Landsbanki

Consolidated Financial Statements 2006

Landsbanki Íslands hf. | Austurstræti 11 | 155 Reykjavík | Iceland | www.landsbanki.com

Landsbanki

Content

Consolidated Key Figures

Operations

Operations	2006	2005	2004	2003	2002
Interest revenues	133,102	66,437	34,252	21,871	21,813
Interest expenses	91,611	43,441	19,517	12,540	14,082
Net interest revenues	**41,491**	**22,996**	**14,734**	**9,331**	**7,732**
Fee and commission income	32,459	18,479	10,234	6,959	4,745
Fee and commission expenses	4,092	1,754	1,344	843	669
Net fee and commission income	**28,366**	**16,726**	**8,891**	**6,116**	**4,076**
Other operating revenues	**19,568**	**21,257**	**9,842**	**3,535**	**2,109**
Net operating revenues	**89,426**	**60,978**	**33,467**	**18,982**	**13,916**
Salaries and related expenses	24,458	12,682	7,794	5,656	4,387
Administrative expenses	14,130	8,284	6,667	5,158	4,117
Operating expenses	**38,588**	**20,967**	**14,460**	**10,815**	**8,505**
Impairment on loans and advances and assets held for sale	6,144	6,197	4,485	4,656	2,863
Profit before impairment on goodwill and income tax	**44,694**	**33,815**	**14,521**	**3,512**	**2,549**
Impairment on goodwill	0	3,033	0	0	0
Income tax	4,479	5,764	1,798	457	475
Net profit	**40,215**	**25,017**	**12,723**	**3,055**	**2,074**
Attributable to:					
Shareholders of Landsbanki Íslands hf.	38,906	24,740	12,574	2,956	2,028
Minority interests	1,309	277	149	99	45

Balance Sheet

Balance Sheet	2006	2005	2004	2003	2002
Cash and cash balances with Central Bank	31,669	16,611	18,237	11,642	8,145
Loans and advances to financial institutions	215,618	86,919	72,060	37,130	10,748
Loans and advances to customers	1,438,395	984,593	542,215	326,400	214,787
Financial assets at fair value and associates	376,809	218,894	64,730	63,744	36,337
Other assets	110,432	98,443	39,900	9,323	7,808
Total assets	**2,172,924**	**1,405,460**	**737,141**	**448,239**	**277,824**
Deposits from financial institutions	141,105	144,596	63,476	43,840	30,665
Deposits from customers	682,846	334,163	215,730	152,320	108,306
Borrowing	1,014,976	689,989	375,084	209,357	108,479
Subordinated loans	89,754	49,074	22,570	13,090	8,216
Other liabilities	94,785	74,022	21,572	6,389	5,057
Equity	144,282	110,059	37,705	22,382	16,309
Minority interests	5,175	3,557	1,004	862	792
Total liabilities and equity	**2,172,924**	**1,405,460**	**737,141**	**448,239**	**277,824**

Key ratios

Key ratios	2006	2005	2004	2003	2002
Return on equity before impairment on goodwill and taxes	40.3%	61.8%	57.2%	20.9%	17.0%
Return on equity after taxes	36.3%	45.8%	49.5%	17.6%	13.5%
Tier 1 ratio	13.0%	11.9%	7.8%	6.9%	7.7%
Equity ratio (CAD)	14.8%	13.1%	10.4%	9.9%	10.6%
Cost-income ratio	43.2%	34.4%	43.2%	57.0%	61.1%
Operating expenses as a ratio of average capital position	2.1%	2.0%	2.5%	3.0%	3.1%
Interest spread as a ratio of average capital position	2.3%	2.2%	2.6%	2.6%	2.8%
Deposits / loans to customers	47.5%	33.9%	39.6%	48.0%	50.4%
Ratio of provision to lending position at year-end	0.37%	0.58%	0.73%	1.47%	1.33%
Loan loss ratio	0.13%	0.19%	0.33%	0.55%	0.89%
Share price at year-end	26.50	25.30	12.10	5.80	3.65
Change in share price adjusted for dividend payments	5.9%	110.7%	110.3%	61.6%	10.6%
Number of positions at year-end	2,117	1,725	1,121	1,025	986
Exchange rates					
Exchange rate ISK / EUR for P/L average of year	87.57	76.59	86.97	87.39	85.92
Exchange rate ISK / EUR for Balance sheet at year-end	93.72	74.7	83.51	89.76	84.71

ISK million

Consolidated Key Figures

Operations	2006 Q4	2006 Q3	2006 Q2	2006 Q1	2005 Q4	2005 Q3	2005 Q2	2005 Q1
Interest revenues	34,887	33,154	37,527	27,535	21,073	18,594	14,309	12,461
Interest expenses	25,306	23,840	23,865	18,601	13,818	12,272	9,180	8,172
Net interest revenues	**9,581**	**9,314**	**13,662**	**8,934**	**7,255**	**6,322**	**5,129**	**4,289**
Fee and commission income	9,323	7,547	7,791	7,797	5,359	4,775	4,864	3,481
Fee and commission expenses	1,325	979	849	940	598	392	403	361
Net fee and commission income	**7,998**	**6,568**	**6,943**	**6,857**	**4,761**	**4,383**	**4,461**	**3,120**
Dividend income	161	99	269	1,834	191	161	616	105
Net (loss) gain on financial assets and liabilities held for trading	492	1,943	(1,011)	750	5,503	3,550	(163)	1,978
Net (loss) gain on financial assets designated at FV through P/L	5,913	594	(489)	7,680	1,205	1,167	1,003	2,490
Fair value adjustments in hedge accounting	78	25	(25)	(96)	(361)	232	(81)	216
Foreign exchange difference	(58)	(145)	(12)	(49)	92	359	(161)	97
Profit (loss) from associates	1,133	(15)	(262)	843	643	505	275	484
Net gain of disposal groups held for sale	(479)	155	51	188	63	270	817	0
Other operating revenues	**7,240**	**2,656**	**(1,478)**	**11,150**	**7,337**	**6,243**	**2,307**	**5,370**
Net operating revenues	**24,819**	**18,538**	**19,127**	**26,942**	**19,352**	**16,949**	**11,898**	**12,779**
Salaries and related expenses	6,989	5,963	6,256	5,249	4,136	3,077	3,114	2,355
Administrative expenses	4,042	3,754	3,496	2,839	2,933	1,905	1,764	1,683
Operating expenses	**11,031**	**9,717**	**9,752**	**8,088**	**7,069**	**4,982**	**4,879**	**4,037**
Impairment on loans and advances and assets held for sale	1,332	1,597	1,660	1,555	1,805	1,687	1,359	1,345
Profit before impairment on goodwill and income tax	**12,457**	**7,224**	**7,714**	**17,299**	**10,479**	**10,280**	**5,660**	**7,396**
Impairment on goodwill	0	0	0	0	(259)	3,293	0	0
Income tax	(1,596)	1,480	1,572	3,023	1,929	1,882	602	1,351
Net profit	**14,053**	**5,744**	**6,143**	**14,276**	**8,809**	**5,105**	**5,058**	**6,045**
Attributable to:								
Shareholders of Landsbanki Íslands hf.	13,664	5,281	5,966	13,995	8,734	4,995	5,000	6,011
Minority interests	389	463	177	280	75	110	58	34

Balance Sheet	31.12.2006	30.9.2006	30.6.2006	31.3.2006	31.12.2005	30.9.2005	30.6.2005	31.3.2005
Cash and cash balances with Central Bank	31,669	25,714	22,806	19,403	16,611	8,134	8,211	14,136
Loans and advances to financial institutions	215,618	168,993	68,793	75,597	86,919	53,727	66,442	56,984
Loans and advances to customers	1,438,395	1,303,676	1,294,462	1,208,510	984,593	837,941	761,901	630,899
Financial assets at fair value and associates	376,809	305,294	275,113	300,780	218,894	156,243	119,208	82,630
Other assets	110,432	158,395	150,295	165,613	98,443	86,212	66,311	65,993
Total assets	**2,172,924**	**1,962,072**	**1,811,468**	**1,769,902**	**1,405,460**	**1,142,258**	**1,022,072**	**850,642**
Deposits from financial institutions	141,105	97,097	135,722	138,092	144,591	138,693	92,755	79,582
Deposits from customers	682,846	513,054	475,045	469,333	334,168	275,295	262,655	218,481
Borrowing	1,014,976	979,748	853,367	806,627	689,989	531,417	521,870	417,947
Subordinated loans	89,754	85,892	91,141	83,514	49,074	47,224	49,394	49,327
Other liabilities	94,785	151,746	128,714	151,130	74,022	48,804	34,378	30,241
Equity	144,282	129,876	123,088	117,187	110,059	98,749	58,954	53,988
Minority interests	5,175	4,660	4,392	4,019	3,557	2,076	2,066	1,076
Total liabilities and equity	**2,172,924**	**1,962,072**	**1,811,468**	**1,769,902**	**1,405,460**	**1,142,258**	**1,022,072**	**850,642**

ISK million

Report of the Board of Directors and Group Managing Directors & CEOs

The Consolidated Financial Statements for the year 2006 consist of the Consolidated Financial Statements of Landsbanki Íslands hf. and its subsidiaries. The Consolidated Financial Statements are prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU).

At year-end the Bank's shareholders in Landsbanki numbered 28,735 compared to 29,675 as of beginning of the year. Samson eignarhaldsfélag ehf., which holds 41,36% in the company, is the only shareholder with a stake over 10%.

According to the income statement, the Group's after tax profit for 2006 amounted to ISK 40,215 million. The Landsbanki Group's equity at year-end totalled ISK 144,282 million. The capital adequacy ratio (CAD rules) of the Group was 14.8%. As of 31 December 2006, the Group's total assets were ISK 2,172,924 million.

In August, Landsbanki Íslands hf. acquired all the shares in the UK retail bank Cheshire Guernsey Ltd. The transaction was completed in September. Subsequently the retail bank's name was changed to Landsbanki Guernsey Ltd.

At the Bank's AGM, the Board of Directors will move that shareholders be paid a dividend of 40%, equivalent to ISK 4,408 million and that the remaining profit be disposed of as indicated in the summary of changes in equity in the annual financial statement.

The Board of Directors of the Bank and the Group Managing Directors & CEOs hereby confirm the Consolidated Financial Statements of Landsbanki Íslands hf. for 2006 by affixing their signatures.

Reykjavík, 25 January 2007

Board of Directors

Björgólfur Guðmundsson
Chairman

Kjartan Gunnarsson — Þorgeir Baldursson

Þór Kristjánsson — Guðbjörg Matthíasdóttir

Group Managing Directors and Chief Executive Officers

Sigurjón Þ. Árnason — Halldór J. Kristjánsson

Independent Auditor´s Report

To the Shareholders and Board of Directors of Landsbanki Íslands hf.

We have audited the accompanying consolidated financial statements of Landsbanki Íslands hf (the Bank) and its subsidiaries (the Group) which comprise the consolidated balance sheet as of 31 December 2006 and the consolidated income statement, consolidated statement of changes in equity and consolidated cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the 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 European Union (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 misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies 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 accompanying consolidated financial statements give a true and fair view of the financial position of the Group as of 31 December 2006, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU.

Reykjavík, 25 January 2007

PricewaterhouseCoopers hf.

