), the arrangement is accounted for as a loan and the underlying asset is not recognised in the Bank’s financial statements.

Loans are initially recognised at fair value, which is the cash advanced, plus any transaction costs. Subsequently, they are measured at amortised cost using the effective interest method. Accrued interest is included in the carrying amount of the loans and advances.

Notes

22. **Impairment**

The carrying amount of the Bank's financial assets not at fair value through profit and loss, is reviewed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated. An impairment is recognised in the income statement whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount.

a. Impairment on loans

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

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

(i) significant financial difficulty of the borrower;
(ii) a breach of contract, such as a default on instalments or on interest or principal payments;
(iii) the Bank granting to the borrower, for economic or legal reasons relating to the borrower's financial difficulty, a refinancing concession, that the lender would not otherwise consider;
(iv) it becomes probable that the borrower will enter bankruptcy or undergo other financial reorganisation;
(v) the disappearance of an active market for that financial asset because of financial difficulties; or
(vi) observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of loans, even if the decrease cannot yet be identified with the individual financial assets in the group, including:
- adverse changes in the payment status of borrowers in the group; or
- general national or local economic conditions connected with the assets in the group.

Individually assessed loans

Impairment losses on individually assessed loans are determined by an evaluation of the exposures on a case-by-case basis. At each balance sheet date, the Bank assesses whether there is any objective evidence that individual loans are impaired. This procedure is applied to all loans that are considered individually significant. In making the assessment, the following factors are considered:
• the Bank's aggregate exposure to the customer;
• the amount and timing of expected receipts and recoveries;
• the likely dividend available on liquidation or bankruptcy;
• the complexity of determining the aggregate amount and ranking of all creditor claims and the extent to which legal and insurance uncertainties are evident;
• the realisable value of security (or other credit mitigants) and likelihood of successful repossession; and
• the likely deduction of any costs involved in recovery of amounts outstanding.

Impairment loss is calculated by comparing the carrying amount of individual loans with the present value of their expected future cash flows, discounted at their original effective interest rate. In the case of loans at variable interest rates, the discount rate used is their current effective interest rate. The carrying amount of impaired loans is reduced through the use of an allowance account.

Collectively assessed loans

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

Notes

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

Estimates of changes in future cash flows for groups of assets are consistent with changes in observable data from period to period, for example changes in property prices, payment status, or other factors indicative of changes in the probability of losses on the group and their magnitude. The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Bank to minimise any differences between loss estimates and actual losses.

Loan write-offs
Loans are written off, partially or in full, when there is no realistic prospect of recovery.

b. Reversal of impairment

If, in a subsequent period, the amount of an impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is recognised as revenue in the income statement.

c. Calculation of recoverable amount

The recoverable amount of the Bank's investments in financial assets carried at amortised cost is calculated as the present value of estimated future cash flows, discounted at the original effective interest rate.

The recoverable amount of other assets is the greater of their fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

23. **Property and equipment**

a. Recognition and measurement

Items of property and equipment are measured at cost less accumulated depreciation and impairment losses.

Where parts of an item of property and equipment have different useful lives, those components are accounted for as separate items of property and equipment.

b. Subsequent costs

The Bank recognises in the carrying amount of an item of property and equipment the cost of replacing part of such an item when that cost is incurred if it is probable that the future economic benefits embodied with the item will flow to the Bank and the cost of the item can be measured reliably. The decision, if subsequent costs are added to the acquisition cost of property and equipment, is based on whether an identified component, or part of such component, has been replaced or not, or if the nature of the subsequent cost means a contribution of a new component. All other costs are expensed in the income statement when incurred.

c. Depreciation

Depreciation is recognised in the income statement on a straight-line basis over the estimated useful lives of each component of an item of property and equipment. The estimated useful lives are as follows:

Real estate	50 years
Office equipment and fixtures	3-5 years

Depreciation methods, useful lives and residual value are reassessed annually.

Notes

24. **Short positions in listed securities**

Short positions are carried at fair value with all fair value changes recognised in the income statement.

25. **Deposits**

Deposits consist of time deposits and demand deposits. Deposits are recognised at amortised cost, including accrued interests.

26. **Borrowings**

The Bank's borrowings consist primarily of loans from banks (including "repo" transactions) and issued bonds and bills which are listed.

When the Bank sells a financial asset and simultaneously enters into a “repo” or “stock lending” agreement to repurchase the asset (or a similar asset) at a fixed price on a future date, the arrangement is accounted for as a deposit, and the underlying asset continues to be recognised in the Bank’s financial statements.

Borrowings are initially recognised at fair value less attributable transaction costs. Subsequently, they are measured at amortised cost using the effective interest method. Accrued interest is included in their carrying amount.

27. **Subordinated liabilities**

Subordinated liabilities are bonds issued by the Bank with subordinated terms. Subordinated liabilities have the characteristics of equity in being subordinated to other liabilities of the Bank. In the calculation of equity ratio, these bonds are included in equity, as shown in note 35. The loans are recognised as liabilities with accrued interest and indexation at year-end.

Subordinated liabilities are initially recognised at fair value less attributable transaction costs. Subsequently, they are measured at amortised cost using the effective interest method. Accrued interest is included in their carrying amount.

28. **Tax liabilities**

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

Deferred tax is provided for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

Notes

29. **Other liabilities**

Other liabilities are measured at cost.

30. **Financial guarantees**

Financial guarantees are contracts that require the Bank to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument.

Financial guarantee liabilities are initially recognised at their fair value, and initial fair value is amortised over the life of the financial guarantee. The guarantee liability is subsequently carried at the higher of this amortised amount and the present value of any expected payment, when a payment under the guarantee has become probable. Financial gurantees are included within other liabilities.

