

ANNUAL REPORT 2008



KEY FIGURES

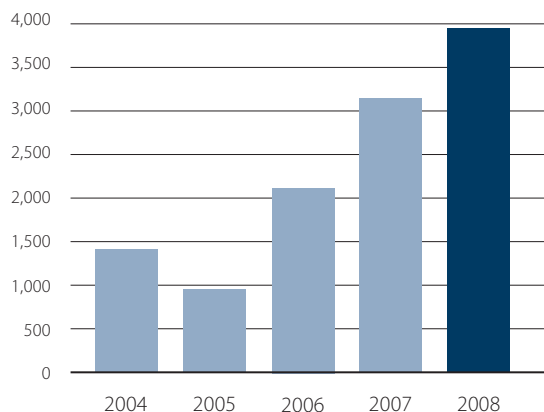
INCOME STATEMENT	2008	2007	Change
Interest income	7,122,641	4,968,499	43%
Interest expense	(5,941,621)	(4,189,400)	42%
Net interest income	1,181,020	779,099	52%
Fee and commission income	1,073,657	1,600,755	(33%)
Fee and commission expense	(32,624)	(72,558)	(55%)
Net fee and commission income	1,041,033	1,528,197	(32%)
Net financial income	1,824,984	158,982	-
Other income	(75,562)	694,037	(111%)
Net operating income	3,971,475	3,160,315	26%
Administrative expenses	(1,032,477)	(902,147)	14%
Impairment losses on financial assets	(2,247,655)	(8,467)	-
Profit before income tax	691,343	2,249,701	(69%)
Income tax	168,812	(469,629)	(136%)
Profit for the year	860,155	1,780,072	(52%)
Basic and diluted earnings per share	0.81	1.62	(50%)
BALANCE SHEET	31.12.2008	31.12.2007	Change
Assets			
Cash and cash equivalents	15,524,332	7,241,857	114%
Loans to Central Bank	5,011,885	0	-
Securities	10,266,874	20,659,461	(50%)
Securities used for hedging	7,337,259	10,418,582	(30%)
Loans to customers	10,310,113	9,599,516	7%
Other assets	4,927,350	4,629,262	6%
Total assets	53,377,813	52,548,678	2%
Liabilities and equity			
Short positions in listed securities	15,825,079	5,709,533	177%
Securities used for hedging	5,212,949	0	-
Deposits	8,575,692	0	-
Borrowings	13,624,594	37,288,541	(63%)
Other liabilities	3,515,493	3,363,518	5%
Equity	6,624,006	6,187,086	7%
Total liabilities and equity	53,377,813	52,548,678	2%
CAD Ratio	22.3%	28.1%	

AMOUNTS ARE IN ISK '000

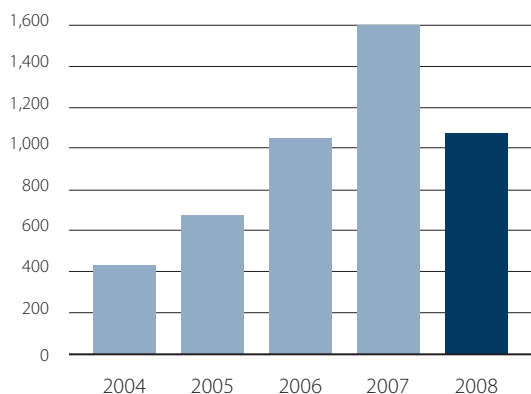
YEAR IN REVIEW

- The Bank's profit in 2008 amounted to ISK 860 million, compared to ISK 1,780 million in 2007.
- Net operating income was ISK 3,971 million, compared to ISK 3,160 million the year before, an increase of 26%.
- Net interest income in 2008 amounted to ISK 1,181 million, compared to ISK 779 million in 2007.
- Net fee and commissions income was ISK 1,041 million, a 32% decrease from the 2007 record of ISK 1,528 million.
- Return on equity after tax was 15% in 2008, compared to 37% in 2007.
- Equity increased by 7% during the year, from ISK 6,187 million in 2007 to ISK 6,624 million in 2008.
- The Bank's balance sheet increased by 2% in 2008 and amounted to ISK 53,378 million at the end of the year.
- The Bank was granted a commercial banking licence during the year.
- Following the licence, a shareholders' meeting approved a change to the name of the Bank from MP Investment Bank hf. to MP Bank hf.
- The Bank began accepting deposits after receiving the commercial banking licence and at year-end deposits amounted to ISK 8,576 million.