Vignir Rafn Gíslason

Þórir Ólafsson

Consolidated Income Statement for the year 2006

Notes		2006	2005
	Interest revenues	133,102	66,437
	Interest expenses	91,611	43,441
8	**Net interest revenues**	**41,491**	**22,996**
	Fee and commission income	32,459	18,479
	Fee and commission expenses	4,092	1,754
9	**Net fee and commission income**	**28,366**	**16,726**
10,11	Dividend income	2,362	1,073
11	Net gain on financial assets and financial liabilities held for trading	2,174	10,868
11,12	Net gain on financial assets designated at fair value through profit and loss	13,699	5,866
11	Fair value adjustments in hedge accounting	(18)	6
11	Foreign exchange difference	(263)	387
11,21	Profit from associates	1,699	1,907
11	Net gain (loss) of disposal groups held for sale	(85)	1,150
	Other operating revenues	**19,568**	**21,257**
	Net operating revenues	**89,426**	**60,978**
13	Salaries and related expenses	24,458	12,682
	Administrative expenses	14,130	8,284
	Operating expenses	**38,588**	**20,967**
14	Impairment on loans and advances and assets held for sale	6,144	6,197
	Profit before impairment on goodwill and income tax	**44,694**	**33,815**
	Impairment on goodwill	0	3,033
15	Income tax	4,479	5,764
	Net profit	**40,215**	**25,017**
	Attributable to:		
	Shareholders of Landsbanki Íslands hf.	38,906	24,740
	Minority interest	1,309	277
16	**Earnings Per Share:**		
	Earnings Per Share	3.67	2.74
	Diluted earnings per share	3.48	2.61

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Consolidated Balance Sheet as of 31 December 2006

Notes		2006	2005
	Assets		
	Cash and cash balances with Central Bank	31,669	16,611
	Loans and advances to financial institutions	215,618	86,919
17	Loans and advances to customers	1,438,395	984,593
18	Bonds and debt instruments	169,598	51,535
18	Shares and equity instruments	49,328	58,292
18	Hedged securities	105,190	129,663
18,19	Derivatives held for trading	38,358	13,886
20	Derivatives held for hedging	10,498	4,689
21	Investments in associates	3,837	4,456
22	Property and equipment	5,823	4,260
23	Intangible assets	14,351	10,461
24	Non-current assets and disposal groups classified as held for sale	21,349	16,459
	Unsettled securities trading	36,965	11,264
	Other assets	31,944	12,372
	Total assets	**2,172,924**	**1,405,460**
	Liabilities		
25	Deposits from financial institutions	141,105	144,596
26	Deposits from customers	682,846	334,163
27	Borrowing	1,014,976	689,989
28	Subordinated loans	89,754	49,074
19	Trading liabilities	20,866	26,504
20	Derivatives held for hedging	6,473	4,086
29	Tax liabilities	6,593	7,289
	Liabilities included in disposal groups classified as held for sale	7,242	4,475
	Unsettled securities trading	29,987	20,428
30	Other liabilities	23,623	11,240
	Total liabilities	**2,023,466**	**1,291,844**
	Equity		
	Share capital	10,581	10,614
	Share premium	50,595	52,277
	Reserves	2,060	1,790
	Retained earnings	81,046	45,377
		144,282	**110,059**
	Minority interest	5,175	3,557
31	**Total equity**	**149,457**	**113,617**
	Total liabilities and equity	**2,172,924**	**1,405,460**

32-38 Other information

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Consolidated Equity Statement

	Attributable to equity holders of the Company							
		Share Premium		Reserves				
	Share capital	Additionally paid in capital	Statutory account	Translation	Fair value	Retained earnings	Minority interest	Total
Equity 1 January 2004	7,500	4,355	268			10,259		22,382
Changes due to conversion to IFRS							862	862
Equity 1 January 2004 - adjusted	**7,500**	**4,355**	**268**	**0**	**0**	**10,259**	**862**	**23,244**
Capital increase	475	3,171						3,646
Dividends paid						(721)	0	(721)
Translation differences				(20)				(20)
Changes in minority interest							(7)	(7)
Net profit 2004						12,574	149	12,723
Equity 31 December 2004	**7,975**	**7,526**	**268**	**(20)**	**0**	**22,112**	**1,004**	**38,865**
Changes due to conversion to IFRS	(21)	(237)				103	0	(156)
Equity 1 January 2005	**7,954**	**7,288**	**268**	**(20)**	**0**	**22,214**	**1,004**	**38,709**
Capital increase	800	10,600						11,400
Merger with Burðarás	2,121	38,172						40,293
Purchases and sales of treasury shares	(260)	(4,052)						(4,312)
Dividends paid						(1,577)		(1,577)
Translation differences				(53)				(53)
Fair value adjustment of investment properties, included in disposal groups					1,864		870	2,734
Changes in minority interest							1,406	1,406
Net profit 2005						24,740	277	25,017
Equity 31 December 2005	**10,614**	**52,009**	**268**	**(73)**	**1,864**	**45,377**	**3,557**	**113,617**
Equity 1 January 2006	**10,614**	**52,009**	**268**	**(73)**	**1,864**	**45,377**	**3,557**	**113,617**
Purchases and sales of treasury shares	(33)	(1,683)						(1,715)
Dividends paid						(3,237)		(3,237)
Translation differences				269				269
Changes in minority interest							308	308
Net profit 2006						38,906	1,309	40,215
Equity 31 December 2006	**10,581**	**50,326**	**268**	**196**	**1,864**	**81,046**	**5,175**	**149,457**

Additional disclosures:

According to the Bank's Articles of Association, total share capital amounts to ISK 11,021 millions. At year-end 2006 own shares amounted to ISK 440 millions and share capital in the Balance sheet thus amounted to ISK 10,581 millions. One vote is attached to each share. The Board of Directors has proposed to the 2006 Annual General Meeting that a dividend of 40% of the share capital amounted, equivalent to ISK 4,408 million.

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Consolidated Statement of Cash flow for the year 2006

	2006	2005
Interest received	112,432	32,750
Interest paid	(42,388)	(36,847)
Fees and commission received	31,259	14,810
Fees and commission paid	(3,012)	(1,814)
Dividends received	2,362	537
Net trading and other income	11,826	10,084
Cash payments to employees and suppliers	(18,618)	(19,711)
Income taxes paid	(3,915)	(1,769)
Cash flow from operating profits before changes in operating assets and liabilities	**89,945**	**(1,960)**
Changes is operating assets and liabilities:		
– net increase in loans and advances to banks	(125,964)	(4,678)
– net increase in loans and advances to customers	(387,282)	(415,215)
– net increase in trading assets	(64,076)	(146,849)
– net increase in other assets	(24,398)	(17,001)
– net increase in deposits from other banks	54,705	83,458
– net increase in amounts due to customers	305,433	113,478
– net (decrease)/increase in trading liabilities	(6,016)	18,427
– net (decrease)/increase in other liabilities	(6,194)	24,023
Cash flow used in operating activities	**(163,848)**	**(346,317)**
Change in property and equipment	(1,670)	(734)
Change in financial assets designated at fair value through profit and loss	18,076	(21,589)
Change in subsidiaries and associates	(26,589)	(5,909)
Change in intangible assets	(942)	(8,058)
Cash flow used in investing activities	**(11,126)**	**(36,290)**
Repayments and proceeds from borrowed funds and debt securities	197,333	339,613
Interest paid on long term borrowed funds and debt securities	(39,087)	(23,790)
Repayments and proceeds from subordinated loans	30,220	30,235
Interest paid on subordinated loans	(4,508)	(3,133)
Dividends paid	(3,237)	(1,577)
Change in own stock	(1,715)	44,721
Increased share capital	0	2,661
Cash flow provided by financing activities	**179,006**	**388,730**
Increase in cash	4,032	6,123
Cash at beginning of year	31,417	25,630
Foreign exchange difference	5,698	(336)
Cash and cash equivalents at year-end	**41,147**	**31,417**

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1 General information

Landsbanki Íslands hf. (the Group) is a universal bank, providing retail, corporate and investment banking services. The Group operates in 14 countries and has 2,117 employees at year-end.

The Group's parent company is Landsbanki Íslands hf. (the Bank), which is a limited-liability company incorporated and domiciled in Iceland. The Bank was established in 1886 and remained state-owned until 1998 when the State decided to privatise the Bank through a public offering. Today, the Bank's shares are listed on the Main List of the Iceland Stock Exchange (ICEX).

These consolidated financial statements were approved for issue by the Board of Directors on 25 January 2007.

2 Summary of significant accounting policies

The principal accounting policies applied in preparing these consolidated financial statements are set out below. These policies have been consistently applied to all the periods presented, unless otherwise stated.

2.1 Basis of preparation

The consolidated financial statements of Landsbanki Íslands hf. 2006 have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU. The consolidated financial statements reflect IFRS and interpretations issued and effective in December 2006.

The accounting policies, as adopted by the EU, depart from full IFRS in the following areas, relating to the Group's operations:

Standards:
- IFRS 7: Financial Instruments: Disclosures

IFRS 7, Financial Instruments: Disclosures, and a complementary Amendment to IAS 1, Presentation of Financial Statements - Capital Disclosures (effective from 1 January 2007). IFRS 7 introduces new disclosures to improve the information about financial instruments. It requires the disclosure of qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk and market risk, including sensitivity analysis to market risk. It replaces IAS 30, Disclosures in the Financial Statements of Banks and Similar Financial Institutions, and disclosure requirements in IAS 32, Financial Instruments: Disclosure and Presentation. It is applicable to all entities that report under IFRS. The amendment to IAS 1 introduces disclosures about the level of an entity's capital and how it manages capital. The Group assessed the impact of IFRS 7 and the amendment to IAS 1 and concluded that the main additional disclosures will be the sensitivity analysis to market risk and the capital disclosures required by the amendment of IAS 1.

The Group will apply IFRS from annual periods beginning 1 January 2007.

Amendments to published standards effective 1 january 2007:
- IAS 19 Amendment – Actuarial Gains and Losses, Group Plans and Disclosures;
- IAS 21 Amendment – Net Investment in a Foreign Operation;
- IAS 39 Amendment – Cash Flow Hedge Accounting of Forecast Intragroup Transactions;
- IAS 39 Amendment – The Fair Value Option;
- IAS 39 and IFRS 4 Amendment – Financial Guarantee Contracts;
- IFRS 1 (Amendment), First-time Adoption of International Financial Reporting Standards, and IFRS 6 (Amendment), Exploration for and Evaluation of Mineral Resources;

IAS 39 Amendment – The Fair Value Option. This amendment changes the definition of financial instruments classified at fair value through profit or loss and restricts the ability to designate financial instruments as part of this category. The Group believes that this amendment should not have a significant impact on the classification of financial instruments, as the Group should be able to comply with the amended criteria for the designation of financial instruments at fair value through profit and loss.

IAS 39 and IFRS 4 Amendment – Financial Guarantee Contracts. These types of contract are accounted for under IAS 39. The measurement and disclosure requirements under IAS 39 have not resulted in a material change to the Group's policies.
IAS 19 Amendment, IAS 21 Amendment, IAS 39 Amendment – Cash flow hedge accounting of forecasted intragroup transactions, IFRS 1, IFRS 6, IFRIC 4 and IFRIC 5 are not relevant to the Group's operating activities and therefore have no material effect on the Group's policies.

These consolidated financial statements have been prepared under the historical cost convention, having regard to the revaluation of financial assets and financial liabilities (including derivative instruments) at fair value through profit or loss.

The preparation of financial statements in accordance with IFRS requires the use of certain accounting estimates. It also requires management to exercise judgement in the process of applying various accounting policies. Accounting assumptions and estimates of major significance are disclosed in particular in Note 3.

2.2 Consolidation

(a) Subsidiaries

Subsidiaries are all entities over which the Group has the power generally accompanying a shareholding of more than one-half of the voting rights to govern financial and operating policies. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases. On the date of reporting, the Bank's subsidiaries were comprised of the following:

Company	Share owned	Activity
Landsbanki Holdings (UK) plc	100%	Holding company
Heritable Bank Ltd (UK)	100%	Corporate banking
Teather & Greenwood Holdings plc (UK)	100%	Stockbrokers and financial services
Landsbanki Holdings Europe SA (Luxembourg)	100%	Holding company
- Landsbanki Luxembourg SA (Luxembourg)	100%	Private and corporate banking
- Kepler Equities SA (France)	86%	Stockbrokers and financial services
Landsbanki Guernsey Ltd (UK)	100%	Retail banking

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Merrion Capital Group Ltd (Ireland)	50%	Stockbrokers and financial services
LI Investments AB (Sweden)	100%	Holding company
LI Investments Europe Ltd (Cyprus)	100%	Holding company
Landsvaki hf. (Iceland)	100%	Operation company for mutual funds
Landsbankinn eignarhaldsfélag ehf. (Iceland)	100%	Holding company
Landsbankinn - Fjárfesting hf. (Iceland)	100%	Holding company
Landsbankinn fasteignafélag ehf. (Iceland)	100%	Real estate company
SP – Fjármögnun hf. (Iceland)	51%	Leasing company
Verðbréfun hf. (Iceland)	100%	Securitization company
LI Investments Ltd (British Virgin Islands)	100%	Holding company
Stofnlánadeild Samvinnufélaga (Iceland)	100%	Holding company (dormant)
Hömlur hf. (Iceland)	100%	Holding company for appropriated assets

The purchase method is used to account for the investment in subsidiaries by the Group. The acquisition price is measured as the fair value of its stated assets, equity instruments issued and liabilities incurred or assumed at the transaction date, plus costs directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured at their fair values on the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded 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 directly in the income statement.