31. **Employee benefits**

a. Defined contribution plans

Obligations for contribution to pension plans are recognised as an expense in profit or loss when they are due.

b. Share-based payment transactions

The parent company has entered into stock option contracts with its employees, which enable them to acquire shares in the parent company at an exercise price corresponding to the fair value of the shares at grant date. The grant date fair value of options granted to employees is recognised as an employee expense, with a corresponding increase in equity, over the period in which the employees become unconditionally entitled to the options. The amount recognised as an expense is adjusted to reflect the actual number of share options that vest.

c. Treasury shares stated as other liability on account of put options

When the parent company sells treasury shares to its employees with put options - i.e., the right to sell the shares back to the parent company at the purchase price - equity is not increased. Equity will be increased if the put option is not exercised. In the consolidated financial statements the nominal value of share capital and share premium is increased, but options reserve decreased. The value is classified as a liability among other liabilities.

d. Fair value of share-based payments

The fair value of services received in return for share options granted is measured by reference to the fair value of share options granted. The estimate of the fair value of the services received is measured based on the Black-Scholes formula. Measurement instruments include share price on measurement date, exercise price of the instrument, expected volatility (based on weighted average volatility adjusted for changes expected due to publicly available information), weighted average expected life of the instruments (based on historical experience and general option holder behaviour), expected dividends, and the risk-free interest rate (based on government bonds). Expectations of early exercise are not incorporated into the Black-Scholes formula.

32. **Share capital**

a. Treasury shares

Acquired own shares and other equity instruments (treasury shares) are deducted from equity. No gain or loss is recognised in income statement on the purchase, sale, issue or cancellation of treasury shares. Consideration paid or received is recognised directly in equity.

Incremental transaction costs of treasury share transactions are accounted for as a deduction from equity, net of any related income tax benefit.

Notes

When classifying a financial instrument, or component of it, in the consolidated financial statements, all terms and conditions agreed between the Bank and the holders of the instrument are considered. To the extent there is an obligation that would give rise to a financial liability, the instrument is classified as financial liability, rather than an equity instrument.

When share capital is repurchased, the amount of the consideration paid, including directly attributable costs, is recognised as a change in capital.

b. Share premium

Share premium represents excess of payment above nominal value (ISK 1 per share) that shareholders have paid for shares sold by the Bank. According to the Icelandic Companies Act, 25% of the nominal value of share capital must be held in reserve which can not be paid out as dividend to shareholders.

c. Translation reserve

Foreign exchange differences arising on translation of financial statements of foreign operations are recognised directly in a separate component of equity. When a foreign operation is disposed of, in part or in full, the relevant amount in the translation reserve is transferred to profit or loss.

d. Option reserve

The reserve includes the accrued part of the fair value of share options. This reserve is reversed if share options are exercised or forfeited.

e. Dividends on share capital

Dividends on share capital are deducted from equity in the period in which they are approved by the Bank's shareholders.

f. Earnings per share

The Bank presents basic and diluted earnings per share (EPS) data for its shares. Basic EPS is calculated by dividing the profit or loss by weighted average number of shares outstanding during the period. Diluted EPS is determined by adjusting the profit or loss for the effects of all dilutive potential shares, which comprise share options granted to employees.

33. **New standards and interpretations**

The Bank has adopted all IFRSs, interpretations and amendments to existing standards that are applicable for the year ended 31 December 2008 and relevant to the Bank. The Bank has not adopted early any IFRSs, interpretations or amendments effective after 31 December 2008.

Amounts are in ISK '000

Notes

34. **Critical accounting estimates and judgements in applying accounting policies**

The Bank makes estimates and assumptions that affect the reported amounts of assets and liabilities within the financial year. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

a. Impairment losses on loans

The management reviews its loan portfolios to assess impairment at least every three months. In determining whether an impairment loss should be recorded in the income statement, the Bank makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there have been changes in the payment status of borrowers in a group or economic conditions. Management uses estimates based on historical loss experience for assets with similar credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

b. Fair value of financial instruments

The fair value of financial instruments that are not quoted in active markets are determined by using valuation techniques which are reviewed regularly by qualified independent personnel. All models that are used must be approved and calibrated to ensure that outputs reflect actual data.

c. Financial asset and liability classifications

The Bank's accounting policies provide scope for assets and liabilities to be designated on inception into different accounting categories in certain circumstances.

In designating financial assets or liabilities at fair value through profit and loss, the Bank has determined that it has met one of the criteria for this designation set out in accounting policy.

35. **Capital management and allocation**

a. Regulatory capital

Equity at the end of the year amounted to ISK 6,624 million, equivalent to 12.4% of total assets according to the balance sheet. The capital adequacy ratio of the Bank, calculated in accordance to Article 84 of the Act on Financial Undertakings, is 22.3%. The minimum requirement according to that Act is 8.0%. The ratio is calculated as follows:

	31.12.2008
Capital requirements for:	
Credit risk	1,059,198
Market risk	856,273
Operational risk	465,330
Total risk base	2,380,801
Tier 1 capital:	
Recorded capital	6,624,006
Total capital	6,624,006
Surplus capital	4,243,205
Solvency ratio	22.3%

Notes

b. Capital management

It is the Bank's policy to maintain a strong capital base to support the development of its business and to meet regulatory capital requirements at all times. The Bank recognises the impact on shareholder returns of the level of equity capital employed within the Bank and seeks to maintain a prudent balance between the advantages and flexibility afforded by a strong capital position and the higher returns on equity possible with greater leverage.

Capital planning is discussed regularly within the Board of Directors as the Bank’s policy is to hold a strong capital base from diverse sources. The Banks makes continuous estimates and assumptions regarding e.g. economic, business and financial conditions that affect the capital plan as well as the quantification of risks factor.

The principal forms of capital are included in the following balances on the consolidated balance sheet: share capital, share premium, other reserves, retained earnings, and subordinated liabilities. Capital also includes the collective impairment allowances held in respect of loans and advances.

The Icelandic Financial Supervisory Authority (FME) supervises the Bank on a consolidated basis and, as such, receives information on the capital adequacy of, and sets capital requirements for, the Bank as a whole.

36. **Risk management disclosure**

The purpose of the risk management and credit control unit is to identify, quantify, control and report on the risks that the Bank is exposed to in its daily activities. The unit also participates in drafting the overall risk policy of the Bank and has representatives on the finance committee, the credit committee and the security and IT committee. The unit’s main activities include monitoring and managing credit risk, market risk, liquidity risk and operational risk. The board of directors sets the rules and guidelines regarding the Bank's risk policy and the obligations of risk Management and credit control. The division reports regularly to the board of directors, the CEO and to the finance committee on the Bank’s positions and exposure to risk.

Committees

The Bank operates a finance committee, a credit committee and a security and IT committee; all chaired by the CEO.

On the Bank's finance committee are the CEO, the heads of risk management, treasury, business development, accounting and legal department and other employees as determined by the CEO. The finance committee meets regularly and each department reports on its operations and positions activity since the previous meeting. The committee addresses matters regarding the Bank's risk management, financing, capital management and proprietary trading.