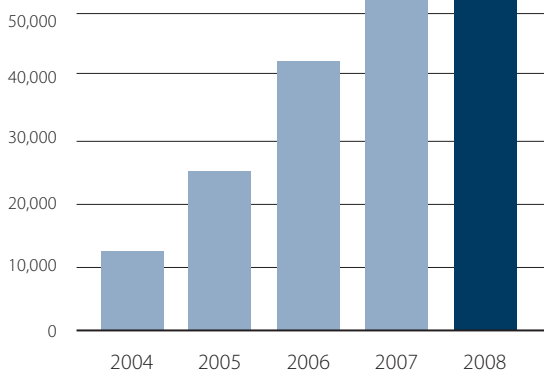
NET OPERATING INCOME



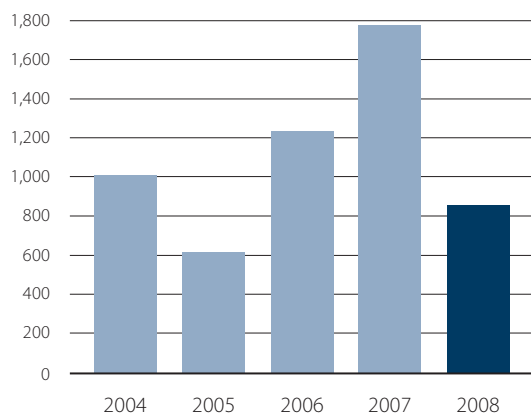
FEES AND COMMISSION INCOME



TOTAL ASSETS

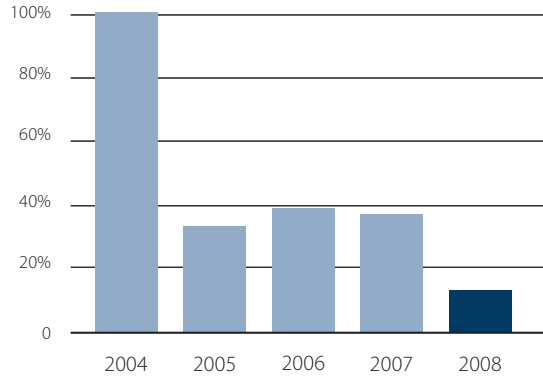


PROFIT FOR THE YEAR

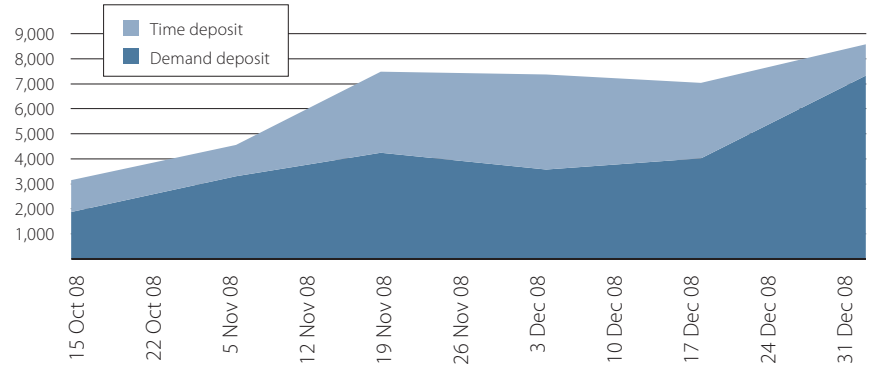


AMOUNTS ARE IN ISK MILLION

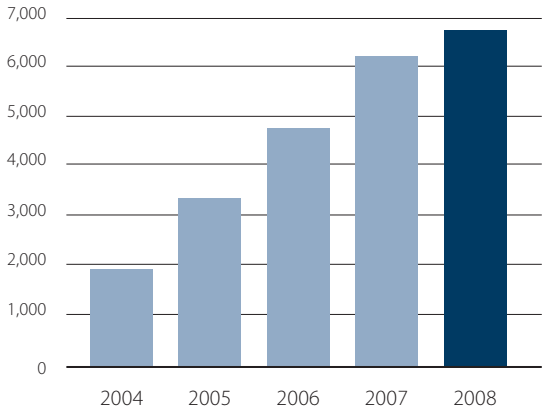
RETURN ON EQUITY



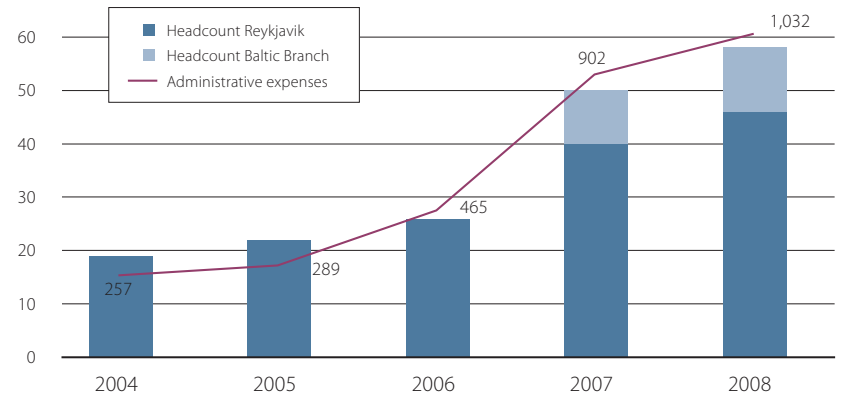
DEPOSITS



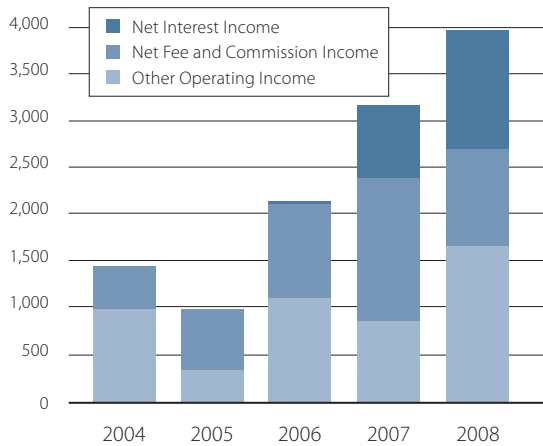
EQUITY



HEADCOUNT AND OPERATING EXPENSES



BREAKDOWN OF REVENUES



BALANCE SHEET



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CHAIRMAN'S ADDRESS

Sound judgment and a steady hand

The year 2008 will be remembered around the world as the year when access to credit ground to a halt and a recession started. For Iceland, this downturn spiralled into the worst economic collapse in the nation's history. Earlier disasters on this island were of natural origin, such as the plague in 1402 and volcanic eruptions of 1783. To find a similar event in Iceland whose foundations lie in human error one must go back to 1262, when the country succumbed to the rule of the Norwegian monarch after being weakened by continuous infighting for most of the 13th century.

Surviving such a monumentally disastrous year and being able to present an IFRS annual account without any reservations must be considered quite a feat in itself for any Icelandic bank. Last year, MP Bank was faced with almost every imaginable adversity. The Icelandic currency collapsed, the Reykjavik stock market fell over 94%, our largest international counterparty, Lehman Brothers, went bankrupt, the Baltic countries entered a recession, our three largest local counterparties went into receivership and Icelandic counterparty risk can now only be mitigated by government guarantees.

Readers of MP Bank's earlier annual reports may recall the gloomy view and dire warnings of excess which were contained in their pages. When writing my address one year ago it was already quite clear that the day of reckoning was near. But its severity was beyond my imagination. I had expected the failure of several Icelandic holding companies but I didn't forecast that the state of the three largest banks would be so bad that the government and the strong Icelandic pension fund system couldn't back them up. I expected Iceland's situation to be similar to that of many other western countries.

An almost complete restructuring of Iceland's economy is inevitable. In the last few years, banks and other service industries have been crowding out the country's traditional industries such as fishing, manufacturing and tourism. Expansion based on foreign loans and an overvalued currency had created the illusion of increased productivity and economic progress. Rectification will be costly and painful but inevitable. The pace of recovery will depend upon how fast the working

Margeir Pétursson was born in 1960. After graduating with a law degree from the University of Iceland in 1984, Mr Pétursson worked as a lawyer for the state-owned bank Búnaðarbanki Íslands from 1984 until 1989. As well as practising law, Mr Pétursson was a professional chess grand master from 1989 to 1996. Mr Pétursson established MP Securities in 1999 and became the Chairman of the Board in 2000. MP Securities became MP Investment Bank in 2003 and MP Bank in 2008. Additionally, Mr Pétursson has served on several boards of directors in Iceland and internationally.



Margeir Pétursson,
Chairman of the Board

population can adjust to a new and harsh reality. There are several opportunities for creating value-added enterprises, mainly due to the fall in the Icelandic currency, which is still far away from full post-collapse downwards adjustment.

