

NEW ACT ON SECURITIES TRANSACTIONS – MiFID

A new Act on Securities Transactions, No. 108/2007, took effect on 1 November 2007. The Act incorporates into Icelandic law the European Markets in Financial Instruments Directive, MiFID.

MiFID extends to all the states of the European Economic Area (EEA), i.e. the member states of the EU, in addition to Iceland, Norway and Liechtenstein. The new Act on Securities Transactions has the effect that various important rules relating to the Bank's securities trading need to be changed.

The Act has an impact on all natural and legal persons who engage in securities trading.

The objective of MiFID is to establish harmonised rules on consumer protection for investors and create an integrated financial market. The directive focuses on surveillance, quality of execution and provision of information. Furthermore, the legislation is intended to ensure that clients of financial undertakings are at all times provided with appropriate information and advice in securities trading. The new legislation on securities trading emphasises the following three points:

- That securities trading should be consistent with the investment goals of the client;
- That the client should be able bear the financial risk associated with the trade; and
- That the trade should be of a nature that permits the client to understand the associated risks.

1 CONSUMER PROTECTION FOR INVESTORS

1.1 The objective of MiFID is to improve consumer protection for investors. The directive takes into account the experience and knowledge of parties engaging in financial trading. The level of consumer protection varies, with less protection afforded to investors with more experience and knowledge of securities trading. For this reason, the Bank is required to classify investors into three principal categories:

- Retail clients (private investors)
- Professional clients
- Eligible counterparties

1.2 The Bank is required to classify all its clients into the above categories and notify them of the category that they fall into and of the significance of their classification.

1.3 Following the entry into effect of the rules, private clients will receive more extensive information from the Bank than before. The Bank will provide clients with the information necessary for them to make informed decisions about their investments.

1.4 The Bank is required to obtain information from its clients in order to ensure that its employees are able to provide appropriate investment-related advice and

services. This is done by means of an assessment, which is in two parts. First, the client is assessed based on experience and knowledge, and classified accordingly as a retail client, professional client or eligible counterparty. Second, the Bank assesses whether certain trades are suitable for the client based on the client's knowledge and experience of such trading.

- 1.5 If a client has not been classified into one of the three categories of investors, the employees of the Bank are only permitted to offer general information concerning securities trading, such as market prices of financial instruments. If, on the other hand, the client has been classified, the Bank can provide investment advice, which means personal advice concerning financial instruments and trading on one or more occasions. The advice should be based on the personal circumstances of the client. Investment advice refers to any form of explanation or information, both regarding the risk and consequences of a certain choice, e.g. recommending a trade in a certain type of financial instrument.

2 PRIVATE CLIENTS

- 2.1 According to the definition of the Act, retail clients, are parties who do not meet the conditions of the Securities Transactions Act for classification as professional clients. In practice, this group includes most individuals and smaller undertakings and companies. Private clients enjoy the maximum protection afforded by the provisions of the Securities Transactions Act as regards consumer protection for investors.

3 PROFESSIONAL CLIENTS

- 3.1 Professional clients are investors possessing the experience, knowledge and expertise to make their own investment decisions and properly assess the associated risks.
- 3.2 A professional client will receive less consumer protection than a private client. Professional clients may include the following:
 - 3.2.1 Legal persons licensed to operate or engaged in regulated activities in financial markets, including financial undertakings, insurance companies, collective investment undertakings and pension funds
 - 3.2.2 Large undertakings meeting at least two of the following requirements:
 - a. Balance sheet total is ISK 1,847 million or higher;
 - b. Net turnover is ISK 3,695 million or higher;
 - c. Equity is ISK 185 million or higher.
 - 3.2.3 Amounts under this item are base amounts tied to the exchange rate of the euro (EUR) on 3 January 2007 (ISK 92.37);
- 3.3 National and regional governments, central banks and international institutions;
- 3.4 Other institutional investors whose main activity is to invest in financial instruments;
- 3.5 Parties approved as professional clients on the basis of an application from the client to the Bank.

- 3.6 Professional clients may request to be treated as retail clients in all trading with the Bank or in individual transactions.
- 3.7 Retail clients may request to be treated as professional clients. When a private client requests to be treated as a professional client, the Bank will assess the expertise, experience and knowledge of the client and then notify the client whether the request is granted.

4 ELIGIBLE COUNTERPARTIES

- 4.1 Eligible counterparties are parties falling within the scope of sections 1, 2 or 3 of the definition of professional clients.
- 4.2 Eligible counterparties enjoy less investor protection than other professional clients. They are understood to possess the most extensive financial strength, knowledge and expertise of all investors, and therefore do not need as extensive protection and advice as, e.g., private clients. Clients in this category are free to request to be transferred between categories and to enjoy increased protection, either as professional clients or as retail clients.

5 BEST EXECUTION OF TRADES

- 5.1 The Bank has established rules on the best execution of trades. The substance of these rules is, in brief terms, to ensure that clients' trade orders are executed so as to result in the best possible conclusion for the client with regard to price, costs, speed, likelihood of execution and settlement, size, nature and any other consideration relevant. The Rules of Best Execution are published on the Bank's website.

6 THE BANK'S POLICY ON CONFLICTS OF INTEREST

- 6.1 The Bank has established a policy to deal with any conflicts of interest that may arise. The Bank's Rules on Conflicts of Interest can be accessed on the Bank's website.