The Credit Committee consists of the Bank’s CEO, the heads of Risk Management and Credit Control, Treasury, Business Development and Legal Department. The CEO shall decide whether any other employees should attend the meetings. The committee addresses matters regarding the Bank's loan activities and is the primary forum for any discussion of the Bank’s loan activity policy. The committee is responsible for the approval of individual loans as well as deciding on credit limits for individual clients in derivative trades.

Security and IT Committee is the main forum for discussions and decision regarding Operational risk, Security and IT systems. The committee consist of Bank’s CEO, IT manager, Office Manager, the heads of Risk Management and Credit Control, Business Development and Legal Department.

Notes

37. **Credit risk**

One of the Bank's primary sources of risk is credit risk. Counterparty credit risk means that if one or more borrowers fail to meet their financial obligations towards the Bank, the Bank has to recognise losses due to these defaults. To a very large extent the Bank's loan portfolio consists only of senior loans, most of which are highly collateralized.

a. Credit approval process

The originating department prepares a proposal for each loan or credit line which is presented to the credit committee for approval. The proposal consists of a basic description of the client, the purpose of the loan, a simple credit assessment and arguments for or against granting the loan. The committee decides whether there is need for further credit assessment and on what terms the loan may be granted. Further credit assessment may be conducted internally by the Bank or by third party.

b. Credit collateral

The Bank places emphasis on ensuring that loans are secured with collateral that can be marked to market, and that asset coverage exceeds 100%, e.g. senior I loans. The Bank applies appropriate haircuts on all collateral in listed securities in order to ensure proper risk mitigation. For all collateral in listed securities, the Bank maintains the right to liquidate collateral in case its market value falls below the predefined limit.

c. Credit rating, control and provisioning

The Risk Management and Credit Control unit is responsible for credit rating and reviewing the loan portfolio. In case of any significant delay of payments or defaults the unit carefully analyses the underlying assets and loan documents and organizes the process of collection.

The Bank monitors the value of collateral by listed securities on a real time basis, ensuring that prompt action can be taken if necessary.

General provisioning for loan impairments is decided based upon an assessment of the portfolio as a whole based on the seniority of the loans, the degree of collateralisation and the Bank's history of defaulted loans. Risk Management and Credit Control suggest a general provisioning percentage for the portfolio. Risk Management and Credit Control reassess impairments in the event of collateral decay, delayed payments or other early warning signs. Furthermore, the division prepares proposals for specific provisioning and keeps track of results from outsourced collecting activities. All provisions require approval by the CEO, CFO and the Credit Committee.

d. Loan portfolio management

To ensure an effective diversification of the loan portfolio the Board has set a limit framework defining maximum exposure as a ratio of the Bank's equity and/or the total size of the loan portfolio. These limits include limitation on joint exposure to associated clients, exposure to individual and associated industries, single regions and countries etc. It is the responsibility of risk management and credit control to monitor that these limits are not being violated and to report discrepancies to the Credit Committee.

Amounts are in ISK '000

Notes

e. Maximum exposure to credit risk

The following table presents the maximum exposure to credit risk of on balance sheet and off balance sheet financial instruments, before taking account of any collateral held or other credit enhancements.

	2008	2007
Cash and cash equivalents	15,524,332	7,241,857
Loans to Central Bank	5,011,885	0
Derivatives	1,419,923	1,380,422
Fixed income securities	9,626,049	17,205,899
Securities used for hedging	7,337,259	10,418,582
Loans to customers	10,310,113	9,599,516
Receivables and prepayments	1,525,676	1,627,276
Total	50,755,237	47,473,552

f. Breakdown of financial assets not at fair value

Financial assets not measured at fair value, exposed to credit risk, are summarised below:

	Neither past due nor impaired	Past due but not impaired	Impaired	Gross	Less: allowance for impairment	Net carrying amount
31 December 2008						
Cash and cash equivalents	15,458,806	0	655,228	16,114,034	(589,702)	15,524,332
Loans to banks	1,873,523	0	0	1,873,523		1,873,523
Loans to individuals	1,520,728	482,866	11,999	2,015,593	(11,999)	2,003,594
Corporate loans	6,518,431	14,565	1,383,720	7,916,716	(1,483,720)	6,432,996
Other assets	1,460,359	65,317	149,175	1,674,851	(149,175)	1,525,676
Total	26,831,847	562,748	2,200,122	29,594,717	(2,234,596)	27,360,121
31 December 2007						
Cash and cash equivalents	7,241,857			7,241,857		7,241,857
Loans to banks	2,281,327			2,281,327		2,281,327
Loans to individuals	1,670,991		8,684	1,679,675	(42,756)	1,636,919
Corporate loans	5,681,270			5,681,270		5,681,270
Other assets	1,627,276			1,627,276		1,627,276
Total	18,502,721	0	8,684	18,511,405	(42,756)	18,468,649

Past due but not impaired financial assets are those assets where contractual payments are past due but the Bank believes that impairment is not appropriate on the basis of the level of security or collateral available. Past due loans are reported as the total loan and not only the payments that are past due.

Amounts are in ISK '000

Notes

g. Gross amount of financial assets that were past due but not impaired were as follows:

	Past due up to 30 days	Past due 31-60 days	Past due 61-90 days	Over 90 days	Total	Fair value of collateral
31 December 2008						
Loans to individuals		128,829		354,036	482,865	166,228
Corporate loans	14,565				14,565	7,844
Others			65,318		65,318	
Total	14,565	128,829	65,318	354,036	562,748	174,072

h. Breakdown of the loan portfolio by industry sectors:

	Individuals	Holding companies	Services	Other	Total
31 December 2008	2,003,594	5,714,787	718,209	1,873,523	10,310,113
31 December 2007	1,636,919	3,458,995	2,222,274	2,281,328	9,599,516

i. Breakdown of loans by seniority

The Bank's loan portfolio mainly consists of senior I loans which are secured with collateral which can be marked to market, and have asset coverage exceeding 100% and senior II loans which have first priority claims on all of the borrower's assets, and in some cases additional collateral such as unlisted shares and other collateral which cannot be marked to market. The loan portfolio contains less than 25% of junior loans which have second line claims on the borrower's assets and no mezzanine loans where the loan is unsecured and subordinated to all of the borrower's liabilities.

j. The Bank obtained assets by taking possession of collateral held as security, as follows:

	2008	2007
Equities	1,576	0
Total	1,576	0

Amounts are in ISK '000

Notes

38. **Liquidity risk**

Liquidity risk is the risk that the Bank will encounter difficulty in meeting contractual payment obligations associated with its financial liabilities, or will only be able to do so substantially above the prevailing market cost of funds. The risk mainly arises from mismatches in the timing of cash flows. The Bank has internal rules that require certain matching of the maturities of assets and liabilities. Furthermore, to ensure the sufficiency of funds, the Bank has lines of credit, overdraft facilities and highly liquid securities such as treasury bills and treasury bonds.