Inter-company transactions, balances and unrealised gains on transactions between group companies are eliminated in the consolidated accounts. Unrealised losses are also eliminated unless the transaction provides evidence of impairment of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

(b) Transactions and minority interests

The Group applies a policy of treating transactions with minority interests as transactions with parties external to the Group. Disposals to minority interests result in gains and losses for the Group that are recorded in the income statement. Purchases from minority interests result in goodwill, being the difference between any consideration paid and the relevant share acquired of the carrying value of net assets of the subsidiary.

(c) Associates

Associates are all entities over which the Group has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the share capital conferring voting rights. Investments in associates are accounted for by the equity method of accounting and are initially recognised at cost. The Group's investment in associates includes goodwill (net of any accumulated impairment loss) identified on acquisition.

The Group's share of its associates' post-acquisition profits or losses is recognised in the income statement, and its share of movements of reserves is recognised in reserves under equity. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When the Group's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the associate.

Unrealised gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of associates have been changed where necessary to ensure consistency with the policies adopted by the Group.

Investments in associates held for the purpose of investment banking and restructuring are accounted as Financial asset designated at fair value through profit and loss.

2.3 Segment reporting

A business segment is a part of the Group's assets and operations which is subject to risks and returns differing from those of other business segments. A geographical segment is a part of the assets and operations within a specific economic environment that are subject to risks and returns that are different from those of segments operating in other economic environments.

2.4 Foreign currency translation

(a) Functional and presentation currency

Items included in the financial statements of the Group's individual entities are measured using the currency of the economic environment in which the entity operates (the functional currency). The consolidated financial statements are presented in millions of Icelandic kronas (ISK), which is the Bank's functional and presentation currency.

(b) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates of the date of the transaction. Foreign exchange gains and losses resulting from the settlement of such transactions, and the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies, are recognised in the income statement, except when deferred in equity as qualifying net investment hedges. Translation differences on non-monetary items, such as equities held at fair value in the income statement, are reported as part of these income statement movements.

(c) Group companies

The results and financial position of Group companies that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

(i) the assets and liabilities of each balance sheet are translated at the closing rate at the year-end;
(ii) items of each income statement are translated at the average exchange rate for the year (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions);
(iii) all resulting exchange differences are recognised as a separate component of equity.

Exchange differences arising from the translation of the net investment in foreign entities, and of borrowings and other currency instruments designated as hedges on such investments, are taken to shareholders' equity. When a foreign company is sold, such exchange differences are recognised in the income statement as part of the gain or loss on the sale.

2.5 Derivative financial instruments and hedge accounting

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at their current fair value. Fair values are based on quoted market prices in active markets, including recent market transactions, and valuation techniques, including discounted cash flow models and options pricing models, as appropriate. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

The best evidence of the fair value of a derivative at initial recognition is the transaction price (i.e. the fair value of the consideration given or received) unless the fair value of that instrument is based on comparison with comparable transactions in similar instruments. Fair value can also be based or founded on the basis of pricing models.

Derivatives embedded in other financial instruments are treated as separate derivatives when their economic characteristics and risks are not closely related to those of the host contract and the host contract is not carried at fair value on the income statement. These embedded derivatives are measured at fair value with changes in fair value recognised in the income statement.

The method of recognising the resulting fair value gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. The Group designates certain derivatives as hedges of the fair value of assets or liabilities (fair value hedge). Hedge accounting is used for derivatives designated in this way provided certain criteria are met.

The Group documents, at the inception of the transaction, the relationship between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. The relationship is documented and an assessment made, both at hedge inception and at each reporting period, of whether the derivatives used in hedging transactions are highly effective in offsetting changes in fair values of hedged items.

(a) Fair value hedge

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk.

If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of a hedged item for which the effective interest method is used is amortised to profit or loss over the period to maturity. The adjustment to the carrying amount of a hedged equity security remains in retained earnings until the disposal of the equity security.

(b) Net investment hedge

Any gain or loss on a hedging instrument relating to the effective portion of a hedge of net investments in foreign operations is recognised in equity as translation reserve; the gain or loss relating to the ineffective portion is recognised immediately in the income statement. Gains and losses on net investments accumulated in equity are included in the income statement when the foreign operation is disposed of.

(c) Derivatives that do not qualify for hedge accounting

Derivative financial instruments which do not qualify for hedge accounting are recognised as trading assets or trading liabilities. Changes in their fair value are recognised immediately in the income statement.

2.6 Interest income and expense

Interest income and expense are recognised in the income statement using the effective interest method for all instruments measured at amortised cost.

The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that discounts estimated future cash flows or receipts through the expected life of the financial instrument or, when appropriate, a shorter period, making it equivalent to the net carrying amount of the financial asset or financial liability in the balance sheet. When calculating the effective interest rate, the Group estimates cash flows, considering all contractual terms of the financial instrument, but does not consider future credit losses. The calculation includes all fees and amounts paid or received between parties to the contract that are an integral part of the effective interest rate, as well as transaction costs and all other premiums or discounts.

Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised at the rate of interest used to discount the impairment loss. Interest income on financial assets which have been written down as a result of impairment is calculated based on the net amount of the financial asset taking the write-down into consideration.

2.7 Fee and commission income

Fees and commissions are generally recognised on an accrual basis when the service has been provided. Loan commitment fees for loans are generally deferred (together with related direct costs) and recognised as an adjustment to the effective interest rate on the loan. Commission and fees arising from negotiating, or participating in the negotiation of, a transaction for a third party – such as arrangement of transactions with equities or other securities or the purchase or sale of businesses – are recognised on completion of the underlying transaction. Portfolio and other management advisory and service fees are recognised based on the applicable service contracts, usually on a time-apportionate basis. Asset management fees related to investment funds are recognised rateably over the period the service is provided. The same principle for income reporting is applied for other custody services that are continuously provided over an extended period of time.

2.8 Financial assets

The Group classifies its financial assets in the following categories: trading assets, financial assets designated at fair value through profit or loss at inception and loans and advances. Management determines the classification of its investments at initial recognition.

(a) Trading assets

A financial asset is classified in this category if it is primarily held for the purpose of selling in the short term. Derivatives are also classified as trading assets unless designated as hedging instrument.

(b) Financial assets designated at fair value through profit or loss at inception

Financial assets and financial liabilities are designated at fair value through profit or loss when:

• Doing so significantly reduces measurement inconsistencies that would arise if the related derivatives were treated as held for trading and the underlying financial instruments were carried at amortised cost for such as loans and advances to customers or banks and debt securities in issue;

• Certain investments, such as equity investments, that are managed and evaluated on a fair value basis in accordance with a documented risk management or investment strategy and reported to key management personnel on that basis are designated at fair value through profit and loss; and

• Financial instruments, such as debt securities held, containing one or more embedded derivatives significantly modify the cash flows, are designated at fair value through profit and loss.

Such financial assets are reported at current fair value and changes recognised in the income statement. The classification of financial assets placed in this category cannot be changed after their original classification.

(c) Loans and advances

Loans and advances are financial assets with defined payments that are not quoted in an active market. They arise when the Group provides funds directly to a debtor with no intention of trading them.

Purchases and sales of trading assets and financial assets designated at fair value through profit or loss are recorded on the date on which the Group commits to purchase or sell the asset. Loans are recognised when the funds related to the loan are disbursed to the borrowers. All financial assets are initially recorded at fair value plus transaction costs. Transaction costs are, however, not included in the initial cost of trading assets and financial assets designated at fair value through profit or loss. Financial assets are derecognised when they have been transferred to another party, for instance when the rights to receive cash flows from the financial assets have expired or where the Group has transferred substantially all risks and rewards of ownership.

Financial assets designated at fair value through profit or loss and trading assets are subsequently carried at fair value. Loans and advances are carried at cost using the effective interest method. Gains and losses arising from changes in the fair value of the financial assets at fair value on the income statement and trading assets are included in the income statement in the period in which they arise.

The fair values of quoted investments in active markets are based on current bid prices. If the market for a financial asset is not active (and for unlisted securities), the Group establishes fair value by using recognised valuation techniques. These include the use of recent arm's length transactions, references to other materially equivalent instruments, discounted cash flow analysis and option pricing models and other valuation techniques commonly used by market participants. In some instances when recognised valuations do not give reliable measurement for equity instruments, they are measured at cost.

The Group is involved in Total Return Swaps derivative contracts. In instances where the Group has transferred loans previously accounted for in the balance sheet to Total Return Swaps, it has evaluated that this did not fulfill the condition for derecognition under IAS 39. The loans are therefore still accounted for in the balance sheet as Loans to financial institutions, measured at amortized cost. In instances where the Total Return Swap contracts relates to off-balance sheet items, only the derivative is accounted for, at fair value.

2.9 Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legal enforceable right to offset the recognised amounts and there is an intention to settle on a net basis.

2.10 Sale and repurchase agreements

Repurchase agreements (repos) are financial instruments providing for the sale of securities under agreement to repurchase the same securities at a predetermined price. Control of the securities remains in the hands of the Group during their entire transaction period and the securities remain on its balance sheet as trading assets or as financial assets designated at fair value through profit or loss, as appropriate.

2.11 Securities lending and borrowing

Lending agreements are financial instruments where the securities are not sold but are returned to the Group at the end of contract. Control of the securities remains in the hands of the Group during their entire transaction period and the securities remain on its balance sheet as trading assets or as financial assets designated at fair value through profit or loss, as appropriate.

Securities borrowed are not recognised in the financial statements, unless these are sold to third parties, at which point the obligation to repurchase the securities is recorded as a trading liability at fair value and any subsequent gain or loss included in net trading income.

2.12 Impairment of loans and advances

At each balance sheet date, the Group assesses whether there is objective evidence that a loan or loan portfolio is impaired. A loan or loan portfolio is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset and that loss event (or events) has an impact on the estimated future cash flows of the loan or group of loans that can be reliably estimated. Objective evidence of impairment includes observable data about the following loss events:

(i) significant financial difficulty of the borrower;

(ii) a breach of contract, such as a default on instalments or on interest or principal payments;

(iii) the Group granting to the borrower, for economic or legal reasons relating to the borrower's financial difficulty, a refinancing concession, that the lender would not otherwise consider;

(iv) it becomes probable that the borrower will enter bankruptcy or undergo other financial reorganisation;

(v) the disappearance of an active market for that financial asset because of financial difficulties; or

(vi) observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of loans since the initial recognition of those assets, 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 a group of loans.

The Group defines loans that are individually significant and assesses first whether objective evidence of their impairment exists, and individually or collectively for loans and advances that have not been defined as individually significant. If the Group determines that no objective evidence of impairment exists for significant loans, it includes the loan in a group of loans with similar credit risk characteristics and collectively assesses them for impairment. Individual significant assets for which an impairment loss is recognised are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss on loans and advances has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the asset's recoverable value. The recoverable value is the present value of estimated future cash flows (excluding future credit losses that have not been incurred), discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced by the amount of impairment through the use of an allowance account and the amount of the loss is recognised in the income statement. In the case of a loan at variable interest rates, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract.

For impairment calculation of the present value of the estimated future cash flows of a collateralised financial asset, regard is had for estimated sale or redemption value of the collateral less costs for obtaining and selling the collateral. Such calculation is made on the basis of objective assessment of loss, whether or not foreclosure is probable.

For the purposes of a collective evaluation of impairment, loans and advances are grouped on the basis of similar credit risk characteristics (i.e. on the basis of the Group's grading process that considers asset type, industry, geographical location, collateral type, past-due status and other relevant factors). Such classification, based on credit risk, gives a good indication of the impairment of a group of assets.

Future cash flows in a group of loans evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the Group and historical loss experience for assets with similar credit risk characteristics. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience was originally based and to remove the effects of previously existing loss factors which do not exist currently.

Estimates of changes in future cash flows for groups of assets should be 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 Group to minimise any differences between loss estimates and actual losses.

When a loan is uncollectible, it is fully written off against the provision for loan impairment on the balance sheet. Loans are written off after all the necessary procedures have been completed, as provided for in the Group's rules, and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of the provision for loan impairment in the income statement.