MP Bank is ready to participate in the recovery, but only on the sound economic ground that has proven so beneficial to its clients and to the stakeholders in the Bank. We will watch closely the state-owned banking system that is being formed and whether policy makers will steer further away from a free market economy. Attempts to postpone the painful changes by budgetary means will lead to hyperinflation and a prolonged period of economic subsistence.

Needless to say, 2008 was an incredibly challenging year for MP Bank. The key to a successful handling of the current crisis now lies in how we lay the foundations for future opportunities. Receiving our full commercial banking licence in October was the highlight of the year. Strong inflows into deposits and asset management signalled recognition by investors that we are trusted to protect their interests during challenging times.

The Board of Directors would like to thank the CEO and all the employees for their fine efforts and good results during the past difficult year. We are convinced they will continue to work with sound judgement and a steady hand.

Margeir Pétursson,
Chairman of the Board

A handwritten signature in blue ink, appearing to read 'Margeir P. Pétursson', written in a cursive style.

BOARD OF DIRECTORS

Sigfús Ingimundarson was born in 1965. He graduated with a degree in business administration from the University of Iceland in 1992. Mr Ingimundarson is the CEO of privately-held Eignarhaldsfélagið Miklatorg ehf., which owns the IKEA furniture franchise in Iceland. His other major investment interests include real estate and land development. Mr Ingimundarson has been a member of the Board since 2002.



Sigfús Ingimundarson,
Vice Chairman of the Board

Birkir Baldvinsson was born in 1940. After graduating from Northrop Aeronautical University in 1959 he worked for Icelandic Civil Aviation, then for Icelandic Airlines in Hamburg, Glasgow and Luxembourg. In Luxembourg he was Deputy Director of Maint./Engineering for Cargolux Airlines. In 1976, Mr Baldvinsson started his own business career in aircraft sales, real estate and catering. He is currently CEO of Birkir Baldvinsson Investment ehf., and served as an associated board member of SPRON Bank from 2004 to 2008.



Birkir Baldvinsson
Member of the Board

Hallgrímur G. Jónsson was born in 1940. After completing his education, he started working for J. S. Helgason ehf., a family firm. At the same time, he started working for newly founded SPV Savings Bank and later became head of that bank. Under his leadership, SPV Savings Bank became the strongest Icelandic savings bank. During his long career, Mr Jónsson has served as board member or Chairman of the Board for numerous companies, banks and savings banks in Iceland.



Hallgrímur G. Jónsson
Member of the Board

Sigurður Gísli Pálmason was born in 1954. He studied business administration at the Polytechnic of Central London in 1977. His business career spans over 30 years, beginning at the retail company Hagkaup, first as Head of Purchasing, then Managing Director and later as Chairman of the Board of Directors. Mr Pálmason is currently the owner and Chairman of the Board of Dexter Investments Ltd. and of Eignarhaldsfélagið Miklatorg ehf. in Iceland.



Sigurður Gísli Pálmason,
Member of the Board

CEO'S ADDRESS

MP Bank's operations in 2008 were characterised by challenging market conditions and falling asset prices around the world. MP Bank was affected by the fall of Lehman Brothers and the collapse of the three largest banks in Iceland, with high impairment losses on financial assets. A slowdown in fee income was offset by higher net interest income and strong results from proprietary trading. Flexibility, a swift reaction to the markets and the expertise of MP Bank's employees were key factors in the positive results for the year.

Profitable in 2008

MP Bank achieved reasonable profitability in 2008, despite the hostile business environment. The slowdown in stock market trading meant lower fee income, but bond trading increased four-fold compared to 2007 levels. Net interest income grew by a healthy 52%. Proprietary Trading achieved good profits, primarily in the government and housing bond markets. Since 2004 the Bank has been a market maker and primary trader in all Icelandic government guaranteed bonds. We have been constantly increasing our market share in bond trading and underwriting and after the collapse of the large banks we have played an ever increasing role in ensuring liquidity in that very important market. During the last two years, the Bank has consistently advocated an inflation defensive strategy which has proven to be very prudent.

Asset Management had a successful year and all managed portfolios showed positive results. Assets under management doubled during 2008. Our clients' excellent investment results and our independent and prudent advisory services have greatly increased demand for the Bank's Asset Management service.

Commercial banking licence

MP Bank was granted a full commercial banking licence in October 2008. Therefore, the Bank can now offer a full banking service to our asset management and other clients. The new

Styrmir Þór Bragason was born in 1970. He holds a degree in Business Administration from the University of Iceland and an MSc degree in Banking and Finance from the University of Stirling in Scotland and is a licensed securities trader. Mr Bragason has extensive experience of the financial market, as CEO of Atorka Group, as head of Landsvaki (the asset management company of Landsbanki Íslands) and as a senior manager in the Securities Trading Division of Búnaðarbanki Íslands. He joined MP Bank in 2006.



Styrmir Þór Bragason,
CEO of MP Bank

business line has already positively affected the Bank's business and more than one third of its funding now comes from deposits.

A strong team achieves strong results

Considering the demanding environment on domestic and foreign financial markets, the Bank's overall results for 2008 are good. A strong, united group of experts is the underlying reason for the excellent performance and the individuals who form the dedicated team are highly valued. I want to take this opportunity to thank all employees for their important contribution to the strong results we delivered in the difficult year of 2008, and I count on their relentless efforts in making 2009 a year of opportunities as well.

Styrmir Þór Bragason,
CEO of MP Bank

ADDRESS FROM THE HEAD OF THE BALTIC BRANCH

The year 2008 will go down in the history of MP Bank's Baltic Branch as a year of transformation and the one in which a solid foundation for the Bank's operations in Lithuania were laid down.

In the first half of 2008, the branch moved to its new modern and centrally located offices. Much effort was spent on strategic and institutional development, operations and organisation building and systems development. Thanks to MP Bank's flexible service and innovative investment products on offer, the client base also grew. Corporate finance and asset management services were successfully launched in the second half of the year, paving the way for a more diversified offering of services.

A year of challenges

Of course the Baltic Branch was not immune to the challenges presented by the onset of the global financial crisis. Despite skilful liquidation of the Branch's own proprietary trading portfolio of Baltic stocks in an attempt to minimise losses from falling markets, all of the Branch's operating profit for the year was offset by realised portfolio losses, thus ending the Branch result for the year in the red. Likewise, the falling value of clients' assets prompted deliberate contraction of the leveraged products portfolio, in order to minimise the risk for both clients and the Bank.

However, once fear and uncertainty subsided, clients resumed trading, and the Branch managed to win corporate finance and asset management mandates. The latter business lines will be especially important for 2009, in line with changing attitudes and the news needs of investors and companies which the Branch serves.