Liquidity is managed by treasury and monitored by risk management. Liquidity position is reported to the finance committee. The Bank is subject to the Central Bank's requirements about minimum coverage ratio between cash flows of assets and liabilities. At the end of the year 2008, the Bank was in compliance with external liquidity requirements.

The following table shows the Bank's contractual maturity profile at 31 December 2008 and 31 December 2007, including both on and off balance sheet items. The analysis is based on the period remaining until the contractual maturity according to the requirements under IFRS 7.

2008	0-1 month	1 to 3 months	3-12 months	1-5 years	Over 5 years	No stated maturity	Total
Assets:							
Cash and cash equivalents	15,524,332						15,524,332
Loans to Central Bank		5,011,885					5,011,885
Derivatives	1,419,923						1,419,923
Fixed income securities	1,190,632	964,877	577,767	2,831,458	4,061,315		9,626,049
Shares and other variable income securities	640,825						640,825
Securities used for hedging	1,707,823		40,335	886,051	4,703,050		7,337,259
Loans to customers	2,831,700	1,304,667	3,418,570	1,695,289	1,059,887		10,310,113
Other assets	1,525,676						1,525,676
Total	24,840,911	7,281,429	4,036,672	5,412,798	9,824,252	0	51,396,062
Liabilities:							
Short positions	1,024,989	0	5,990,610	6,517,551	2,291,929		15,825,079
Securities used for hedging	2,478	0	1,876,179	2,727,168	607,124		5,212,949
Derivatives	20,145	9,982					30,127
Deposits	7,330,213	755,248	490,231				8,575,692
Borrowings	9,419,609	1,718,135	734,255	1,752,595			13,624,594
Subordinated liabilities				29,411			29,411
Current tax liabilities			11,435				11,435
Deferred tax liabilities						17,895	17,895
Other liabilities	3,426,625						3,426,625
Total	21,224,059	2,483,365	9,102,710	11,026,725	2,899,053	17,895	46,753,807
Assets - Liabilities	3,616,852	4,798,064	(5,066,038)	(5,613,927)	6,925,199	(17,895)	4,642,255

Amounts are in ISK '000

Notes

2007	0-1 month	1 to 3 months	3-12 months	1-5 years	Over 5 years	No stated maturity	Total
Assets:							
Cash and cash equivalents	7,241,857						7,241,857
Derivatives	783,535	433,660	8,874	154,353			1,380,422
Fixed income securities	17,205,899						17,205,899
Shares and other variable income securities	3,453,562						3,453,562
Securities used for hedging	4,895,103	4,568,587	954,892				10,418,582
Loans to customers	1,315,231	3,046,237	3,395,028	1,817,141	25,879		9,599,516
Other assets	1,627,276						1,627,276
Total	36,522,463	8,048,484	4,358,794	1,971,494	25,879	0	50,927,114
Liabilities:							
Short positions	5,709,533						5,709,533
Derivatives	148,090	109,855	16,043				273,988
Borrowings	19,738,560	9,617,751	2,513,673	5,208,842	209,715		37,288,541
Subordinated liabilities				43,846			43,846
Current tax liabilities	187,594						187,594
Deferred tax liabilities						193,863	193,863
Other liabilities	2,664,227						2,664,227
Total	28,448,004	9,727,606	2,529,716	5,252,688	209,715	193,863	46,361,592
Assets - Liabilities	8,074,459	(1,679,122)	1,829,078	(3,281,194)	(183,836)	(193,863)	4,565,522

39. **Currency risk**

Currency risk arises when financial instruments are not denominated in the reporting currency and can both affect the Bank's income and balance sheet. A large part of the Bank's financial assets and liabilities is denominated in foreign currencies. Any mismatch between assets and liabilities in each currency is monitored closely and managed within limits. Currency positions are monitored by risk management and reported to the finance committee. The Bank is subject to limits set by the Central Bank of Iceland regarding the maximum open currency position. At 31 December 2008 the Bank's long position in foreign currencies exceeded those limits as a result of the liquidation status of the Bank's counterparties in forward foreign exchange contracts. Contracts that terminated on 8 October 2008 due to the liquidation status of the counterparties are calculated according to closing prices as of that date. The Central Bank has been informed about this and due to the abnormal market situation will not take any actions. The Bank has taken measures to gradually reduce the open currency position below the statutory requirements.

Amounts are in ISK '000

Notes

The table below summarises the Bank's exposure to currency risk at 31 December 2008 and the comparable figures for 31 December 2007.

Breakdown of assets and liabilities by currency:

2008	EUR	LTL	USD	UAH	Other	Total
Assets:						
Cash and cash equivalents	1,045,239	18,275	579,996	25,818	356,611	2,025,939
Derivatives	805,876	125,399	134,714	0	49,737	1,115,726
Fixed income securities	5,085			944,912	385,877	1,335,875
Shares & other variable income securities	169,123	27,744	194,677	1,349	34,121	427,014
Securities used for hedging	215,548	165,274	42,250	456	265,585	689,112
Loans to customers	1,834,324	398,345	850,988	1,329,436	739,581	5,152,674
Investments in associates		164,833				164,833
Property and equipment		400,931				400,931
Other assets		11,545				11,545
Total	4,075,195	1,312,346	1,802,625	2,301,971	1,831,513	11,323,649
Liabilities:						
Short positions	184,625	92,710	134,473		138,010	549,818
Securities used for hedging	2,478					2,478
Derivatives	30,127					30,127
Deposits from customers	1,217,352		46,655		50,175	1,314,182
Borrowings	3,457,895					3,457,895
Other liabilities		8,758				8,758
Total	4,892,477	101,468	181,128	0	188,185	5,363,257
Net balance sheet position	(817,282)	1,210,878	1,621,497	2,301,971	1,643,328	5,960,392
Net off balance sheet position	(14,475)	(39,873)	54,225	0	(187,814)	(187,936)
Net position	(831,757)	1,171,005	1,675,722	2,301,971	1,455,514	5,772,456