If the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the original impairment was recognised, the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in the income statement.

2.13 Intangible assets

(a) Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets of the acquired subsidiary/associate on the date of acquisition. Goodwill related to a merger and on acquisitions of subsidiaries is included in intangible assets. Goodwill on acquisitions of associates is included in investments in associates. Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Gains and losses on the disposal of a subsidiary/associate include the carrying amount of goodwill relating to the entity sold.

Goodwill is allocated to cash-generating units for the purpose of impairment testing. Impairment of goodwill, based on impairment test procedures of IAS 36, is expensed in the income statement.

(b) Computer software

Acquired computer software licenses are capitalised on the basis of the costs incurred to acquire and take into service the specific software. These costs are amortised on the basis of their expected useful lives (five years).

The Group assess at each reporting date whether there is any indication that an software asset may be impaired. If any such indication exists, the Group estimates the recoverable amount of the asset. The recoverable amount is the higher of the asset's fair value less costs to sell or its value in use. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

Costs associated with developing or maintaining computer software programs are recognised when the expense is incurred.

2.14 Property, plant and equipment (PPE)

Land and buildings consist mainly the Bank's branches and offices. All property, plant and equipment is stated at historical cost less depreciation. Historical cost of PPE includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

Land is not depreciated. Depreciation on other assets is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives, as follows:

Buildings	25-100 years,
Computer hardware	3-5 years,
Other chattels	3-10 years.

The assets' residual values and useful lives are reviewed annually and adjusted if appropriate.

Assets that are subject to depreciation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may be lower than the estimated recoverable value. The recoverable amount is the higher of the asset's fair value less costs to sell or its value in use. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

Gains and losses on disposals are determined by comparing the sale price of an asset with its carrying amount on the date of sale. Gains and losses are included in the income statement.

2.15 Non-current assets and disposal group classified as held for sale

Non-current assets held for sale are the Group's appropriated assets which are in the process of being sold. This item includes also a disposal group which is held for sale. Liabilities connected with the disposal group are recognised as a separate liability on the balance sheet. The presentation and measurement of these assets and liabilities are based on IFRS 5, Non-current assets held for sale and discontinued operations. Items included under non-current assets held for sale are recognised at the lower of carrying amount or fair value less cost to sell, taken into account the measurement requirement exception in IFRS 5.

2.16 Leases

(a) A Group company is the lessee

The leases entered into by the Group are primarily operating leases, including house rental agreements. The total payments made under operating leases are charged to the income statement on a straight-line basis over the period of the lease.

When an operating lease is terminated before the lease period has expired, the total amount of the entire leasing contract until the end of the period is expensed.

(b) A Group company is the lessor

When assets are held subject to a finance lease, the present value of the lease payments is recognised as a receivable as a part of loan and advances to customers. The difference between the gross receivable and the present value of the receivable is recognised as income due. Lease income is recognised over the term of the lease using a method which reflects a constant periodic rate of return.

2.17 Cash and cash equivalents

In the cash flow statement, cash and cash equivalents are defined as cash and non-restricted balances with the Central Bank, amounts due from other banks and treasury bills.

2.18 Provisions

Provisions for restructuring cost and disputes are recognised in the consolidated financial statements when it is more likely than not that an outflow of Group resources will be required to settle the obligation and the amount can be reliably estimate.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognised as interest expense.

2.19 Financial guarantee contracts

Financial guarantee contracts are contracts that require the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payments when due, in accordance with the terms of a debt instrument. Such financial guarantees are given to banks, financial institutions and other bodies on behalf of customers to secure loans, overdrafts and other banking facilities.

Financial guarantees are initially recognised in the financial statements at fair value on the date the guarantee was given. Subsequent to initial recognition, the bank's liabilities under such guarantees are measured at the higher of the initial measurement, less amortisation calculated to recognise in the income statement the fee income earned on a straight line basis over the life of the guarantee and the best estimate of the expenditure required to settle any financial obligation arising at the balance sheet date. These estimates are determined based on experience of similar transactions and history of past losses, supplemented by the judgment of Management.

2.20 Employ benefits

(a) Pension obligation

Group companies operate various pension schemes. Most of the Group companies have defined contribution plans, where the companies pay contributions to publicly or privately administered pension insurance plans on a mandatory, contractual or voluntary basis. The Group has no further payment obligations once the contributions have been paid. The contributions are recognised as employee benefit expense monthly when they are due.

A few of the Group companies have a defined benefit plan. A defined benefit plan is a pension plan that defines an amount of pension benefit that an employee will receive on retirement, usually dependent on one or more factors, such as age, years of service and compensation.

The liability recognised in the balance sheet in respect of defined benefit pension plans is the present value of the defined benefit obligation at the balance sheet date less the fair value of plan assets, together with adjustments for unrecognised actuarial gains or losses and past service costs. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating the terms of the related pension liability.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions in excess of the greater of 10% of the value of plan assets or 10% of the defined benefit obligation are charged or credited to income over the employees' expected average remaining working lives. Past service costs are recognised immediately in administrative expenses, unless the changes to the pension plan are conditional on the employees remaining in service for a specified period of time (the vesting period). In this case, the past-service costs are amortised on a straight-line basis over the vesting period.

(b) Share-based compensation

The Group has entered in to stock options contracts with its employees enabling them to acquire shares in the Bank. In all instances the exercise price corresponds to the market value of the shares at grant date. The stock options were granted after 7 November 2002 and cost related to the agreements is expensed during the vesting period based on the related terms. The agreements are both equity and cash settled and the expenses recognised in the income statement.

2.21 Deferred income tax

Deferred income tax is recognised in full as a liability, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated interim financial statements. Deferred income tax is, however, not recognised if it arises from the original recognition of an asset or liability in a transaction other than a merger of companies, which affects neither its accounting nor taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

The principal temporary differences arise from revaluation of certain financial assets and liabilities, including derivative contracts and depreciation of property, plant and equipment. Temporary differences also include tax losses carried forward and the difference between the fair values of assets acquired and their tax base.

Deferred tax assets are recognised where it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Deferred income tax arising from temporary differences in connection with investments in subsidiaries and associates is recognised in the consolidated financial statements. This is not done, however, where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the difference will not reverse in the foreseeable future.

Income tax payable on profits, based on the applicable tax law in each jurisdiction, is recognised as an expense in the period in which profits arise. The tax effects of income tax losses available for carry forward are recognised as an asset when it is probable that future taxable profits will be available against which these losses can be utilised.

2.22 Borrowings

Borrowings are recognised initially at fair value, being their issue proceeds net of transaction costs incurred. Borrowings are subsequently stated at amortised cost using the effective interest method.

2.23 Subordinated loans

The Group has borrowed funds by issuing bonds on subordinated terms. The bonds have the characteristics of equity in being subordinated to other liabilities of the Group. In the calculation of the capital ratio, the bonds are included with equity, as shown in note 31. The loans are entered as liabilities with accrued interest and indexation.

2.24 Trading liabilities

Trading liabilities primarily consist of derivatives with negative fair values and delivery obligations for short sales of securities. Trading liabilities are measured at fair value.

Gains and losses realised on disposal or redemption and unrealised gains and losses from changes in the fair value of trading liabilities are reported as Net gain on financial assets and liabilities held for trading. Interest and dividend expense on trading liabilities are included in Net interest income.

2.25 Share capital

(a) Share issue costs

Costs directly attributable to the issue of new shares are shown in equity as a deduction from the proceeds.

(b) Dividends on ordinary shares

Dividends on ordinary shares are recognised in equity in the period in which they are approved by the Bank's shareholders meeting.

(c) Treasury shares

Where the Bank, or other member of the Group, purchases the Bank's equity share capital, the consideration paid is deducted from total shareholders' equity as treasury shares until they are cancelled. Where such shares are subsequently sold or reissued, any consideration received is included in shareholders' equity.

2.26 Fiduciary activities

The Group acts as custodian, holding or placing assets on behalf of individuals, institutions and pension funds. These include various mutual funds managed by the Group. These assets and income arising thereon are excluded from these financial statements, as they do not belong to the Group.

2.27 Comparatives

Where necessary, comparative figures have been adjusted to conform with changes in presentation in the current year.

3 Critical accounting estimates and judgements in applying accounting policies

The Group makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next 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. The accounting estimated based on these assumptions will by definition seldom be equivalent to the relevant real outcome. The discussion below examines estimates and assumptions which involve a substantial risk of causing material correction to the carrying amounts of assets and liabilities within the next financial year.

(a) Impairment losses on loans and advances

The Group reviews its loan portfolios to assess impairment at least on a quarterly basis. In determining whether an impairment loss should be recorded in the income statement, the Group 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 has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with 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 derivatives

The fair value of financial instruments not quoted in active markets are determined by various recognised valuation techniques. When valuation techniques (e.g. models) are used to determine fair value, they are validated and periodically reviewed by qualified personnel independent of the area that created them. All models are certified before they are used, and calibrated to ensure that outputs reflect actual data and comparative market prices. To the extent practicable, models use only observable data, however areas such as credit risk require management to make estimates. Changes in assumptions about these factors could affect the reported fair value of financial instruments.

(c) Securitisations and special purpose entities (SPEs)

The Group sponsors the formation of special purpose entities (SPEs) primarily for the purpose of allowing clients to hold investments, for asset securitisation, and for buying or selling credit protection. The Group does not consolidate SPEs that it does not control. Where it is difficult to determine whether the Group does control an SPE, it makes an objective assessment about its exposure to risk and reward, as well as about its ability to make operational decisions for the SPE in question. In many instances, elements are present that, considered in isolation, indicate control or lack of control over an SPE, but when considered together make it difficult to reach a clear conclusion. In such cases, the SPE is consolidated.

(d) Income taxes

The Group is subject to income taxes in numerous jurisdictions. Significant estimates are required in determining the worldwide provision for income taxes. There are many transactions and calculations for which the ultimate tax determination is uncertain during the ordinary course of business. The Group recognises liabilities for anticipated tax audit issues based on estimates of whether additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the income tax and deferred tax provisions in the period in which such determination is made.

4 Management of financial risk

The Group's risk policy and procedures ensure that the risks involved in its operations are known, measured and monitored. Risk is managed to ensure that it remains within the limits adopted by the Group for its operations and complies with regulatory requirements. The Group follows a policy dealing with different types of risks in combination, to ensure that fluctuations resulting from unexpected events, affecting both the Group's equity and its performance, will be both limited and manageable.

The Board of Directors is responsible for the Group's basic policy on risk, ensuring that it conforms to the Bank's strategy, the experience of its management, its capital adequacy and readiness to accept risk. The Group CEOs are responsible to the Board for its daily operations and manage its risk through committees. Furthermore, managing directors are responsible to the CEOs for the activities of their respective divisions and for ensuring that risk accords with the Bank's policy.

The Bank has four standing committees: the Asset and Liability Committee (ALCO), the Asset Management Committee, the Credit Committee and the Operations Committee. In addition to these committees, meetings of managing directors serve as a forum for consultation between the CEOs and managing directors. Two committees operate within the Board of Directors, an Audit Committee and Remuneration Committee, preparing examination by the Board of specific areas of operation and investigating in more detail matters related to them.

The compliance officer ensures that the Bank's rules on securities trading and insider trading are followed, and that Group operations comply with the Act on Securities Transactions, Act on Actions to Combat Money Laundering and other relevant statutes and regulations. Each of Landsbanki's subsidiaries has a compliance officer, and the Group compliance officer supervises their work and reports to the Board of Directors. Since the Bank's internal auditing is carried out on a Group basis, the director of Internal Audit for the parent company audits all Group companies. Internal auditing is an essential aspect of the Bank's risk management control; each operating unit is audited at least once a year.

4.1 Financial instruments and risk management strategy

Clients' assets and liabilities can bear fixed or variable rates of interest, for a longer or shorter term. It is essential for the Group to control its investments closely, in order to maintain a balance in interest rates and maturities of assets and liabilities. The Group also endeavours to increase its interest rate margin by offering both short-term and long-term credit, while at the same time it must maintain sufficient liquidity to meet its commitments. By extending credit to both corporations and individuals, on varying terms reflecting the risk of loss in each instance, the Group endeavours to achieve an acceptable interest rate margin. This risk is not limited to interest bearing assets on the Bank's balance sheet but also includes guarantees and other financial instruments.