Vygandas Jūras was born in 1969. He has over 15 years of experience working in finance-related positions both in Lithuania and abroad. Prior to joining MP Bank, Mr Jūras worked as Director of Strategic Development and Research at TEOLT and for five years was a partner and Country Director at private equity firm BaltCap Management. Prior to joining BaltCap, Mr Jūras advanced in his career from associate to manager at the international financial advisory services firms PricewaterhouseCoopers, Deloitte and KPMG/Barents Group, working in the United States, Central Asia and Ukraine. He holds a Master's Degree in Management from the International School of Management in Lithuania and a BA from Macalester College in the United States.



Vygandas Jūras,
Head of MP Bank - Baltic Branch

Strong performance by pension funds

The Bank's pension fund business in Lithuania performed particularly well in 2008. The year ended with 7000 client accounts and a substantial increase in funds under management. MP Pension Funds Baltic was one of only a few funds in Lithuania that did not lose money for its clients in 2008.

Plans for 2009

2009 promises to be a year of positive challenges as well. The Branch will not only continue along its well-planned development path during these times of uncertainty, but it will also think ahead, seek out and embrace the many unique opportunities that present themselves during such turbulent times.

Vygandas Jūras,
Head of MP Bank - Baltic Branch

ABOUT MP BANK

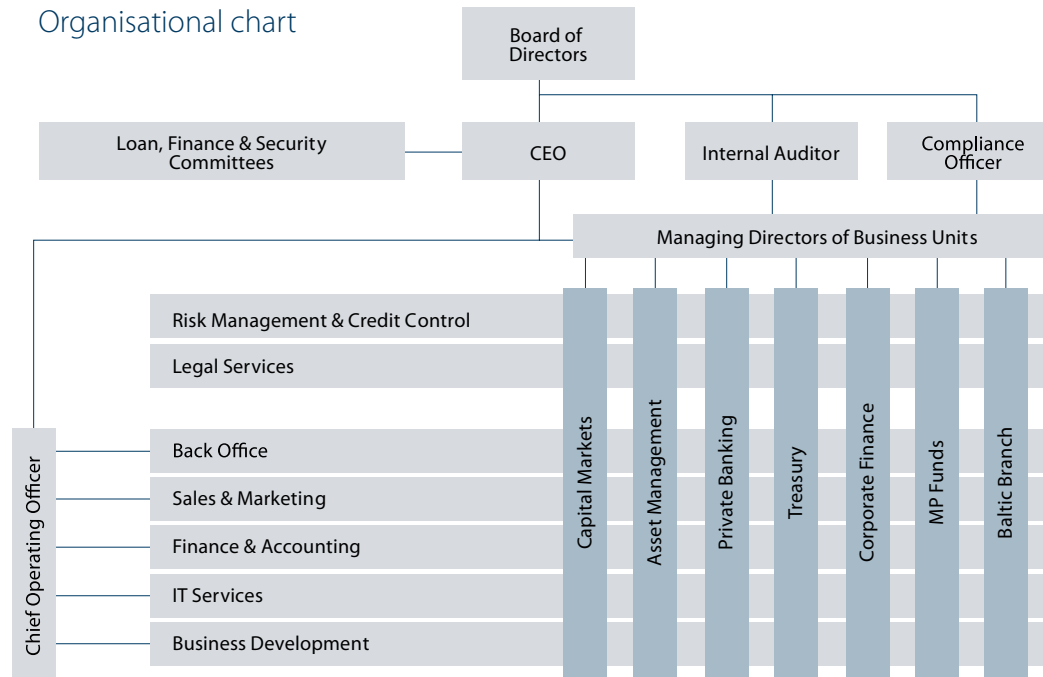
The company was founded as MP Securities in 1999 and became an investment bank in 2003, offering a full range of investment banking services. The Bank was granted a full commercial banking licence in October 2008 and has started accepting deposits in Iceland. MP Bank will be celebrating ten years of operations in 2009.

The Bank's headquarters are in Reykjavik, Iceland and a branch office is operated in Vilnius, Lithuania.

Clients and services

The Bank's primary goal is to be the first choice among high net-worth individuals and institutional investors, providing innovative services and consistent long term results. The Bank offers comprehensive solutions in asset management and private banking for private entities and investors. The Bank is a broker-dealer of securities on domestic and international markets, and provides all major services in the field of corporate finance, including the most common forms of financing for clients.

Organisational chart



The team

The Bank employs a tight-knit team of experts who achieve success on the basis of diverse education, market knowledge and extensive experience.

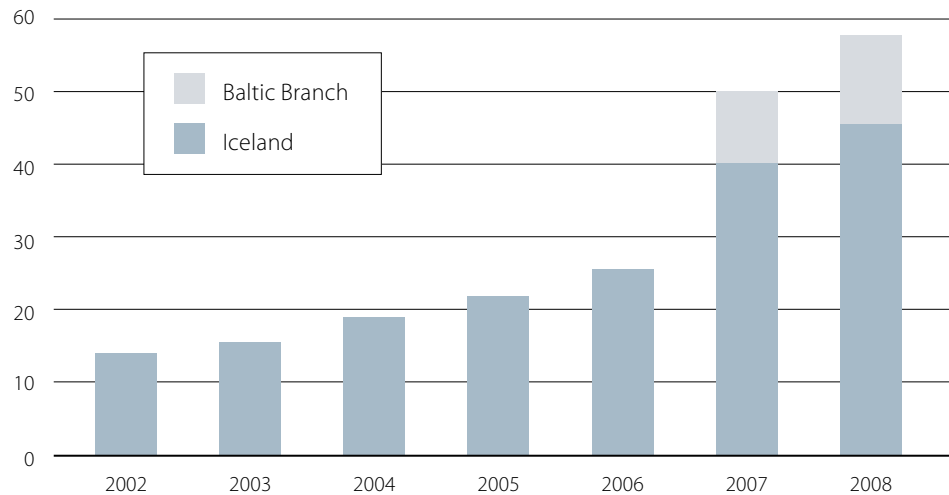
Agility and a receptiveness to change are among MP Bank's most important assets and have served the Bank well during the current global market turbulence. In this regard, the Bank's limited size is also an advantage. Employees are encouraged to foster an adaptive culture in which roles can change quickly, and efficiency is of key importance.

The mission

MP Bank's mission is to achieve success on behalf of its clients, employees and shareholders. Our results speak for themselves.

The Bank brings value to its customers by creating long-term relationships with customised solutions. MP Bank's solutions are based on the needs and expectations of its clients and managed with only their interests in mind.

Employees



COMPANY HISTORY

1999

MP Securities hf. (MP Verðbréf hf.) is established by Margeir Pétursson, who owns 80% of shares, and Sverrir Kristinsson and Ágúst Sindri Karlsson, each of whom owns 10% of shares.

The initial share capital is USD 1.6 million.