2007	EUR	LTL	USD	UAH	Other	Total
Assets:						
Cash and cash equivalents	719,311	67,695	376,716		263,523	1,427,245
Derivatives	210,238	42,744	110,780	1,781	273,695	639,238
Fixed income securities					578,637	578,637
Shares & other variable income securities	1,084,808	467,448	441,949	8,908	209,382	2,212,495
Securities used for hedging	2,765,974		810,130		2,116,918	5,693,022
Loans to customers	1,923,041	1,695,149	1,780,480	1,083,389	734,857	7,216,916
Total	6,703,372	2,273,036	3,520,055	1,094,078	4,177,012	17,767,553
Liabilities:						
Derivatives	73,750	1,183	16,986		16,892	108,811
Borrowings	6,440,121	209,716	1,971,136		1,136,707	9,757,680
Total	6,513,871	210,899	1,988,122	0	1,153,599	9,866,491
Net balance sheet position	189,501	2,062,137	1,531,933	1,094,078	3,023,413	7,901,062
Net off balance sheet position	(288,061)	(1,437,398)	(1,757,692)	(1,392,166)	(2,423,858)	(7,299,175)
Net position	(98,560)	624,739	(225,759)	(298,088)	599,555	601,887

Amounts are in ISK '000

Notes

40. **Interest rate risk**

The Bank's exposure to interest rate risk is twofold. On one hand, the Bank has a proprietary portfolio of bonds, where market rates affect prices and any fluctuations are recognised in the income statement. On the other hand, the Bank has mismatch in assets and liabilities with fixed interest terms in the banking book. The banking book generally pertains to the Bank's loans on the asset side and borrowings and deposits on the liability side. This mismatch does not create immediate effect on the income statement but nevertheless affects the Bank's economic value.

The Bank takes measures to minimise interest rate risk in the banking book by matching the interest rate profile and duration of assets with the Bank’s liabilities. This is obtained in part by matching the currency and duration of the funding of the Bank with its assets, as well as using derivative and non-derivative financial instruments to manage effectively the risk of an adverse impact on the Bank’s earnings. For this purpose, a number of different derivatives are used, including forward currency contracts, currency swaps and interest rate swaps. Proprietary positions which are subject to interest rate risk fall under the scope of the Bank's market risk management.

The table below breaks down assets and liabilities in the banking book according to their interest repricing time, in each currency:

31 December 2008	ISK	EUR	LTL	USD	CHF	Other	Total
Assets:							
0-1 year	5,453,054	4,223,382	568,573	165,164	204,139	495,746	11,110,058
1-2 years	313,127					206,367	519,494
2-3 years	2,944			59,476	109,695	48,238	220,353
3-4 years				506,253	174,283	192,506	873,042
over 4 years				214,711		927,574	1,142,285
Total	5,769,125	4,223,382	568,573	945,604	488,117	1,870,431	13,865,232
Liabilities:							
0-1 year	15,675,614	4,682,243		46,655		50,175	20,454,687
1-2 years	1,752,595						1,752,595
Total	17,428,209	4,682,243	0	46,655	0	50,175	22,207,282
Net interest rate gap	(11,659,084)	(458,861)	568,573	898,949	488,117	1,820,256	(8,342,050)

Amounts are in ISK '000

Notes

41. **Market risk**

Market risk constitutes risk due to changes in market prices of instruments and interest rates. The Bank has a strict policy on controlling the market risk and to keep the exposure within the limit framework. The risk management unit follows the market risk limits daily and reports regularly to the finance committee and to the CEO.

a. Market price risk
Market price risk arises from changes in the market values of equities in the Bank's portfolio, the size of which varies greatly. The Bank invests primarily in equities listed on regulated securities markets, but has also invested in unlisted equities and bonds. The Bank's risk is the general risk involved in investing in equities. Efforts are made to reduce this risk through active risk management. The risk management monitors the market price risk and reports regularly to the finance committee and to the CEO.

b. Interest rate risk associated with proprietary positions is summarised below. The table shows proprietary positions broken down by remaining maturity, or time until interest rate reset, if shorter.

31 December 2008	< 1 year	1-3 years	3-5 years	5-7 years	> 7 years	Total
Assets:						
Bonds, ISK indexed	574,780	1,889,779		3,533,250	512,933	6,510,742
Bonds, ISK non-indexed	1,764,300			15,133		1,779,433
Bonds in foreign currencies	394,196	299,737	641,941			1,335,874
Derivatives	1,419,923					1,419,923
Total	4,153,199	2,189,516	641,941	3,548,383	512,933	11,045,972
Liabilities:						
Bonds ISK indexed					61,870	61,870
Bonds ISK non-indexed	5,990,610	3,835,749	2,681,802	2,230,057		14,738,218
Derivatives	30,127					30,127
Total	6,020,737	3,835,749	2,681,802	2,230,057	61,870	14,830,215
31 December 2007						
Assets:						
Bonds, ISK indexed	2,537,575	3,029,096	5,351,139		3,665,948	14,583,758
Bonds, ISK non-indexed	1,161,237		882,268			2,043,505
Bonds in foreign currencies	244,373	334,263				578,636
Derivatives	1,226,069	154,353				1,380,422
Total	5,169,254	3,517,712	6,233,407	0	3,665,948	18,586,321
Liabilities:						
Bonds ISK indexed	457,724					457,724
Bonds ISK non-indexed		1,718,287		1,194,808	2,338,714	5,251,809
Derivatives	273,988					273,988
Total	731,712	1,718,287	0	1,194,808	2,338,714	5,983,521

Amounts are in ISK '000

Notes

42. **Exposure to inflation**

The Bank is exposed to Icelandic inflation since Consumer Price Index (CPI) indexed assets exceed CPI indexed liabilities. All indexed assets and liabilities are valued according to the CPI measure at any given time and changes in CPI are therefore recognised in the income statement as interest. The balance of CPI linked assets and liabilities is specified as follows:

	31.12.2008	31.12.2007
Icelandic government bonds	5,166,311	9,277,306
Debt securities	1,344,431	4,848,728
Cash equivalents	902,095	734,851
Liabilities	(2,963,279)	(2,718,291)
Derivative contracts	0	(2,114,290)
Net inflationary position	4,449,558	10,028,304

43. **Operational risk**

The risk involved in the Bank's operations is primarily linked to the risks inherent in each type of security in which the Bank invests, although there are a considerable number of other factors which can also affect its operations and performance, such as employee negligence, violations of rules, problems with information systems and loss of key personnel. The Bank's reputation may be damaged, either for the above reasons or as a result of other factors which are difficult to control. MP Bank hf. could suffer losses as the result of an incorrect analysis of investment options, whilst a failure of the Bank's information systems could result in losses which the company would have to cover and thereby affect its performance. A situation could arise where key personnel decide to resign and take up a position with a competitor, potentially resulting in the loss of both important expertise and clients. Decisions by the Bank's personnel in connection with specific investments are extremely important for the Bank's performance.