By taking positions and trading in listed and unlisted financial instruments, Landsbanki can take advantage of short-term movements on the equity and bond markets, as well as currency and interest rate fluctuations. Currency risk is generally kept in balance. Part of the Group's currency risk is hedged with currency swaps. Interest rate risk is also partly hedged against any drop in the fair value of fixed interest rate assets and any increase in the fair value of customers' deposits on fixed terms through interest rate swaps and currency interest rate swaps.

4.1.1 Hedge accounting

The Group designates specific derivatives as hedges of the fair value of assets or liabilities. Hedge accounting is used for derivatives designated in this way provided certain criteria are met.

(a) Fair value hedge

The Group uses interest rate and currency swaps to hedge part of its interest rate risk against any possible impairment of the fair value of fixed interest rate assets and liabilities in both ISK and foreign currencies. The net fair value of these swaps as of 31 December 2006 was positive of ISK 4,068 million.

(b) Net investment hedge

The Group balances currency risk deriving from net investment in activities abroad against foreign currency borrowing. Loans amounting to ISK 40,063 million (2005: ISK 11,648 million) were recognised as hedges, resulting in exchange rate loss in 2006 of ISK 6,857 million (2005: ISK 359 million profit) recognised in equity against exchange rate profit from investments in subsidiaries.

4.1.2 Counterparty Risk

Counterparty risk is the Group's greatest single risk factor. Counterparty risk is the risk that a borrower or counterparty in a transaction will be unable to meet its financial obligations. The Group manages this risk by setting limits for acceptable risk for individual borrowers or groups of borrowers, specific regions or industrial sectors. Such risk factors are under constant surveillance and are reviewed regularly. Counterparty risk is also managed through regular assessments of clients' credit ratings, modifications of lending authorisations or acquiring better collateral to secure clients' commitments.

The Board of Directors sets detailed lending rules, including maximum obligations for individual clients and related parties. The purpose of these rules is to limit the maximum risk of the Group. They cover clients' total exposures, so that the indirect risk to the Group through its clients is added to the direct claims of the Bank and its subsidiaries. Financial instruments issued by a client, which are used to guarantee other obligations of third parties not financially connected, are also added to the direct claims. According to the Bank's internal rules, the maximum total exposures through an individual customer or financially connected parties may not exceed 20% of the Group's equity.

Clients classified in the best risk classes, according to the Bank's rating system, may comprise an aggregate exposure of as much as 25% of the Group's equity, but only in the form of short-term obligations. Parties classified in poorer risk categories may not comprise overall exposures for the Group exceeding 10% of its equity. In similar fashion, however, this exposure may be increased to as much as 15%, provided the portion exceeding 10% is in the form of short-term commitments.

The Bank's Credit Committee sets detailed lending rules based on the basic policy laid down by the Board of Directors. Employees' lending authorisations are well defined and incremental. The Credit Committee delegates and reviews employees' authorisations and is responsible for reviewing lending rules. Comprised of the CEOs and managing directors, it meets regularly to discuss all credit decisions exceeding the authorisations of branches, subsidiaries or the Corporate Banking Division. The Committee checks the composition of the loan portfolio with regard to industrial sectors, geographical regions, collateral and other aspects, as well as monitoring defaults and default trends. Detailed reports on the position of the Group's largest debtors are reviewed by the Credit Committee, together with special reports, e.g. on the situation of the economy in general and specific industrial sectors, etc.

(a) Derivatives

Counterparty risk from derivative contracts is managed by the Bank's Securities and Treasury division. Risk from derivative contracts is assessed as a credit equivalent, comprised of the fair value of the contract and its assessed future risk.

(b) Credit-related commitments

Guarantees and letters of credit, which irrevocably commit the Group to make payment to a third-party in the event a customer cannot fulfil his obligations, involve the same credit risk as loans. Import guarantees and documentary credits are secured by the goods shipments they cover, thus representing a lower risk than direct loans. Unused credit lines represent a commitment to increase loans or guarantees. The Group could conceivably suffer losses equivalent to the total amount of open credit lines. The Group monitors the duration of credit lines, since longer-term obligations generally imply a greater credit risk.

(c) Netting arrangements

In order to further limit counterparty risk arising from financial instruments, the Group enters into netting agreements. These arrangements ensure that in the case of foreclosure, the Group can set off all contracts covered by the netting agreement against the debt. The arrangements generally include all market transactions between the Group and the client.

4.2 Geographical location of loans and advances to customers

	2006		2005	
		%		%
Iceland (Home country)	894,328	62	661,532	67
UK & Ireland	249,958	17	150,391	14
Luxembourg	219,724	15	123,862	12
Other	74,385	5	48,809	6
Total	**1,438,395**	**100**	**984,593**	**100**

4.3 Market Risk

Market risk is the risk arising from the impact of changes in market prices on the value of the Group's assets and liabilities, both on and off its balance sheet. This includes both interest rate and equity risk on its trading portfolio, as well as currency risk on all its portfolios. Market risk is, however, mainly limited to the Bank's trading book transactions.

The Board of Directors has set a ceiling on the Bank's market risk, which may not exceed 15% of its total risk-weighted asset base. Within this limit, equity risk may not exceed 12%, currency risk may not be more than 2% and the maximum interest rate risk on market bonds and other financial instruments may not exceed 6%. ALCO sets detailed rules on the Group's maximum market risk. Risk control is effected on a Group basis, under direction of Risk Management. Authorisations to take positions subject to market risk are mainly limited to the Securities and Treasury division of the parent company, where total market risk for the Group is also managed. In addition to the Securities and Treasury division of the parent company, trading desks of its subsidiaries Kepler, Teather & Greenwood and Merrion Capital have limited authorisations for exposures on own account.

Total market risk for the Group is calculated at the end of each banking day and controlled by means of an authorisation system adopted by ALCO. Since no single instrument can cover all the aspects of market risk, the Group applies several methods in its daily risk measurement, including VaR (Value-at-Risk) and stress testing, and uses indicators such as net position and value per bp (Vpb). VaR is used to measure trading book market risk. VaR is a statistical instrument which measures the Group's maximum expected loss for the next working day under normal market conditions for a 99% confidence interval. The Group's loss should only exceed the resulting value on one working day out of a hundred. VaR models are tested for reliability in accordance with the guidelines of the Basel Committee on Banking Supervision.

The following tables show the VaR estimate for market risk for the bank's total equity exposure with and without equity held in financial assets designated at fair value through profit and loss and market risk without financial assets designated at fair value through profit and loss and unlisted equities:

	1 January to 31 December 2006				12 months to 31 December 2005		
Market Risk	**Average**	**High**	**Low**	**2006**	**Average**	**High**	**Low**
Interest rate risk	176	749	58	250	228	597	27
Foreign exchange risk	67	360	2	9	10	72	1
Equities risk	1,281	2,908	541	1,017	1,127	2,456	510
Total VaR (99% 1 day holding period)	**1,524**	**4,017**	**601**	**1,276**	**1,365**	**3,125**	**538**
Total VaR (99% 10 day holding period)	**4,819**	**12,703**	**1,901**	**4,035**	**4,316**	**9,881**	**1,703**

Market Risk without financial assets designated at FV through P/L

	Average	High	Low	2006	Average	High	Low
Interest rate risk	176	749	58	250	228	597	27
Foreign exchange risk	67	360	2	9	10	72	1
Equities risk	1,183	1,926	323	987	869	1,343	469
Total VaR (99% 1 day holding period)	**1,426**	**3,035**	**383**	**1,246**	**1,106**	**2,012**	**497**
Total VaR (99% 10 day holding period)	**4,509**	**9,598**	**1,211**	**3,940**	**3,499**	**6,362**	**1,571**

Market risk without financial assets designated at FV through P/L and unlisted equities

	Average	High	Low	2006	Average	High	Low
Interest rate risk	176	749	58	250	228	597	27
Foreign exchange risk	67	360	2	9	10	72	1
Equities risk	296	427	180	293	202	286	128
Total VaR (99% 1 day holding period)	**539**	**1,536**	**240**	**552**	**440**	**955**	**156**
Total VaR (99% 10 day holding period)	**1,704**	**4,857**	**759**	**1,746**	**1,391**	**3,020**	**493**

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4.3.1 Currency Risk

The Group is exposed to risk from changes in the exchange rates of major foreign currencies, which affect the Bank's financial position and cash flow. ALCO sets risk limits for each currency and for total currency exposures both overnight and intraday, which are monitored daily. The following table shows the carrying amount of the Group's assets and liabilities by currency. Off-balance sheet amounts show the notional amounts of financial instruments in foreign currencies.

Concentrations of assets, liabilities and off balance sheet items.

At 31 December 2006	ISK	EUR	USD	GBP	CHF	Other	Total
Assets							
Cash and cash balances with Central Bank	20,481	10,054	333	125	591	85	31,669
Loans and advances to financial institutions	24,531	65,641	13,950	109,140	922	1,434	215,618
Loans and advances to customers	542,618	309,612	141,165	204,757	118,553	121,690	1,438,395
Bonds and debt instruments	36,463	131,544	0	1,592	0	0	169,598
Shares and equity instruments	24,810	4,860	1,005	7,131	756	10,766	49,328
Hedged securities	80,528	2,321	3,418	11,231	0	7,692	105,190
Derivatives held for trading	15,737	10,250	8,852	1,598	783	1,137	38,358
Derivatives held for hedging	1,022	7,489	505	1,444	34	3	10,498
Investments in associates	3,531	306	0	0	0	0	3,837
Property and equipment	4,083	785	0	666	288	0	5,823
Intangible assets	1,691	5,500	95	6,998	68	0	14,351
Non-current assets and disposal groups classified as held for sale	18,524	0	0	2,825	0	0	21,349
Unsettled securities trading	5,130	21,068	225	8,996	1,520	26	36,965
Other assets	16,472	12,361	29	2,549	431	102	31,944
Total assets	**795,622**	**581,791**	**169,577**	**359,052**	**123,947**	**142,935**	**2,172,924**
Liabilities and equity							
Deposits from financial institutions	37,427	50,728	10,585	33,201	3,668	5,496	141,105
Deposits from customers	80,440	81,128	13,159	350,257	121	157,741	682,846
Borrowing	108,800	538,249	250,896	24,699	22,219	70,113	1,014,976
Subordinated loans	6,226	78,602	2,137	0	0	2,789	89,754
Trading liabilities	12,375	3,359	1,963	1,305	97	1,767	20,866
Derivatives held for hedging	1,591	2,358	981	1,095	48	400	6,473
Tax liabilities	5,985	492	0	116	0	0	6,593
Liabilities included in disposal groups held for sale	7,242	0	0	0	0	0	7,242
Unsettled securities trading	0	20,142	581	5,886	2,003	1,375	29,987
Other liabilities	10,980	5,492	240	6,407	502	2	23,623
Total equity	149,457	0	0	0	0	0	149,457
Total liabilities and equity	**420,524**	**780,550**	**280,542**	**422,966**	**28,658**	**239,683**	**2,172,924**
Net on-balance sheet position	375,097	(198,759)	(110,965)	(63,914)	95,289	(96,748)	
Net off-balance sheet position	(375,993)	199,281	110,516	64,175	(95,192)	97,213	
Net position	**(896)**	**522**	**(449)**	**261**	**97**	**465**	

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4.4 Mismatch of assets and liabilities

(a) Interest rate risk on portfolios

Portfolio interest rate risk arises from the impact on the interest margin and/or the market value of equity of interest rate changes on assets and liabilities outside of the Bank's trading book. This risk is primarily the result of duration mismatch of assets and liabilities. Portfolio interest rate risk is among the Group's more important risk factors.

(b) Liquidity Risk

Liquidity risk is the risk of losses the Group could incur should it be unable to meet its obligations when due. The Group's liquidity risk is divided into three types: intraday liquidity risk, short-term liquidity risk extending over several months, and risk due to mismatch of longer-term assets and liabilities. A distinction is also made, in measuring and managing liquidity risk, between domestic and foreign liquidity risk.

ALCO formulates liquidity management policy, monitors the Group's liquidity position and provides advice on the composition of its assets and liabilities. The objective is to minimise fluctuations in liquidity and ensure that the Group always has sufficient access to funding to cover outflows arising from its obligations in the coming month. Treasury implements this policy and estimates future cash flow in co-operation with Risk Management.