The Company focuses on providing specialised asset management services as well as acting as a discount broker.

Margeir Pétursson and Auður Finnbogadóttir are the co-Managing Directors of the Company.

Lawyer Ágúst Sindri Karlsson becomes the first Chairman of the Board.

With five employees in a two-room office, the Company manages to turn a healthy profit in its first year of operations.

2000

A Corporate Finance Division is established, focusing on share offerings, valuations and consulting.

Auður Finnbogadóttir becomes the sole Managing Director of the Company.

Margeir Pétursson becomes Chairman of the Board.

MP Securities moves to its current headquarters and the number of employees increases to 15.

2001

MP Securities makes a strategic decision to pursue an investment banking licence.

A substantial increase is made in share capital, whereby Jón Pálmason and Sigurður Gísli Pálmason, among others, become shareholders.

MP Securities provides international private banking services in association with a bank in Switzerland.

2002

Share capital is increased substantially to strengthen the capital base of the Company and to prepare for an investment banking licence.

Sigfús Ingimundarson becomes Vice Chairman of the Board of Directors.

MP Securities becomes a strategic shareholder in Atorka, an Icelandic investment company listed on the Icelandic Stock Exchange. Margeir Pétursson becomes Chairman of Atorka.

2003

The Icelandic Financial Supervisory Authority (FME) grants the company an investment banking licence and subsequently the name is changed to MP Investment Bank hf. (MP Fjárfestingarbanki hf.).

Sigurður Valtýsson takes over as Managing Director.

Bond underwriting becomes a significant revenue source for the Corporate Finance Division.

SPV Savings Bank (now BYR Savings Bank) becomes a shareholder in the Bank.

2004

MP Investment Bank becomes active in the municipal bond market.

The Bank becomes primary dealer in government securities for the National Debt Agency and market maker in the housing bonds market (HFF-Bonds) for the Housing Financing Fund.

For a significant profit, the Bank sells its holdings in a number of listed companies, including Atorka, Og Vodafone, Íslandsbanki and Landsbanki.

2005

MP Investment Bank opens a branch in London.

MP Investment Bank sets its focus on Central and Eastern Europe and prepares incursions into those markets in 2006.

2006

MP Investment Bank appoints Styrmir Þór Bragason as its Managing Director.

MP Investment Bank is authorised to provide financial services as an investment bank in Denmark, Finland, Norway, Sweden and the UK as well as the three Baltic countries (Estonia, Latvia and Lithuania).

The Bank becomes a direct member of the OMX Baltic Stock Exchanges.

The Bank enters into an agreement with Raiffeisen Capital Management to offer various Raiffeisen funds in Iceland.

2007

MP Investment Bank opens a branch in Vilnius, Lithuania, which provides brokerage services and investment funds for sale to institutional investors and high net worth individuals.

The Bank is granted a direct membership to the stock exchanges of Helsinki, Copenhagen, Oslo and Stockholm, thereby becoming the first European financial institution with direct membership to all the OMX Stock Exchanges in the Nordic countries and the Baltic States, as well as the Oslo Stock Exchange.

The Bank's Asset Management Unit wins a mandate to become portfolio managers of one half of the total assets of the Depositors' and Investors' Guarantee Fund.

MP Pension Fund Baltic is established in Lithuania, a subsidiary of the Bank, which offers second and third stage pension savings plans to Lithuanians.

The Bank establishes MP Funds Management Company hf., which is granted a licence from the Financial Supervisory Authority in Iceland to operate as an authorised management company for mutual funds and investment funds.

The number of employees at the Reykjavík headquarters grows from 26 to 40, and from three to ten at the Baltic Branch.

2008

MP Investment Bank hf. appoints Vygandas Jūras as Head of MP Investment Bank hf. Baltic Branch. The Baltic Branch relocates to a new office building in "Vilniaus Vartai".

On 10 October, the Icelandic Financial Supervisory Authority grants MP Investment Bank hf. a commercial banking licence and the Bank begins accepting deposits. At a shareholders' meeting on 14 November, the Bank's name is changed to MP Bank hf. (MP Banki hf.).

After receiving its commercial banking licence, MP Bank negotiates access to the systems of the Icelandic Banks Data Centre (Reiknistofa bankanna). The Bank also becomes part of the Icelandic Central Bank's RTGS system (Stórgreiðslukerfi) and the company FGM's Netting System (Jöfnunarkerfi FGM).

RISK MANAGEMENT AND CREDIT CONTROL

The recent economic developments and the severe deterioration of the financial sector in Iceland have underlined the importance of having well-defined risk policies and active risk management.

The Board of Directors and senior management of MP Bank have dictated a conservative risk policy with a prudent approach to leverage and lending and MP Bank constantly seeks to align its operations according to its view of the current and future situations in the markets in which it operates.

The Bank's Risk Management and Credit Control Division is responsible for identifying, quantifying and managing the risks associated with the operations of the Bank and for controlling the Bank's loan portfolio. The Unit participates in drafting the overall risk policy of MP Bank and has representatives on the Finance Committee, the Credit Committee and the Security and IT Committee. The unit reports directly to the CEO.

Risk management challenges

The strain on the financial markets placed Risk Management and Credit Control in a central role in the day-to-day operations of the Bank and the past year highlighted the importance of having active and thorough risk management.

Risk Management and Credit Control participates in the Bank's regulatory reporting and the Bank places great emphasis on handling these reports in a diligent, timely and responsible fashion. In 2008, new business lines and systems were introduced in connection with the commercial banking licence and the Unit actively participated in the safe and efficient implementation of new systems and products.

The largest material risk the Bank faces is credit risk. It arises primarily from direct lending and through the leveraged security swaps held by the Bank's customers. Risk Management and Credit Control manages the loan portfolio and the unit monitors the quality and level of collateralisation for all credit-related products on a real time basis. The loan portfolio primarily consists of senior loans with a relatively high level of collateralisation as the Bank emphasises that collateralised assets are liquid, can be marked to market and have first priority claims.

The recent developments in the financial markets increase the necessity for strict liquidity risk management and the Bank holds a high level of secured liquidity. Its commercial banking licence enables the Bank to accept deposits and these already form a substantial portion of the Bank's funding. There is a suitable balance between the lifetime of assets and liabilities, both relatively short. The proprietary trading of MP Bank is primarily kept at highly liquid positions, making it possible to reduce or re-align with short notice. The Bank will continue to focus on seniority in its loan portfolio and to keep a high liquidity ratio.

Strong capital base

MP Bank holds a solid capital base which exceeds regulatory minimum requirements several times over and will in the future continue to operate with a prudent view on leverage and risk taking. The Bank's capital adequacy policy is regularly revised by the Board of Directors and is based upon a cautious risk appetite and the Board's view of the current and future financial and economic situation. The relatively small size and flexibility of the Bank, combined with a strong capital base and high liquidity, places it in a good position to weather the current storms in financial markets and to emerge even stronger as a result.