Operational risk can be reduced through staff training, process re-design and enhancement of the control environment. The risk management and credit control unit monitors the operational risk by tracking loss events, quality deficiencies, potential risk indicators and other early-warning signals. The unit takes an active role in internal control and quality management.

44. **Hedging**

A part of the Bank's portfolio consists of securities held as a hedge against derivatives positions of customers. Mismatches in currency exposure between the Bank's loan portfolio and debts are hedged using forward contracts on currencies to reduce risk from adverse movements in foreign exchange rates.

Amounts are in ISK '000

Notes

45. **Financial assets and liabilities - Accounting classification**

The table below sets out the Bank's classification of each class of financial assets and liabilities.

2008	Trading	Designated at fair value	Loans and receivables	Other at amortised cost	Total carrying amount	Fair value
Assets:						
Cash and cash equivalents				15,524,332	15,524,332	15,524,332
Derivatives	1,419,923				1,419,923	1,419,923
Fixed income securities	8,293,594	1,332,455			9,626,049	9,626,049
Shares & other variable income securities	640,825				640,825	640,825
Securities used for hedging	7,337,259				7,337,259	7,337,259
Loans to customers			10,310,113		10,310,113	
Other assets			1,525,676		1,525,676	
Total	17,691,601	1,332,455	11,835,789	15,524,332	46,384,177	
Liabilities:						
Short positions in listed securities	15,825,079				15,825,079	15,825,079
Securities used for hedging	5,212,949				5,212,949	5,212,949
Derivatives	30,127				30,127	30,127
Deposits from customers				8,575,692	8,575,692	
Borrowings				13,624,594	13,624,594	
Subordinated liabilities				29,411	29,411	
Current tax liabilities				11,435	11,435	
Deferred tax liabilities				17,895	17,895	
Other liabilities				3,426,625	3,426,625	
Total	30,127	0	0	25,685,652	25,715,779	

2007	Trading	Designated at fair value	Loans and receivables	Other at amortised cost	Total carrying amount	Fair value
Assets:						
Cash and cash equivalents				7,241,857	7,241,857	7,241,857
Derivatives	1,380,422				1,380,422	1,380,422
Fixed income securities	14,671,580	2,534,319			17,205,899	17,205,899
Shares & other variable income securities	3,453,562				3,453,562	3,453,562
Securities used for hedging	10,418,582				10,418,582	10,418,582
Loans to customers			9,599,516		9,599,516	
Other assets			1,627,276		1,627,276	
Total	29,924,146	2,534,319	11,226,792	7,241,857	50,927,114	
Liabilities:						
Short positions in listed securities	5,709,533				5,709,533	5,709,533
Derivatives	273,988				273,988	273,988
Borrowings				37,288,541	37,288,541	
Subordinated liabilities				43,846	43,846	
Current tax liabilities				187,594	187,594	
Deferred tax liabilities				193,863	193,863	
Other liabilities				2,664,227	2,664,227	
Total	5,983,521	0	0	40,378,071	46,361,592	

Amounts are in ISK '000

Notes

46. Net interest income

a. Interest income is specified as follows:

	2008	2007
Cash and cash equivalents	2,980,963	275,191
Derivatives	845,463	2,454,995
Fixed income securities	1,121,869	746,063
Loans to customers	2,145,179	1,479,370
Other interest income	29,167	12,880
Total interest income	7,122,641	4,968,499

Interest expense is specified as follows:

	2008	2007
Deposits	220,099	0
Borrowings	5,689,529	4,152,166
Subordinated liabilities	7,028	8,458
Other interest expense	24,965	28,776
Total interest expense	5,941,621	4,189,400
Net interest income	1,181,020	779,099

b. A breakdown of interest income and expense:

	Interest income	Interest expense	Net interest income
2008			
Financial instruments not at fair value through profit or loss	5,155,309	5,136,160	19,149
Financial instruments at fair value through profit or loss	1,967,332	805,461	1,161,871
Total	7,122,641	5,941,621	1,181,020
2007			
Financial instruments not at fair value through profit or loss	1,767,441	4,189,400	(2,421,959)
Financial instruments at fair value through profit or loss	3,201,058	0	3,201,058
Total	4,968,499	4,189,400	779,099

Amounts are in ISK '000

Notes

47. **Net financial income**

Net financial income is specified as follows:	2008
Gains on shares and other variable income securities	698,324
Gains on fixed income securities	758,879
Dividend income	31,616
Foreign currency exchange difference	336,165
Net financial income	1,824,984

48. **Administrative expenses**

Administrative expenses are specified as follows:	2008	2007
Salaries and related expenses	552,760	502,738
Other operating expenses	446,640	382,510
Depreciation	33,077	16,899
Total administrative expenses	1,032,477	902,147

49. **Salaries and related expenses**

Salaries and related expenses are specified as follows:

Salaries	457,120	390,172
Pension fund contributions	44,542	44,631
Other salary-related expenses	31,639	36,170
Share-based payments	19,459	31,765
Total salary and salary-related expenses	552,760	502,738

Average number of employees during the year	48	38
The Bank's total number of employees at year-end	54	52

Amounts are in ISK '000

Notes

50. **Employment terms for the Board of Directors and the CEO**

Salaries paid to the Board of Directors and the CEO for their work for companies within the Bank and ownership in the Bank are specified as follows:

	Salaries		Ownership at year-end	
	2008	2007	2008	2007
Styrmir Þ. Bragason, CEO	14,400	64,400	10,000	10,000
Margeir Pétursson, Chairman of the Board	4,800	4,800	312,087	312,087
Sigfús Ingimundarson, Deputy Chairman	1,200	1,200	8,233	7,733
Ágúst Sindri Karlsson	600	600	4,200	4,200
Jón Þorsteinn Jónsson	600	600		
Hallgrímur G. Jónsson	120		289	
Sigurður Gísli Pálmason	600	600	140,073	130,593
Gunnar Árnason, alternative board member	120	120		
Jón Hjartarson, alternative board member		120		
Jón Pálmason, alternative board member	120	120	139,623	130,593
Sigurður R. Helgason, alternative board member	120	120	200	200
Örn Andrésson, alternative board member	120	120	8,333	8,333
	22,800	72,800	623,038	603,739

Neither the Board of Directors nor the CEO held any put or call options on the Bank's shares at the end of 2008 or 2007.