At the end of 2006, the Bank's liquidity ratio, calculated by balancing assets and liabilities in accordance with the Central Bank's Rules No. 317/2006 was 3.26.

The following table shows the Group's assets and liabilities classified according to their maturities. The classification is based on the residual maturity as of the date of the financial statements.

At 31 December 2006	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Assets						
Cash and cash balances with Central Bank	31,669	0	0	0	0	31,669
Loans and advances to financial institutions	202,425	12,938	254	0	0	215,618
Loans and advances to customers	424,100	195,659	522,501	296,135	0	1,438,395
Bonds and debt instruments	52,924	74,982	17,981	23,711	0	169,598
Shares and equity instruments	0	0	0	0	49,328	49,328
Hedged securities	59,496	1,819	9,037	34,838	0	105,190
Derivatives held for trading	10,561	5,407	10,582	11,807	0	38,358
Derivatives held for hedging	50	3,206	6,565	677	0	10,498
Investments in associates	0	0	0	0	3,836	3,837
Property and equipment	0	0	0	0	5,823	5,823
Intangible assets	0	0	0	0	14,351	14,351
Non-current assets and disposal groups classified as held for sale	0	0	0	0	21,349	21,349
Unsettled securities trading	36,965	0	0	0	0	36,965
Other assets	0	0	0	0	31,944	31,944
Total assets	**818,192**	**294,012**	**566,920**	**367,168**	**126,631**	**2,172,924**
Liabilities and equity						
Deposits from financial institutions	129,564	7,808	3,725	8	0	141,105
Deposits from customers	573,721	66,785	36,717	5,623	0	682,846
Borrowing	71,235	189,734	638,309	115,697	0	1,014,976
Subordinated loans	0	0	4,837	24,828	60,089	89,754
Trading liabilities	13,363	2,292	3,259	1,952	0	20,866
Derivatives held for hedging	215	583	720	4,954	0	6,473
Tax liabilities	0	6,593	0	0	0	6,593
Liabilities included in disposal groups held for sale	0	0	0	0	7,242	7,242
Unsettled securities trading	29,987	0	0	0	0	29,987
Other liabilities	23,623	0	0	0	0	23,623
Total equity	0	0	0	0	149,457	149,457
Total liabilities and equity	**841,709**	**273,796**	**687,567**	**153,063**	**216,788**	**2,172,924**
Off balance sheet derivatives						
Assets						
Foreign exchange derivatives	812,419	286,390	146,518	920	0	1,246,247
Interest rate derivatives	113,379	153,549	354,004	131,552	0	752,484
Equity derivatives	56,297	3,310	0	0	0	59,607
Total off balance sheet assets	**982,095**	**443,249**	**500,522**	**132,472**	**0**	**2,058,338**
Liabilities						
Foreign exchange derivatives	812,419	286,390	146,518	920	0	1,246,247
Interest rate derivatives	92,812	126,916	377,499	155,258	0	752,484
Equity derivatives	0	0	0	0	59,607	59,607
Total off balance sheet liabilities	**905,231**	**413,306**	**524,017**	**156,178**	**59,607**	**2,058,338**
Net on balance sheet position	(23,517)	20,216	(120,647)	214,106	(90,157)	
Net off balance sheet position	76,864	29,943	(23,495)	(23,706)	(59,607)	
Maturity gap	**53,347**	**50,159**	**(144,142)**	**190,400**	**(149,764)**	

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The following table gives a summary of the Group's interest rate risk. It shows the carrying amounts of its assets and liabilities. The carrying amount classification is based on either the repricing date of the contract or its maturity, whichever comes first.

At 31 December 2006	Up to 3 months	3-12 months	1-5 years	Over 5 years	Non-interest bearing	Total
Assets						
Cash and cash balances with Central Bank	31,669	0	0	0	0	31,669
Loans and advances to financial institutions	202,425	12,938	254	0	0	215,618
Loans and advances to customers	966,114	270,116	93,997	108,168	0	1,438,395
Bonds and debt instruments	52,924	74,982	17,981	23,711	0	169,598
Shares and equity instruments	0	0	0	0	49,328	49,328
Hedged securities	59,496	1,819	9,037	34,838	0	105,190
Derivatives held for trading	38,358	0	0	0	0	38,358
Derivatives held for hedging	10,498	0	0	0	0	10,498
Investments in associates	0	0	0	0	3,837	3,837
Property and equipment	0	0	0	0	5,823	5,823
Intangible assets	0	0	0	0	14,351	14,351
Non-current assets and disposal groups classified as held for sale	0	0	0	0	21,349	21,349
Unsettled securities trading	0	0	0	0	36,965	36,965
Other assets	0	0	0	0	31,944	31,944
Total assets	**1,361,485**	**359,856**	**121,269**	**166,717**	**163,597**	**2,172,924**
Liabilities and equity						
Deposits from financial institutions	131,501	7,808	1,789	8	0	141,105
Deposits from customers	602,074	64,857	10,292	5,623	0	682,846
Borrowing	669,750	54,756	221,659	68,810	0	1,014,976
Subordinated loans	30,621	0	3,839	6,090	49,203	89,754
Trading liabilities	20,866	0	0	0	0	20,866
Derivatives held for hedging	6,473	0	0	0	0	6,473
Tax liabilities	0	0	0	0	6,593	6,593
Liabilities included in disposal groups held for sale	0	0	0	0	7,242	7,242
Unsettled securities trading	0	0	0	0	29,987	29,987
Other liabilities	0	0	0	0	23,623	23,623
Total equity	0	0	0	0	149,457	149,457
Total liabilities and equity	**1,461,287**	**127,421**	**237,579**	**80,531**	**266,105**	**2,172,924**
Off balance sheet derivatives						
Assets						
Foreign exchange derivatives	1,039,543	179,647	26,136	920	0	1,246,247
Interest rate derivatives	237,755	135,626	277,481	101,622	0	752,484
Equity derivatives	56,297	3,310	0	0	0	59,607
Total off balance sheet assets	**1,333,596**	**318,583**	**303,617**	**102,542**	**0**	**2,058,338**
Liabilities						
Foreign exchange derivatives	812,419	286,390	146,518	920	0	1,246,247
Interest rate derivatives	461,207	122,647	125,546	43,083	0	752,484
Equity derivatives	0	0	0	0	59,607	59,607
Total off balance sheet liabilities	**1,273,626**	**409,037**	**272,064**	**44,003**	**59,607**	**2,058,338**
Net on balance sheet position	(99,802)	232,435	(116,310)	86,186	(102,508)	
Net off balance sheet position	59,969	(90,454)	31,553	58,538	(59,607)	
Total interest sensitivity gap	**(39,833)**	**141,981**	**(84,757)**	**144,724**	**(162,115)**	

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4.5 Fair value of financial assets and financial liabilities

The following table gives a summary of the carrying amount and fair value of financial assets and financial liabilities not carried at fair value. The fair value has been estimated by discounting the cash flow of financial assets and financial liabilities based on market interest rates for assets and liabilities of the same or similar duration.

	Carrying value	Fair value	Difference
	2006	2006	2006
Financial assets			
Loans and advances to customers	1,438,395	1,430,638	(7,757)
Financial liabilities			
Borrowing	1,014,976	1,009,433	5,542
Net difference			**(2,215)**

4.6 Inflation-indexed assets and liabilities

The Bank's balance sheet has a positive balance between indexed and non-indexed assets. At year-end, indexed assets exceeded indexed liabilities by ISK 118 billion. These amounts only apply to assets and liabilities in ISK.

	2006	2005
Assets	336,303	275,615
Liabilities	(217,492)	(136,559)
	118,811	**139,056**

4.7 Core Income

The Group's Income with reversal of it's net gain from equity holdings, securities and FX trading, reflects it's Core Income. The approach is to reverse net gain/loss from equity holdings of any kind, as well as gain from securities and FX trading. Instead the net interest revenues is increased by the cost of funds of the Group's positions in these items. To calculate the net interest revenues, a risk free rate of treasury shares for each underlying currency is used. Notwithstanding the Bank's definition of its core income, its performance also depends, for instance, on equity and bond positions taken on own account. The following table gives a comparison between the Group's Income and Core Income for the years 2003-2006:

Actual Income	**2006**	**2005**	**2004**	**2003**
Net interest revenues	41,491	22,996	14,734	9,331
Net commissions and fees	28,366	16,726	8,891	6,116
Net gain on equity, securities and FX	19,568	21,257	9,842	3,535
Net operating revenues	**89,426**	**60,978**	**33,467**	**18,982**
Operating expenses	38,588	20,967	14,460	10,815
Impairment on loans and advances and assets held for sale	6,144	6,197	4,485	4,656
Impairment on goodwill	0	3,033	0	0
Profit before income tax	**44,694**	**30,781**	**14,521**	**3,511**
Cost Income Ratio	**43%**	**34%**	**43%**	**57%**
ROE before tax	**40%**	**56%**	**57%**	**21%**
Adjustments				
Net interest revenues	3,640	3,652	1,200	992
Net gain on equity, securities and FX	(19,568)	(21,257)	(9,842)	(3,534)
Impairment on goodwill	0	3,033	0	0
	(15,929)	**(14,572)**	**(8,642)**	**(2,542)**
Core Income				
Net interest revenues	45,131	26,647	15,934	10,323
Net commissions and fees	28,366	16,726	8,891	6,116
Net operating revenues	**73,497**	**43,373**	**24,825**	**16,439**
Operating expenses	38,588	20,967	14,460	10,815
Impairment on loans and advances and assets held for sale	6,144	6,197	4,485	4,656
Profit before income tax	**28,765**	**16,210**	**5,879**	**968**
Core Cost Income Ratio	**53%**	**48%**	**58%**	**66%**
Core ROE before tax	**26%**	**30%**	**23%**	**6%**

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5 Income Statement by quarters

Operations	Q4 2006	Q3 2006	Q2 2006	Q1 2006	Q4 2005
Interest revenues	34,887	33,154	37,527	27,535	21,073
Interest expenses	25,306	23,840	23,865	18,601	13,818
Net interest revenues	**9,581**	**9,314**	**13,662**	**8,934**	**7,255**
Fee and commission income	9,323	7,547	7,791	7,797	5,359
Fee and commission expenses	1,325	979	849	940	598
Net fee and commission income	**7,998**	**6,568**	**6,943**	**6,857**	**4,761**
Dividend income	161	99	269	1,834	191
Net (loss) gain on financial assets and financial liabilities held for trading	492	1,943	(1,011)	750	5,503
Net (loss) gain on financial assets designated at fair value through profit and loss	5,913	594	(489)	7,680	1,205
Fair value adjustments in hedge accounting	78	25	(25)	(96)	(361)
Foreign exchange difference	(58)	(145)	(12)	(49)	92
Profit (loss) from associates	1,133	(15)	(262)	843	643
Net gain of disposal groups held for sale	(479)	155	51	188	63
Other operating revenues	**7,240**	**2,656**	**(1,478)**	**11,150**	**7,337**
Net operating revenues	**24,819**	**18,538**	**19,127**	**26,942**	**19,352**
Salaries and related expenses	6,989	5,963	6,256	5,249	4,136
Administrative expenses	4,042	3,754	3,496	2,839	2,933
Operating expenses	**11,031**	**9,717**	**9,752**	**8,088**	**7,069**
Impairment on loans and advances during the period	1,332	1,597	1,660	1,555	1,805
Profit before impairment on goodwill and income tax	**12,457**	**7,224**	**7,714**	**17,299**	**10,479**
Impairment on goodwill	0	0	0	0	(259)
Income tax	(1,596)	1,480	1,572	3,023	1,929
Net profit	**14,053**	**5,744**	**6,143**	**14,276**	**8,809**
Attributable to:					
Shareholders of Landsbanki Islands hf.	13,664	5,281	5,966	13,995	8,734
Minority interest	389	463	177	280	75

6 Business segments

The Group operates in four business segments:

- Retail Banking
- Corporate Banking
- Securities and Treasury
- Asset Management and Private Banking

Retail Banking includes the Bank's branch network, SP Fjármögnun and Heritable Bank excluding its corporate division.

Corporate Banking includes the Bank's Corporate division and Heritable's Bank's and Luxembourg´s Corporate Banking divisions.

Securities and Treasury is comprised of the parent company's securities operations and Teather & Greenwood Holding plc., Kepler Equities SA and Merrion Capital Group. This division includes securities brokerage, corporate advisory, FX and derivative trading, the Bank's treasury and debt management and proprietary trading.