The Treasury Division handles foreign exchange trades for the Bank's clients and assists in positioning and hedging their positions against foreign exchange risks. The Division also serves as an intermediary for all of MP Bank's loans and loan activities. Loans are typically related to other activities of the Bank, such as securities trading and corporate finance. The Bank also operates on the money market, providing several services, including loans to other financial institutions. Furthermore, proprietary trading is a part of Treasury, mainly focusing on market making and trading in domestic government bonds.

The financial crisis of 2008 had an impact on the activities of the Treasury Division as de-risking measures led to a significant decrease in foreign exchange contracts and inter-bank lending in the second half of the year, eliminating counterparty risk against Icelandic banks. Since October, the Central Bank of Iceland has implemented restrictions on foreign exchange transactions with the Icelandic króna, further restricting the Bank's currency brokerage.

Funding

Adverse conditions on the financial markets, both globally and domestically, created a challenging funding climate last year.

The Bank managed to maintain a good relationship with its creditors, securing strong liquidity throughout the year. The Bank met all obligations as they came due, reducing its reliance on wholesale funding. In October, a significant step was taken towards changing MP Bank's funding profile when it was granted a commercial banking licence, enabling the Bank to accept deposits. The deposit base grew rapidly and represented approximately one third of core funding at the end of the year, further increasing the Bank's liquidity. The growth trend in deposits has continued in 2009 and in February amounted to around 40% of core funding.

Market and interest rate risks

The Treasury Division is also responsible for monitoring and controlling the Bank's interest rate risk and market risk due to positions in foreign currency. The objective is to keep a balance between assets and liabilities and to ensure that the Bank's borrowings reflect the asset side of the balance sheet. The banking collapse in Iceland led the Bank to close all its counterparty risk against Icelandic counterparties, including all foreign currency contracts. This partly offset the currency balance against the Icelandic króna.



ASSET MANAGEMENT

The goal of MP Bank's Asset Management Division is to achieve superior long-term returns for its clients, irrespective of fluctuating market conditions. This has involved building a structure which ensures that the interests of clients are aligned with those of the Bank. After a very eventful year, it has become clearer than ever that a strong mission is essential for withstanding the tests of time.

This clear focus has led to various beneficial investment decisions. One of the most significant of these decisions meant that, at the time of the fall of Iceland's three largest banks in the first week of October 2008, no portfolio in the Asset Management Division contained stocks in or bonds against the relevant banks. The decision to reduce clients' exposure to Icelandic stocks, particularly banks, was made in early 2007 and the sale of the last of those securities was completed in the spring of 2008.

A lowering of risk

It was also beneficial for the Bank's clients to have their portfolios diversified to include foreign government bonds. This was a new departure, as the investments of Icelandic investors in foreign securities have generally been focused almost entirely on stocks, the most obvious reason being that bond yields have generally been significantly higher in Iceland than in most other developed markets. But in 2008, diversification away from the risk of stocks and, moreover, away from Icelandic market risk, despite interest rate differences, proved very successful.

Another example of the lowering of risk was the decision made in late 2007 to increase positions in local inflation-indexed government bonds – a strategy which continued throughout 2008.

Overall, it can be said that the flexibility of the main investment tracks of the division has been used to systematically lower risk over the last two years.

Increased demand

Throughout its almost ten-year history, the Division has grown slowly but steadily, and has kept a decidedly low media profile. In the spring of 2008, a departure from previous policy was signalled when the Bank placed advertisements in the major local media. The reason for this effort was that it was felt within the Bank that the offering of the Division spoke directly to the many Icelandic investors who were becoming concerned about instabilities in the local financial system. MP Bank's Asset Management Division was seen as a very cautious and impartial alternative. The result was that assets under management more than doubled from May to the end of the year, with a steady inflow of new customers.

Opportunities ahead

Individual thinking and a resistance to popular trends and short-term fluctuations have led to superior long-term returns. This means that the Division will be well positioned to evaluate opportunities which will emerge when the dust settles – both locally and in international markets.

In early 2009 MP Bank established a Private Banking Division. The Division's objective is to expand the role of asset management within MP Bank. The Asset Management Division has shown superior returns and gained excellent customer loyalty in recent years.

In recent months, MP Bank has seen a strong demand for private banking services among high net worth individuals who are eager to come to the Bank due to its reputation of professionalism and excellent service. These individuals are especially interested in the more personal and complete service that MP's Private Banking entails. In the first few weeks of 2009, the Private Banking Division has already added a number of new high net worth clients.

Excellent financial services

With the granting of a commercial banking licence on 10 October 2008 from the Icelandic Financial Supervisory Authority, MP Bank can now provide a full range of commercial banking services. Private Banking clients are always offered the best rates and service that MP Bank has to offer.

Private Banking aims to offer excellent financial services to high net worth individuals, corporations and funds, tailored to each individual client's needs. There is an emphasis on personal interaction and professional advice to ensure a higher return in the long run.

Obviously, the last few months have seen incredible changes in Iceland's economy and financial markets. Today, more than ever, it is essential to offer clients an environment based on security and mutual trust. The Private Banking Division at MP Bank will focus on these needs, while offering professional, unbiased and reliable service to its clients.

Private Banking strives to understand each client's life situation and financial goals in order to build a long-term relationship based on mutual confidence, and respect.



MP FUNDS

In the second half of 2007, the MP Fund Management Company ("MP Funds") received a licence to operate as an authorised fund management company for UCITS and other funds for collective investment.

The following funds were established:

The MP Money Market Fund

When the Icelandic Financial Supervisory Authority (FME) took control of the three Icelandic banks (Glitnir, Landsbanki and Kaupthing) at the beginning of October, redemptions in all Icelandic money market funds were immediately delayed and thereafter the FME requested that the fund management companies dissolve their funds. The board of MP Funds acted on this request and the Fund is now in the process of liquidation.

At the end of 2008, the Fund had paid out 82.1% of its closing value on 6 October 2008. Due to these extraordinary circumstances, the MP Money Market Fund will not be able to collect all of its assets and will be forced to write off some of its remaining assets. The Board of MP Funds greatly regrets this, although by comparison with the outcome of other Icelandic money market funds, MP Money Market Fund will likely provide the best return.

The MP Corporate Bond Fund

After the collapse in October, the corporate bond market dried up and redemptions were delayed in all corporate bond funds. The Board of MP Funds decided in December to dissolve the Fund and it is now in the process of liquidation. The final return of the Fund is still unknown, but at the beginning of October, the Fund had 47% of its assets in government securities.