51. **Auditors' fees**

Remuneration to the Bank's auditors is specified as follows:	2008	2007
Audit of annual accounts	10,830	6,823
Review of interim accounts	4,912	3,768
Other services	19,120	9,415
Total auditors' fees	34,862	20,006

Of the aforementioned figures, fees to auditors of subsidiaries and branch in Lithuania amounted to ISK 6.4 million in 2008.

52. **Income tax**

Tax income (expense) recognised in the income statement is specified as follows:

Current tax (expense)	(9,007)	(187,594)
Deferred tax income (expense)	177,819	(282,035)
Total income tax	168,812	(469,629)

Amounts are in ISK '000

Notes

The effective income tax rate for the Bank was negative by 24.4% compared to positive income tax rate of 20.9% the year before. The change between years is mainly attributable to two factors:

• In May 2008, a reduction in statutory tax rate from 18% to 15% was approved by the Parliament. The change is applicable retroactively from 1 January 2008. Due to this change, the income tax liability was reduced by ISK 32 million. The entire amount is recognised in the income statement.

• In May 2008, the Parliament approved a change in corporate tax law, allowing companies to deduct from taxable income, given the fulfilment of certain conditions, capital gains on shares and listed equity derivatives. A deductions is only permitted if taxable losses have been settled. The deduction is permitted against capital gains that are realised in 2008 or later. Securities used for hedging are considered to be under claim of ownership by a contractual counterparty and are therefore not affected by the change in the law. Due to this change, the income tax liability is reduced by ISK 109 million. The entire amount is recognised in the income statement.

Reconciliation of effective tax rate:		2008		2007
Profit before tax		691,343		2,249,701
Income tax using the domestic corporation tax rate	15.0%	(103,701)	18.0%	(404,946)
Effect of tax rates in foreign jurisdictions	0.5%	(3,571)	0.0%	0
Tax exempt revenue	(19.5%)	134,468	0.3%	(6,356)
Non-deductable expenses	0.0%	0	2.4%	(53,470)
Reduction of temporary difference due to change in tax law	(15.8%)	109,305	0.0%	0
Effects of reduction of statutory tax rate	(4.7%)	32,311	0.0%	0
Other items	0.0%	0	0.2%	(4,857)
Effective tax	(24.4%)	168,812	20.9%	(469,629)

53. **Cash and cash equivalents**

Cash and cash equivalents are specified as follows:	31.12.2008	31.12.2007
Cash	128	34
Balances with banks	10,019,545	6,506,972
Money market placements	5,504,659	734,851
Total cash and cash equivalents	15,524,332	7,241,857

54. **Loans to Central Bank**

Loans to Central Bank are specified as follows:

Time deposit with Central Bank	5,011,885	0
Total loans to Central Bank	5,011,885	0

55. **Fixed income securities**

Fixed income securities are specified as follows:

Listed bonds on Iceland Stock Exchange	1,323,586	3,189,912
Listed foreign bonds	1,332,455	16,556
Unlisted domestic bonds	0	1,571,836
Unlisted foreign bonds	0	562,081
Government bonds	6,970,008	11,865,514
Total fixed income securities	9,626,049	17,205,899

Amounts are in ISK '000

Notes

56. Shares and other variable income securities

Shares and other variable income securities are specified as follows:	31.12.2008	31.12.2007
Listed shares on Iceland Stock Exchange	15,627	0
Listed foreign shares	357,568	1,766,750
Listed domestic unit shares	76,491	132,583
Listed foreign unit shares	59,778	120,684
Unlisted domestic shares	121,193	1,421,413
Unlisted foreign shares	10,168	12,132
Total shares and other variable income securities	640,825	3,453,562

57. Securities used for hedging - assets

Securities used for hedging are specified as follows:

Listed bonds on Iceland Stock Exchange	44,817	98,714
Government bonds	5,584,619	0
Listed shares on Iceland Stock Exchange	8,669	2,496,149
Listed foreign shares	615,292	5,138,138
Listed domestic unit shares	787	1,265
Listed foreign unit shares	73,820	713,075
Unlisted domestic shares	1,009,255	1,931,297
Unlisted domestic bonds	0	39,944
Total securities used for hedging	7,337,259	10,418,582

58. Allowance for impairment

Change in specific allowance is specified as follows:	2008	2007
Balance at 1 January	8,684	6,684
Restatement due to adoption of IFRS	0	8,698
Charge to the income statement	2,181,727	8,467
Final write-offs	(55,815)	(15,165)
Balance at 31 December	2,134,596	8,684

Change in collective allowance is specified as follows:

Balance at 1 January	34,072	34,072
Charge to the income statement	65,928	0
Balance at 31 December	100,000	34,072
Total charge for the year	2,247,655	8,467

The impairment allowance is subtracted from the following balance sheet items:

Cash and cash equivalents	589,702	0
Loans to customers	1,495,719	42,756
Other assets	149,175	0
Total allowance at year-end	2,234,596	42,756

Amounts are in ISK '000

Notes

59. **Investments in associates**

Changes in investments in associates are specified as follows:	2008	2007
Investment in associates at the beginning of the year	1,205,627	323,302
Purchases of shares in associates	174,455	245,000
Share of results	(77,499)	686,325
Dividends	(98,000)	(49,000)
Foreign exchange translation difference	123,542	0
Investments in associates at year-end	1,328,125	1,205,627