Asset Management and Private Banking includes the parent company's Asset Management division, Landsvaki hf. and Landsbanki Luxembourg SA without its Corporate Banking division.

Year 2006	Retail Banking	Corporate Banking	Securities & Treasury	Asset Management Private Banking	Other operations	Group
Net interest revenues	15,145	22,714	1,280	2,351	0	41,491
Net fee and commission income	2,860	2,547	19,294	3,665	0	28,366
Net financial gains	(32)	62	19,235	303	0	19,568
Net operating revenues	**17,974**	**25,323**	**39,809**	**6,320**	**0**	**89,426**
Operating expenses	8,752	6,003	19,101	3,239	1,493	38,588
Impairment on loans and advances and assets held for sale	1,200	3,642	1,307	(5)	0	6,144
Profit before income tax	**8,022**	**15,678**	**19,400**	**3,086**	**(1,493)**	**44,694**
Total assets 31 December 2006	**369,908**	**937,353**	**565,340**	**289,422**	**10,901**	**2,172,924**

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6 Business segments (continued)

Year 2005	Retail Banking	Corporate Banking	Securities & Treasury	Asset Management Private Banking	Other operations	Group
Net interest revenues	10,466	11,866	(1,063)	1,727	0	22,996
Net fee and commission income	3,131	2,343	8,785	2,466	0	16,726
Net financial gains	66	247	20,789	154	0	21,257
Net operating revenues	**13,664**	**14,456**	**28,511**	**4,348**	**0**	**60,978**
Operating expenses	8,272	4,155	5,906	2,208	425	20,967
Impairment on loans and advances and assets held for sale	2,026	3,268	0	902	0	6,197
Impairment on goodwill	0	0	3,033	0	0	3,033
Profit before income tax	**3,366**	**7,032**	**19,572**	**1,237**	**(425)**	**30,781**
Total assets 31 December 2005	**261,638**	**636,014**	**285,652**	**215,144**	**7,012**	**1,405,460**

7 Geographical segments - breakdown of revenues

Year 2006	Iceland	UK & Ireland	Luxembourg	Other*	Total
Net interest revenues	24,622	9,407	3,403	4,059	41,491
Net fee and commission income	11,334	7,907	1,845	7,281	28,366
Net financial gains	6,866	1,796	267	10,640	19,568
Net operating revenues	**42,822**	**19,109**	**5,514**	**21,980**	**89,426**
	48%	**21%**	**6%**	**25%**	**100%**

Year 2005	Iceland	UK & Ireland	Luxembourg	Other*	Total
Net interest revenues	17,362	3,921	1,717	(5)	22,996
Net fee and commission income	12,820	2,314	1,350	242	16,726
Net financial gains	20,388	652	156	62	21,257
Net operating revenues	**50,570**	**6,887**	**3,223**	**299**	**60,978**
	83%	**11%**	**5%**	**0%**	**100%**

* Other=Continental Europe, Scandinavia, Canada, USA and other.

8 Net interest revenues

Interest revenues	2006	2005
Interest on deposits and loans to financial institutions	3,767	4,343
Interest on loans and advances	111,247	54,571
Interest on other financial assets	10,368	4,118
Other interest revenues	7,720	3,405
	133,102	**66,437**

Interest expenses	2006	2005
Interest on deposits from credit institutions	7,686	5,106
Interest on deposits from customers	32,160	15,608
Interest on borrowing	39,628	18,087
Interest on subordinated loans	4,721	1,789
Other interest expenses	7,416	2,851
	91,611	**43,441**
Net interest revenues	**41,491**	**22,996**

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9 Net fee and commission income

Fee and commission income	2006	2005
Securities *	20,491	9,261
Asset management	2,554	1,860
Lending	3,980	3,515
Cards	1,244	1,139
Interbank revenues	972	989
Collection and payment services	755	526
Foreign trade	446	386
Other commissions and fees	2,017	804
	32,459	**18,479**
Fee and commission expense	**4,092**	**1,754**
Net fee and commission income	**28,366**	**16,726**

* Securities includes Corporate Advisory, FX and Derivatives, Treasury, Derivatives Trading and Securities Trading

10 Dividend income

	2006	2005
Trading	449	846
Financial assets designated at fair value through profit and loss	1,914	227
	2,362	**1,073**

11 Net gain on trading in equity, bonds, currency and associated companies

	Stock trading	Bond trading	FX	Profit from associates	Other	Total 2006	Total 2005
Dividend income	2,362	0	0	0	0	2,362	1,073
Net gain on financial assets and financial liabilities held for trading	1,917	257	0	0	0	2,174	10,868
Net gain on financial assets designated at fair value through profit and loss	13,699	0	0	0	0	13,699	5,866
Fair value adjustments in hedge accounting	0		0	0	(18)	(18)	6
Foreign exchange difference	0	0	(263)	0	0	(263)	387
Profit from associates	0	0	0	1,699	0	1,699	1,907
Net gain on sale of disposal groups held for sale	22				(107)	(85)	1,150
	18,000	**257**	**(263)**	**1,699**	**(125)**	**19,568**	**21,257**

12 Net gain on financial assets designated at fair value through profit and loss

Equity securities:	2006	2005
Listed	9,368	4,409
Unlisted	4,331	1,457
Total	**13,699**	**5,866**

13 Salaries and related expenses

	2006	2005
Salaries	20,204	10,512
Pension-fund contributions	2,076	1,042
Pension-fund settlement with The Bank Employees' Pension Fund	655	0
Other personnel expenses	1,523	1,128
	24,458	**12,682**
Number of positions at year-end	**2,117**	**1,725**

14 Impairment on loans and advances and assets held for sale

	2006	2005
Loans and advances	5,690	6,347
Financial assets	617	0
None-current assets held for sale	2	(14)
	6,309	**6,333**
Collected previously written-off loans	(165)	(137)
	6,144	**6,197**

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15 Income tax

	2006	2005
Current tax	886	2,181
Deferred tax	3,593	3,583
	4,479	**5,764**

	2006	2005
Profit before tax	44,694	33,815
Tax calculated at a tax rate of local 18%	8,045	6,087
Effect of different tax rates in other countries	1,320	387
Income not subject to tax	(4,684)	(646)
Other	(201)	(64)
	4,479	**5,764**

16 Earnings per share

Basic

Basic earnings per share is calculated by dividing the net profit attributable to equity holders of the Bank by the weighted average number of ordinary shares in issue during the year, excluding the average number of ordinary shares purchased by the Bank and held as treasury shares.

	2006	2005
Profit attributable to equity holders of the Bank	38,906	24,740
Weighted average number of ordinary shares in issue	10,608	9,020
Basic earnings per share (ISK per share)	**3.67**	**2.74**

Diluted

Diluted earnings per share is calculated by adjusting the weighted average number of ordinary shares outstanding to assume conversion of all dilutive potential ordinary shares. For the share options, a calculation is done to determine the number of shares that could have been acquired at fair value (determined as the average annual market share price of the Bank's shares) based on the monetary value of the subscription rights attached to outstanding share options. The number of shares calculated as above is compared with the number of shares that would have been issued assuming the exercise of the share options.

	2006	2005
Profit attributable to equity holders in the bank	38,906	24,740
Weighted average number of ordinary shares in issue	10,608	9,020
Adjustments for:		
– share options	573	476
Weighted average number of ordinary shares for diluted earnings per share	**11,181**	**9,495**
Diluted earnings per share (ISK per share)	**3.48**	**2.61**

17 Loans and advances to customers

	2006	2005
Public entities	8,892	7,670
Corporates		
Fishing industry	134,061	97,958
Retail trade	229,312	142,229
Agriculture	6,170	6,381
Construction and industry	177,854	138,497
Services	596,053	349,676
Other	3,529	10,691
Individuals	299,135	244,634
Allowance for losses on loans and advances	(16,611)	(13,144)
Total loans and advances to customers	**1,438,395**	**984,593**

Provisions for credit losses

Changes during the year:	2006	2005
Balance at beginning of year	13,144	8,359
(Disposals)/acquisitions	(12)	436
Impairment on loans and advances	5,690	6,347
Loans written off	(2,221)	(1,998)
Translation difference	9	0
Balance at year-end	**16,611**	**13,144**
Provision ratio (Provisions for credit losses/total loans and advances to customers)	**1.07%**	**1.27%**

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18 Trading assets and financial assets designated at fair value through profit and loss

Bonds and debt instruments	2006 Trading assets	2006 Fin. assets designated at fair value	2006 Total	2005 Trading assets	2005 Fin. assets designated at fair value	2005 Total
Domestic						
Listed	32,593	0	32,593	28,242	0	28,242
Unlisted	0	0	0	0	0	0
	32,593	0	32,593	28,242	0	28,242
Foreign						
Listed	136,716	0	136,716	23,284	0	23,284
Unlisted	290	0	290	9	0	9
	137,006	0	137,006	23,293	0	23,293
Total Bonds and debt instruments	169,598	0	169,598	51,535	0	51,535
Shares and equity instruments						
Domestic			Total			Total
Listed	18,843	7,022	25,864	8,397	18,389	26,786
Unlisted	2,070	341	2,411	358	341	699
	20,912	7,362	28,275	8,755	18,730	27,485
Foreign						
Listed	8,849	9,804	18,654	9,021	14,911	23,932
Unlisted	1,176	1,224	2,400	6,032	843	6,875
	10,025	11,028	21,053	15,053	15,753	30,807
Total Shares and equity instruments	30,938	18,391	49,328	23,809	34,483	58,292
Hedged securities			Total			Total
Trading bonds	45,583	0	45,583	48,963	0	48,963
Trading equities	59,607	0	59,607	80,701	0	80,701
Total hedged securities	105,190	0	105,190	129,663	0	129,663
Derivatives held for trading	38,358	0	38,358	13,886	0	13,886
Total	344,084	18,391	362,475	218,894	34,483	253,377

19 Derivatives held for trading and trading liabilities

	2006 Contract/notional amount	2006 Fair value Assets	2006 Fair value Liabilities	2005 Contract/notional amount	2005 Fair value Assets	2005 Fair value Liabilities
Foreign exchange derivatives						
Currency forwards	1,008,938	12,981	6,375	477,283	4,422	3,791
OTC currency options bought and sold	263,844	6,673	3,463	212,798	3,331	4,098
Cross-currency interest rate swaps	182,838	8,753	204	58,905	1,572	1,613
	1,455,619	28,407	10,042	748,986	9,325	9,502
Interest rate derivatives						
Interest rate swaps	523,844	5,263	4,057	214,910	3,091	2,264
	523,844	5,263	4,057	214,910	3,091	2,264
Equity derivatives						
Equity forwards	65,213	2,962	6,545	81,269	213	14,503
OTC stock options - bought and sold	14,642	1,726	222	13,454	1,257	235
Equity futures	1,747	0	0	0	0	0
	81,602	4,688	6,767	94,723	1,471	14,738
Total derivatives held for trading	2,061,066	38,358	20,866	1,058,619	13,886	26,504

20 Derivatives held for hedging

	2006 Contract/notional amount	2006 Fair value Assets	2006 Fair value Liabilities	2005 Contract/notional amount	2005 Fair value Assets	2005 Fair value Liabilities
Derivatives designated as fair value hedges						
Interest rate swaps	324,627	5,686	5,324	96,003	3,205	3,201
Cross-currency interest rate swaps	99,722	4,812	1,149	105,011	1,484	885
	424,349	10,498	6,473	201,014	4,689	4,086

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21 Investment in Associates

Company	Total assets	Ownership %	Profit (loss) from associates	Book value 2006	Book value 2005
Eignarhaldsfélagið ehf.	1,289	49.0	(25)	929	0
Greiðslumiðlun hf.	30,173	38.0	169	823	694
Reiknistofa bankanna	1,717	33.9	0	515	515
Creditinfo Group hf.	1,530	43.2	(7)	471	184
Rockview Merrion Investments	906	50.0	105	302	0
Kreditkort hf.	10,689	20.0	55	239	224
Intrum hf.	500	25.0	4	87	83
Líftryggingamiðstöðin hf.	428	34.0	5	139	135
LME eignarhaldsfélag ehf.		40.0	(266)	0	0
Fjárfestingafélagid Grettir hf.		0.0	1,771	0	2,556
Other partially owned companies			(114)	330	64
			1,699	**3,837**	**4,456**

All these investments are unlisted.