The MP Treasury Bond funds

By the end of 2008, MP Funds managed two treasury bonds funds. MP Treasury Bond Fund invests only in treasury bonds and government-guaranteed bonds and can invest in both inflation-indexed and non-inflation-indexed bonds. The MP Short-Term Treasury Fund invests in treasury bills and bonds and government-guaranteed bills and bonds, with the objective of keeping the Fund's duration under three years. The Fund can invest both in inflation-indexed and non-inflation-indexed bonds.

In October 2008, MP Bank was authorised by the Minister of Finance to offer agreements on supplementary insurance coverage and individual pension savings. MP Bank will initially be offering two pre-designed portfolios: MP Private Savings 1, which invests only in treasury bills, bonds and government guaranteed bonds, and MP Private Savings 2, which invests evenly in treasury bills, bonds and government-guaranteed bonds and in term deposits with financial institutions which hold a commercial banking or savings bank licence. Both portfolios were launched at the end of 2008 and will be available to MP Bank clients in the first quarter of 2009.

External funds offered by MP Bank

MP Bank offers a variety of carefully chosen third-party funds and has agreements with several successful and specialised international fund management companies. MP Bank works with Austria-based Raiffeisen Capital Management (RCM) and sells RCM funds in Iceland. MP Bank also co-operates with Sparinvest, an independent, Luxembourg-based asset management company.

MP Funds will continue to develop funds provided in the coming years, both its own funds and selected external funds.

2008 was a very difficult year for stock markets around the world, with many major indexes tumbling by 30-50% due to economic concerns, credit issues, flight to safety and the collapse of some of the larger financial institutions in the United States. The Icelandic stock market was not immune to these adverse conditions and an already difficult year turned into a stock market crash in October when the country's three major banks were nationalised. By the end of the year, the Icelandic stock market had fallen over 94% in value and turnover had nearly come to a standstill.

Despite the crisis, turnover in fixed income markets was quite healthy throughout 2008. Yield movements were volatile during the market turmoil in October, before reaching more normal levels at the end of the year.

New focus

With currency restrictions in place and shrinking equity markets, the focus in the Capital Markets Division has shifted from equity to fixed income trading. Increased revenues from the Icelandic bond market have helped offset the decreased revenues from equity trading.

In the past, and throughout this difficult period, the Capital Markets Division has continued to provide professional customer service and the continuous flow of new clients is recognition of the Division's excellent reputation.

Services

The Capital Markets Division provides brokerage services to both domestic and foreign markets and offers quality

brokerage services to its clients, which include retail clients, high net worth individuals, financial institutions, corporations, pension funds and mutual funds. The Bank is one of the largest members of the Icelandic Stock Exchange, and one of a select few members of the Icelandic market who are primary dealers in treasury bills, notes and bonds. The Division has brokers covering stock markets from Scandinavia, Iceland, the Baltic States, Russia, Western and Eastern Europe and North America.

More emphasis was placed on fixed income markets last year, and they will continue to be the main focus for the division in 2009. The Bank is consistently one of the three biggest operators on the fixed income market, measured by volume.

Prospects for 2009

The beginning of 2009 has continued to present challenges to global stock markets. The turnover in the Icelandic stock market remains and will continue to be at low levels compared to last year. Furthermore, currency restrictions have substantially limited the Division's ability to conduct trades in foreign markets.

The Division's flexibility has allowed it to adapt to the adverse market conditions. The Division will continue to focus on the Icelandic bond market while currency restrictions are in place. With continued challenging market conditions, the approach of the Capital Markets Division for the coming year is cautious. The Division's primary goal is to continue to improve and expand its customer service and to assist its clients to achieve optimal investment results.

CORPORATE FINANCE

Despite the turmoil and credit limitations that characterised the global banking system in 2008, MP Bank's Corporate Finance Division continued its steady growth of total income.

The Division provides all the major services in the field of corporate finance, such as:

- Assisting and advising on sale mandates, mergers and acquisitions;
- Fairness opinions, assistance and advisory on financial Acts;
- Valuations, as independent advisors;
- Running and advising on fund raising efforts by debt and equity.

An active 2008

The year started with the acquisition of Ukrainian pharmaceutical chain LLC Salve, for which the Bank acted as an advisor to a group of Icelandic investors. Other projects in Eastern Europe were put on hold in 2008, due to the turmoil in the global economy, but the pipeline, network and the Bank's presence in these markets was strengthened further during the year.

During 2008, the Bank strengthened its position as an independent financial institution when the Corporate Finance Division issued fairness opinions for the takeover bid of Skipti hf. by Exista hf. and for the proposed merger between Kaupthing Bank hf. and SPRON hf. In the latter part of 2008, the

Corporate Finance Division issued additional fairness opinions and acted as advisor to bankrupt estates in Iceland, due to its independent position.

Facing challenges

As a result of the sudden change in the global financial environment, the Bank now plays a greater role on the bond market. The Corporate Finance Division administered the issuance of corporate bonds on behalf of HS Veitur hf. in 2008. Additional agreements relating to the issuance of bonds were signed at the end of the year, generating a strong pipeline for the Division in 2009.

Other projects were successfully completed in 2008, covering the whole range of services provided by the Corporate Finance Division.

Looking ahead

Due to its enhanced position within the domestic market resulting from the banking collapse, the main focus of the Corporate Finance Division for 2009 will be within Iceland. The division's pipeline and prospects for the year are strong. Notwithstanding the current market turmoil, the sudden change in the financial sector creates opportunities for an independent bank such as MP Bank. This is especially relevant for the Corporate Finance Division, since the need for an independent player to assist with the re-structuring of the Icelandic economy is more important than ever before.

At the beginning of 2009, the Bank brought its major support units under one umbrella by creating the role of Chief operating Officer (COO) responsible for Finance and Operations. The COO holds overall responsibility for daily operations, accounting, back office, customer services, information technology, marketing and project management.

Stronger portfolio

The Bank's newly acquired licence for commercial banking has created new opportunities to broaden and strengthen its customer base by developing and providing new services. Two new product lines have already been added to the Bank's product portfolio: deposit taking and a scheme for pension savings. As the products grow in number and diversity, the Bank must stay focused and maintain strong cost controls in order to remain profitable in today's extremely challenging financial environment.

Focus in 2009

For the remainder of 2009, the main task for the Finance and Operations Division will be to improve overall operations and

quality of services and to increase the number of services offered. This will be achieved primarily by re-thinking and improving business processes and integrating systems in order to maximise direct processing and provide correct and timely data for the Bank's customers, management and employees.

An important component of this strategy is MP Bank's planned rollout of an Internet bank, scheduled for Q1 2009. The new Internet bank will provide MP Bank's customers with direct access to their overall position with the Bank and enable them to conduct everyday banking business online.