60. **Property and equipment**

	Real estate	Office equipment & fixtures	Total
Book value at 1 January 2007	139,675	28,429	168,104
Acquisitions	180,194	49,537	229,731
Net acquisition through business combinations	35,000	0	35,000
Depreciation	(6,776)	(10,122)	(16,898)
Book value at 31 December 2007	348,093	67,844	415,937
Book value at 1 January 2008	348,093	67,844	415,937
Acquisitions	31,761	76,450	108,211
Depreciation	(15,746)	(17,331)	(33,077)
Effects of foreign currency translation	160,382	2,173	162,555
Book value at 31 December 2008	524,490	129,136	653,626

61. **Other assets**

Other assets are specified as follows:	31.12.2008	31.12.2007
Unsettled securities transactions	956,507	1,568,129
Unsettled derivatives transactions	278,035	0
Accounts receivable	217,985	45,934
Pre-paid expenses	73,149	13,213
Total other assets	1,525,676	1,627,276

62. **Short positions in listed securities**

Short positions in listed securities are specified as follows:

Government bonds	14,800,088	5,709,533
Listed foreign shares	433,906	0
Listed foreign unit shares	115,908	0
Unlisted domestic shares	475,088	0
Other	89	0
	15,825,079	5,709,533

Amounts are in ISK '000

Notes

63. Securities used for hedging - liabilities

Securities used for hedging are specified as follows:	31.12.2008	31.12.2007
Listed bonds on Iceland Stock Exchange	5,210,471	0
Listed foreign shares	2,460	0
Other	18	0
	5,212,949	0

64. Borrowings

The Bank's borrowings are specified as follows:

	31.12.2008	31.12.2007
Issued bonds, listed	4,227,825	4,917,661
Issued bills, listed	1,366,968	11,443,389
Loans from credit institutions	7,497,258	20,363,031
Other debt securities	532,543	564,460
Total borrowings	13,624,594	37,288,541

65. Subordinated liabilities

	Currency	Maturity date	Book value 31.12.2008	Book value 31.12.2007
Loans that qualify as Tier II capital:				
Subordinated loan - Interest 6 months REIBOR	ISK	2010	29,411	43,846

66. Deferred tax liabilities

Changes in deferred tax liabilities during the year are as follows:	2008	2007
Balance at the beginning of the year	193,863	(17,044)
Calculated income tax for the year	(168,812)	469,629
Tax assets and liabilities recognised directly in equity	0	(71,128)
Income tax payable on current year's profit	(11,435)	(187,594)
Translation difference	4,279	0
Net tax liability	17,895	193,863

The Bank's deferred tax liabilities are attributable to the following balance sheet items:

	2008	2007
Shares	0	131,166
Derivatives	0	34,286
Loans and trade receivables	0	5,481
Property and equipment	10,818	12,314
Assets and liabilities denominated in foreign currencies	7,077	10,616
Deferred tax liabilities at year-end	17,895	193,863

Notes

67. **Other liabilities**

Other liabilities are specified as follows:	31.12.2008	31.12.2007
Unsettled securities transactions	655,565	2,032,538
Unsettled derivative transactions	1,686,160	0
Accounts payable	52,616	190,406
Withholding taxes	701,614	146,156
Various liabilities	330,670	295,127
Total other liabilities	3,426,625	2,664,227

68. **Share based payments**

The terms and conditions of outstanding stock options are as follows:

	Number of instruments in thousands	Vesting conditions	Contractual life of option
Options granted 2004	466	12-36 months service	3 years
Options granted 2004	18,667	12-48 months service	4 years
Total	19,133		

All options are to be settled by physical delivery of shares. Options vesting in 12 months can be exercised 48 months after the vesting period and options vesting in 24 months can be exercised 36 months after the vesting period. Accordingly 36 months options can be exercised 24 months after the vesting period and the 48 month options can be exercised 12 months after the vesting period.

The number and weighted average exercise price of share price options is as follows in thousands:

	Weighted average exercise price 2008	Number of options 2008	Weighted average exercise price 2007	Number of options 2007
Outstanding at 1 January	3.5	19,647	3.4	49,626
Forfeited during the year	3.2	(514)	3.2	(8,667)
Exercised during the year		0	3.5	(21,312)
Outstanding at 31 December	3.5	19,133	3.5	19,647
Exercisable at 31 December	3.5	19,133	2.7	981

The options outstanding at 31 December 2008 have an exercise price in the range of 2.2 to 4.7 and a weighted average contractual life of 1.5 years.

Total recognised expenses for the year arising from share-based payment transactions amounted to ISK 19 million (2007: ISK 32 million) including adjustments for forfeited options during the year.

Amounts are in ISK '000

Notes

69. **Equity**

According to the parent company's Articles of Association, total share capital amounts to ISK 1,100 million. The nominal amount of treasury shares at end of year 2008 and 2007 amounted to ISK 54,661 thousand and ISK 36,224 thousand respectively. One vote is attached to each share of one ISK and the holders of ordinary shares are entitled to one vote per share at meetings of the Bank.

70. **Related parties**

Identity of related parties
The Bank has a related party relationship with its associates, with its Board of Directors and with the CEO and key employees (together referred to as management).

Balances and transactions with related parties are listed in the table below.

At year end:	31.12.2008	31.12.2007
Loans to management	259,738	214,521
Loans to members of the Board of Directors and large shareholders	2,141,797	1,773,854
Loans to associated companies	1,000,540	102,805

During the year:	2008
Interest income from loans to management	11,326
Interest income from loans to members of the Board of Directors and large shareholders	227,511
Interest income from loans to associated companies	22,014
Fees from related parties	127,043

71. **Group entities**

The Bank holds nine subsidiaries which are all included in the consolidated financial statements. The direct subsidiaries included in the consolidated financial statements are specified as follows:

	Domicile	Share 31.12.2008
MP Baltic Fund Management	Lithuania	100%
MP Sjóðir hf.	Iceland	100%
UAB Heildun	Lithuania	100%
Max Credit Investments Ltd.	UK	100%
Orange International Investments Ltd.	UK	100%
MP East European Credit Investments Ltd.	UK	100%
Reykjavik Savings Investments Ltd.	UK	100%
Saga Credit Investments Ltd.	UK	100%
Visoky Zamok Investments Ltd.	UK	100%

The purpose of the UK-based entities is to invest in securities in Eastern and Mid-Europe. The companies are financed by third parties and by the Bank with the purpose of investing in specific securities that are specified in contracts with the third party investors. The subsidiaries do not bear the risk associated with the investments as all risk is born by the third party. The investments are therefore shown on a net basis in the consolidated financial statements, reflecting the Bank's limited exposure to the investments.