22 Property and equipment

Fixed assets:	Premises	Other	Total
Book value at beginning of year	1,794	2,465	4,260
Additions	533	2,673	3,206
Sold	(63)	(294)	(357)
Disposals	(38)	(777)	(815)
Depreciation charge	(152)	(319)	(471)
Net book value at year-end	**2,075**	**3,748**	**5,823**
Depreciation (straight-line)	1-4%	10-33%	

Assessment value of land and Bank Premises:	2006	2005
Official assessment value of land and Bank premises	1,877	1,756
Replacement value of buildings	2,799	2,470

23 Intangible assets

Goodwill	2006	2005
Opening net book amount	9,380	1,160
Exchange and other differences	2,270	(12)
Acquisition of assets and liabilities from Cedev S.A.	272	0
Acquisition of Landsbanki Guernsey Limited	156	0
Acquisition of Teather & Greenwood	0	4,088
Acquisition of Key Business Financial Corporation	0	603
Acquisition of Kepler Equities	0	2,144
Acquisition of Merrion	0	1,397
Merger with Burðarás hf.	0	3,293
Impairment	0	(3,293)
Net book value at year-end	**12,078**	**9,380**

Software and other intangible assets		
Opening net book amount	1,081	425
Additions	2,950	819
Disposals	(1)	0
Amortisation	(1,532)	(163)
Impairment	(226)	0
Net book value at year-end	**2,274**	**1,081**
Total Intangible assets	**14,351**	**10,461**

All goodwill has been tested for impairment at year-end. The conclusion of the test was that no charges were needed. The goodwill has been divided between the smallest cash generating units based on the required rate of return from each unit. An assessment of a recoverable value of a goodwill is based on its use value.

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24 Non-current assets and disposal groups classified as held for sale

	2006	2005
Appropriated assets	564	920
Allowance for appropriated assets	(210)	(208)
	354	**712**
Disposal group held for sale		
– Investment properties included in disposal groups	18,206	15,613
– Other assets included disposal groups	2,789	135
	20,996	**15,748**
Total non-current assets and disposal groups classified as held for sale	**21,349**	**16,459**

25 Deposits from financial institutions

	2006	2005
Loans from Central Bank and repurchase agreements	46,451	44,730
Loans from other credit institutions	94,654	99,866
	141,105	**144,596**

26 Deposits from customers

	2006	2005
Demand deposits	229,654	113,834
Time deposits	453,192	220,328
	682,846	**334,163**

27 Borrowing

	2006	2005
Securities issues	865,274	620,793
Borrowing	149,702	69,196
	1,014,976	**689,989**

Securities issues:	2006	2005
Europe - MTN	505,287	469,919
USA - MTN	161,541	0
European Commercial Paper (ECP)	21,518	23,318
Other	176,928	127,556
	865,274	**620,793**

For maturity, see note 4.4

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28 Subordinated loans

	2006	2005
Tier I – Non-innovative hybrid capital	41,801	7,472
Tier I – Innovative hybrid capital	18,288	14,928
Tier II	29,665	26,675
	89,754	**49,074**

Subordinated loans	Classification	Currency	Interest	Maturity	2006	2005
London Stock exchange	Tier I	EUR	6.25%	callable	33,439	0
Luxembourg Stock Exchange	Tier I	EUR	4.65%	callable	14,763	11,615
London Stock exchange	Tier I	EUR	Euribor+1,23%	callable	8,361	7,472
Iceland Stock Exchange	Tier I	ISK	6,5%+CPI	callable	1,210	1,106
Iceland Stock Exchange	Tier I	ISK	5,8%+CPI	callable	1,183	1,132
Iceland Stock Exchange	Tier I	ISK	8,65%+CPI	callable	1,132	1,075
					60,089	**22,399**
Luxembourg Stock Exchange	Tier II	EUR	Euribor+0,35%	2015	18,752	14,949
Luxembourg Stock Exchange	Tier II	JPY	3.45%	2033	2,789	2,691
Luxembourg Stock Exchange	Tier II	EUR	7.20%	2026	1,032	823
Luxembourg Stock Exchange	Tier II	EUR	5.44%	2018	960	760
Luxembourg Stock Exchange	Tier II	EUR	4.40%	2035	915	0
Luxembourg Stock Exchange	Tier II	EUR	Euribor+0,8%	2013	379	301
Unlisted	Tier II	USD	Libor+1,85%	2011	2,137	1,897
Unlisted	Tier II	ISK	5,6%+CPI	callable	1,797	1,680
Unlisted	Tier II	ISK	6,09%+CPI	callable	903	844
Unlisted	Tier II	EUR	Euribor+1,35%	2011	0	375
Unlisted	Tier II	USD	Libor+0,66%	2006	0	859
Unlisted	Tier II	EUR	0.00%	2008	0	1,494
					29,665	**26,675**
Total subordinated loans					**89,754**	**49,074**

Subordinated loans are a part of equity according to regulation on the calculation of capital ratio (see note 31). Subordinated loans are fully applicable to the calculation of CAD ratio.

29 Tax liabilities

Tax liabilities specified as follows	2006	2005
Tax to be paid	3,388	3,082
Taxliabilities	3,205	4,207
	6,593	**7,289**

The movement on the deferred income tax account is as follows:		
At 1 January	4,207	127
Income statement charge	(1,002)	3,583
Exchange differences	0	497
	3,205	**4,207**

Deferred income tax liabilities		
Premises and equipment	96	284
Financial assets designated at fair value through profit and loss	2,723	3,773
Non-current assets and disposal groups classified as held for sale	340	380
Miscellaneous assets	657	2
Loan commitment fee	30	2
	3,845	**4,441**

Deferred income tax assets		
Obligations	(62)	(68)
Shareholdings	(579)	(27)
Loan commitment fee	0	(22)
	(640)	**(117)**

The deferred tax charge in the income statement is comprised of the following temporary differences:

Premises and equipment	(188)	75
Miscellaneous assets	76	167
Obligations	3	3
Non-current assets and disposal groups classified as held for sale	(41)	380
Financial assets designated at fair value through profit and loss	(1,050)	3,103
Agricultural Loan Fund	72	(72)
Loan commitment fee	126	(74)
	(1,002)	**3,583**

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30 Other liabilities

Pension liabilities	691	358
Other liabilities	22,932	10,882
	23,623	**11,240**

Most of the Group companies have defined contribution pension plans, where the companies have no further payment obligation once the contributions have been paid. The pension liabilities in the balance sheet of the Group is for defined benefit pension plans that a few of the Group companies have.

31 Capital ratio

	2006	**2005**
Risk-adjusted assets	1,523,143	1,065,074
Capital:		
Tier I capital:		
Equity	144,282	110,059
Subordinated loans	60,089	22,399
Goodwill	(12,078)	(9,381)
Minority interests	5,175	3,557
	197,468	**126,635**
Tier II capital:		
Subordinated loans	29,665	26,675
– deduction in accord with Articles 28 and 85 of Act No 161/2002	(1,062)	(13,601)
Total capital	226,071	139,710
Tier I ratio	**13.0%**	**11.9%**
Capital ratio	**14.8%**	**13.1%**

32 Contingent liabilities

Off-balance sheet contingent liabilities specifies as follows:	**2006**	**2005**
Guarantees issued	95,911	40,737
Available overdrafts	59,946	28,291
Unused credit commitments	63,210	42,507
	219,067	**111,536**

33 Fiduciary activities

The Landsbanki Group provides asset custody, asset management, investment management and advisory services. All of them require the Group to make decisions on the treatment, acquisition or disposal of financial instruments. Assets in Landsbanki's custody are not reported in its accounts. Part of this service involves the Group approving objectives and criteria for the investment of assets in its custody. As of 31 December 2006, financial assets managed by the Group amounted to ISK 376.9 billion (31.12.2005:281 bn). Amounts in custody accounts amounted to ISK 1,751 billion (31.12.2005: 1,321 bn).

34 Executive salaries and benefits

The remuneration to the Board of Directors, CEOs and managing directors of the bank's parent company and subsidiaries and their stock option contracts are as follows:

			Stock Options			
	Salary and benefits	**Options exercised 2006**	**Earned unexercised**	**Contracts 2007-2010**	**Total**	**Holdings at year-end**
Björgólfur Guðmundsson, Chairman of the Board of Directors	6	0	0	0	0	4,559
Kjartan Gunnarsson, Vice-chairman of the Board of Directors	5	0	0	0	0	92
Other Directors	10	0	0	0	0	22
Halldór J. Kristjánsson, CEO	119	0	19	30	49	11
Sigurjón Þ. Árnason, CEO	153	0	80	30	110	0
Managing director responsible for a division comprising 25% or more of the company's equity or performance						
Yngvi Örn Kristinsson, managing director	84	0	22	3	25	0
16 managing directors of the bank's divisions and subsidiaries	1,039	0	159	52	211	11
	1,416	**0**	**280**	**115**	**395**	**4,695**

The strike price of call options on Landsbanki's shares held by CEOs and managing directors ranges from 3.58-14.25. The options can be transferred from one year to the next and can be accumulated and exercised at the end of the period. Measures have been taken to enable the bank to fulfil the contracts concluded and the cost of these measures has been expensed through profit and loss. Holdings include holdings of the parties concerned, their spouses, children who are not financially competent and legal entities under their control/in which they have a holding.

Remuneration to CEOs and managing directors is comprised of basic salary, benefits and performance-linked bonuses reflecting ROE and the increase in the bank's value. Basic salary and benefits comprise ISK 29.2 m of remuneration to CEO Halldór J. Kristjánsson, ISK 37.6 m of remuneration to CEO Sigurjón Þ. Árnason and ISK 21.2 m to managing director Yngvi Ö Kristinsson. Other payments are performance-linked bonuses.

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35 Stock option plan

Employees and managers within the Landsbanki Group hold call options on Landsbanki's shares with a strike price of 3.58 to 14.25. Stock options are granted at market share price on the date granted. Measures have been taken to enable the bank to fulfil the contracts concluded and the cost of these measures has been expensed through profit and loss. The options will be earned from 2003 to 2010. Options are earned over a four-year period and can be exercised at the end of the fourth year and during the following two years. Options held by employees and managers at year-end 2006 totalled ISK 946.4 m nominal value. Earned and unexercised options as of 31 December 2006 totalled ISK 661.9 m nominal value. Options which were granted at prices 3.58-5.7 are earned in 2003-2006 and can be exercised 2006-2008 total ISK 176.7 m nominal value. Options which were granted at prices 7.0-9.0 are earned in 2004-2007 and can be exercised 2007-2009 total ISK 337.5 m nominal value. Options which were granted at prices 12-14.25 are earned in 2005-2010 and can be exercised 2008-2010 total ISK 432.2 m nominal value. In 2006 no new options were granted and no earned options were exercised.

36 Related-parties

Loans to CEOs and managing directors, and to companies fully owned by these persons, amounted to ISK 153 million as of 31 December 2006.

Loans to members of the Board of Directors and their fully owned companies amounted to ISK 26,267 million, including credit granted to companies with which members of the Board are connected through membership of the companies' Boards or ownership ties.

The holding company, Samson eignarhaldsfélag ehf., has a 41.37% holding in the Bank. The Bank has not assisted the company with any provision of credit. One of the company's owners sits on Landsbanki's Board of Directors and loans granted to this person are included in the above amounts.

Total credit extended to associated companies by the Bank amounted to ISK 14,152 million as of 31 December 2006.

All of the loans referred to here have been granted in accordance with the Bank's credit rules and on normal commercial terms. No impairment has been recognised by the Bank against these loans.

37 Auditors fee

	2006	**2005**
Audit and audit related services	99	95
Other professional services	45	23
	145	**118**

38 Acquisitions

On 4. August, Landsbanki Islands hf. announced that it had reached an agreement to acquire a 100% share of Cheshire Guernsey Ltd. This acquisition was achieved through Landsbanki's direct acquisition of shares in Cheshire Guernsey Ltd. The transaction was completed in September. Subsequently the bank's name was changed to Landsbanki Guernsey Limited.

The details of the fair value of the assets and liabilities acquired and goodwill arising are as follows (ISK millions):

Loans and advances to banks	17,246
Deposits	(14,498)
Tax liability	(17)
Goodwill (see note 23)	156
Total Cost of acquisition (discharged by cash)	**2,887**