The following divisions now report directly to the COO:

- Back Office
- Finance and Accounting
- Sales and Marketing
- IT Services
- Business Development





CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR 2008



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ENDORSEMENTS 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 enormously. 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 the 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 a 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%

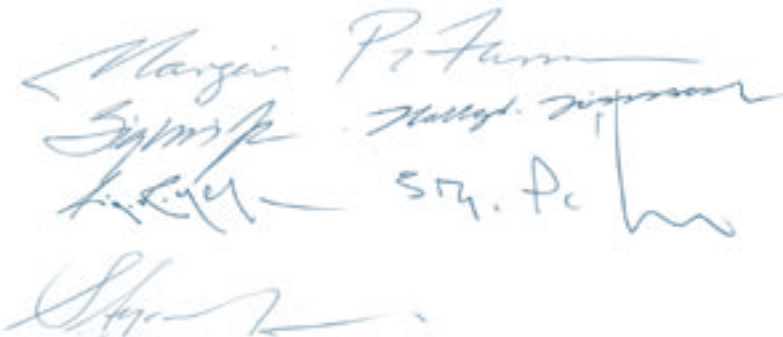
To the best of our knowledge, the consolidated financial statements of MP Bank hf. for the year 2008 give a true and fair view of the assets, liabilities, financial position and financial performance of the Bank. Further, in our opinion the consolidated financial statements and the endorsement of the 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.

Reykjavík, 20 February 2009.

The Board of Directors:

CEO:

The image shows four handwritten signatures in blue ink. The first signature is 'Margeir P. Petursson'. The second is 'Sigurður Gísli Pálmason'. The third is 'Jón Pálmason'. The fourth is a signature that appears to be 'Sigríður Pálmason'. The signatures are arranged in a vertical column, with the first signature at the top and the fourth at the bottom.

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 statement of cash flows 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 under 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 consolidated financial statements in order to design audit procedures that are appropriate under 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.



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 31 to 70 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 31 to 70 are an integral part of these consolidated financial statements

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR 2008

	Share Capital	Share Premium	Reserves			Retained Earnings	Total
			Translation Reserve	Option Reserve	Fair value Reserve		
2007							
Equity at 1.1.2007	1,064,000	1,164,875		(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)		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 31 to 70 are an integral part of these consolidated financial statements

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 31 to 70 are an integral part of these consolidated financial statements

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.

2. Cont'd.

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, and 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.

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.

3. Cont'd.

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.

5. Foreign currencya. *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 króna (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 the spot exchange rate current at the reporting date. The income and expenses of foreign operations are translated into Icelandic króna 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.

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.

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.

NOTES, CONT'D.

12. Cont'd.

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 financial 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.

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.

21. Cont'd.

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.

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:

- significant financial difficulty of the borrower;
- a breach of contract, such as a default on instalments or on interest or principal payments;
- 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;
- it becomes probable that the borrower will enter bankruptcy or undergo other financial reorganisation;
- the disappearance of an active market for that financial asset because of financial difficulties; or
- 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.

22. Cont'd.

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.

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 a 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.

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.

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 guarantees are included within other liabilities.

31. Employee benefits*a. Defined contribution plans*

Obligations for contributions 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 the 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.

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 cannot be paid out as dividend to shareholders.

32. Cont'd.

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.

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.

NOTES, CONT'D.

34. Cont'd.

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 with 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%

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 Bank makes continuous estimates and assumptions regarding e.g. economic, business and financial conditions that affect the capital plan as well as the quantification of risk factors.

35. Cont'd.

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 decisions regarding operational risk, security and IT systems. The Committee consists of the Bank's CEO, IT Manager, Office Manager, the heads of Risk Management and Credit Control, Business Development and Legal Department.

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 collateralised.

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 a third party.

NOTES, CONT'D.

37. Cont'd.

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 organises 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. 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.

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

37. Cont'd.

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		655,228	16,114,034	(589,702)	15,524,332
Loans to banks	1,873,523			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.

NOTES, CONT'D.

37. Cont'd.

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 24% 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

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		5,990,610	6,517,551	2,291,929		15,825,079
Securities used for hedging	2,478		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

NOTES, CONT'D.

38. Cont'd. 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 action. The Bank has taken measures to gradually reduce the open currency position below the statutory requirements.

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		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

NOTES, CONT'D.

39. Cont'd.

2007

	EUR	LTL	USD	CHF	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

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)

NOTES, CONT'D.

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 Unit monitors the market price risk and reports regularly to the Finance Committee and to the CEO.

b. Interest rate risk associated with proprietary positions

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

41. Cont'd.		< 1 year	1-3 years	3-5 years	5-7 years	> 7 years	Total
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	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	0	2,338,714	5,983,521

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.

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	

45. Cont'd.

	Trading	Designated at fair value	Loans and receivables	Other at amortised cost	Total carrying amount	Fair value
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	21,068,155	0	0	25,685,652	46,753,807	

2007**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	

NOTES, CONT'D.

46. Net interest income

a.	<i>Interest income is specified as follows:</i>	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:

	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.	<i>A breakdown of interest income and expense:</i>	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

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		<u>1,824,984</u>

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	<u>1,032,477</u>	<u>902,147</u>

49. Salaries and related expenses

Salaries and related expenses are specified as follows:	2008	2007
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	<u>552,760</u>	<u>502,738</u>
Average number of employees during the year	48	38
The Bank's total number of employees at year-end	54	52

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:	2008	2007
Current tax (expense)	(9,007)	(187,594)
Deferred tax income (expense)	177,819	(282,035)
Total income tax	168,812	(469,629)

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 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, 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 deduction 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)

NOTES, CONT'D.

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
<u>Total cash and cash equivalents</u>	<u>15,524,332</u>	<u>7,241,857</u>

54. Loans to Central Bank

Loans to Central Bank are specified as follows:	31.12.2008	31.12.2007
Time deposit with Central Bank	5,011,885	0
<u>Total loans to Central Bank</u>	<u>5,011,885</u>	<u>0</u>

55. Fixed income securities

Fixed income securities are specified as follows:	31.12.2008	31.12.2007
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
<u>Total fixed income securities</u>	<u>9,626,049</u>	<u>17,205,899</u>

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:	31.12.2008	31.12.2007
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

NOTES, CONT'D.

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
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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

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:	31.12.2008	31.12.2007
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
Total short positions in listed securities	15,825,079	5,709,533

NOTES, CONT'D.

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
Total securities used for hedging	5,212,949	0

64. Borrowings

The Bank's borrowings are specified as follows:	31.12.2008	31.12.2008
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	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:

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

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

NOTES, CONT'D.

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-month 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.

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

NOTES, CONT'D.

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
Axia Asset 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 Central 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.

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