

Summary of the Net Asset Valuation of the New Banks

Background: In October 2008 the operations of the three largest banks in Iceland, Landsbanki Íslands hf, Glitnir Bank hf and Kaupping Bank hf came to a halt. Together, the gross assets of these three banks amounted to roughly 12 times the country's GDP at the time of their demise. Aiming to prevent a general collapse of the Icelandic economy, the Icelandic authorities took action to transfer local assets and local deposit liabilities from each of the failed banks (the "Old Banks") into respective new domestic banks (the "New Banks"), namely NBI hf (New Landsbanki), Íslandsbanki hf ("New Glitnir") and New Kaupping hf ("New Kaupping"). This action was taken to ensure the continuity of basic Icelandic banking operations.

As part of the transfer of assets and liabilities between the Old Banks and respective New Banks, an impartial third party was engaged by the Icelandic Financial Supervisory Agency ("FME") to oversee valuation of the assets and liabilities on behalf of which had de facto control of the New Banks on behalf of the Icelandic Government. An international professional services firm, Oliver Wyman, was selected to execute the valuation. Following extensive preparations by the FME and Oliver Wyman, the FME agreed on 24 December 2008 a contract with another impartial and independent party, Deloitte LLP ("Deloitte").

Fair value concept: The FME instructed Deloitte to prepare its valuation based on a concept of "*fair value*", which assumes that the New Banks *continue to operate as fully capitalised domestic Icelandic banks with no requirement to divest their assets (or settle their liabilities), in the short-term, or on a distressed basis*. The understanding of the FME is that as a consequence of this assumption, the resulting value will be substantially higher than not only the distressed market price, but also higher than the value of the same assets in the hands of a party either unwilling or unable to recapitalise and restructure the New banks as going concerns.

Summary of the Methodology: The methodology can be split into three general areas: (a) Loans to customers – Large Corporate Groups; (b) Loans to customers – Small Medium Enterprise ("SME") and individual borrowers ("Retail"); and (c) Other Assets and Liabilities.

The dominant asset class is "Loans to customers" (namely points (a) and (b) above) which comprise the Large Corporate borrowers and the SME and Retail borrowers. Gross loans to customers (that is the outstanding loan balances before any provisions or adjustments) represented over 80% of gross assets in each of the three New Banks. Large Corporate Group loans represented ca. 40%-70% of total gross loans to customers and ca. 55% -85% of corporate loans to customers across the three New Banks at the respective Carve-Out Dates.

(a) *Loans to customers – Large Corporate Groups methodology:* Deloitte undertook a case-by-case review of the information available in each of the New Banks relating to each of the Large Corporate Groups and the respective companies within the given group. In total Deloitte reviewed over 130 Large Corporate Groups and over 450 companies within those groups. Based on these reviews, Deloitte estimated a range, reflecting the inherent uncertainty in the exercise and the "fair value" instruction

discussed above, of the gross loans. Particular consideration was given to the underlying security supporting the gross loans, namely collateral pledged by the borrower and the Enterprise Value of the given borrower and whether the borrower was already, or soon to be, in a process of liquidation.

(b) Loans to customers – SME and Retail borrowers methodology: the recoverable amounts of SME and Retail loans (including mortgages), were assessed using various assumptions including, but not limited to, average default of borrower segments, the recovery rate of borrower segments if a default occurs, interest rates and indexation characteristics of the loans. The assumptions were based on the “*fair value*” definition discussed above, information available from the New Banks, the Central Bank and third party sources regarding earlier banking crises. Deloitte also considered sensitivities to various assumptions used. The Deloitte work yielded a range of possible outcomes in respect of the aggregate recoverable amounts for each New Bank.

Subjective assumptions: In a valuation exercise of this nature, the result will evidently depend on a number of key subjective assumptions and parameters, including in this case foreign exchange rates, discount rates and the economic scenarios applied. In working out these assumptions, a wide range of third party analyses relating to the future prospects of the Icelandic economy was sourced, both domestic and international. Experience of earlier banking crises in different countries was taken into account where applicable, and care was taken to follow established international best practice when determining and elaborating all parameters.

Conclusions: Because of the economic stress taken into account in the valuation, the estimated “fair value” is lower than the gross book values before the respective Carve-Out Dates. By the same token, owing to the assumptions implicit in the “fair value” definition used, many conceivable scenarios that may imply an even lower valuation lie outside the scope of the Deloitte analysis.

Reporting: The results of Deloitte’s net asset valuations are contained in three separate reports (“valuation Reports”), one for each of the three New Banks. Each report contains two parts. Part 1 addresses the overall methodology, assumptions and principles, the scenarios considered, sensitivities, a summary of numerical conclusions and net asset value ranges and comments, where appropriate. Part 2 includes the detailed case-by-case analysis and evidence supporting the calculations and net asset value ranges. In parallel with Deloitte’s work, Oliver Wyman conducted an ongoing assessment of the appropriateness of the methodology and its application, in comparison with what may be considered international best practice standards. The FME believes that Deloitte’s methodology was appropriate, and there was no reason to believe that it had not been applied in an appropriate manner.

Release: The valuation reports have been made available to core stakeholders, to assist them with the upcoming negotiations between the Icelandic Government, as owner of the New Banks, and the Resolution Committees of the Old Banks, regarding compensation for the net asset transfer from the Old Banks to the New Banks. In accordance with a release plan issued by FME the recipients of the reports will be the Resolution Committees and the Ministry of Finance, and their respective advisors, but allowing for the possibility of access to Deloitte Part 1 and Oliver Wyman’s report to a wider group of defined stakeholders.