

INTERIM REPORT

JANUARY 1 TO JUNE 30, 2000



ICEBANK LTD.

SPARISJÓÐABANKI
ÍSLANDS HF.

Operating Results

The first 6 months of 2000 showed a drastic decrease in profits in comparison with the same period in 1999. Net operating income amounted to ISK 242.5 million, down from ISK 325.4 million, or 25.4%, for the first half of 2000. Operating expenses increased at the same time by 11.5% and amounted to a total of ISK 197.9 million. Payroll costs alone increased by some ISK 30 million, as compared to the first six months of 1999, mainly as a result of the rapid expansion in the Treasury and Securities Division of the bank.

The net profit for the period, after provision for possible credit losses and deduction of calculated taxes, hence amounted to ISK 14.7 million, as compared to ISK 77.4 million in the same period of 1999. While net interest income increased by 54.8% over the same period last year, interest expenses increased by 71.5%, bringing the net interest income to ISK 130.4 million, as compared to ISK 171.4 million for the first half of 1999.

This result is explained mainly by an interest hike in the domestic market and a loss in the book value of the bank's securities portfolio by some ISK 90 million.

Corporate Lending and Provisions

The bank's direct participation in the corporate lending of the Savings Banks continues to increase and amounted to ISK 8.5 billion by mid-year compared to ISK 7.7 billion as at the end of 1999, an increase of 10.4%. Icebank is also the home bank for the other subsidiary companies of the Savings Banks. Provisions for possible credit losses are based on the volume of this lending as well as issued letters of credit and guarantees. An amount of ISK 30 million was set aside for the first 6 months of 2000 and that figure is projected to reach ISK 60 million for the full year. The total reserves for possible credit losses now amount to ISK 461.7 million, of which specific provisions amount to ISK 102.4.

The Balance Sheet

Total assets of the bank increased only slightly during the first six months of 2000, i.e. from ISK 40.7 billion to ISK 41.5 billion, or approximately 2%. The bank's equity amounted to ISK 1.860 million by 30 June 2000, of which ISK 603.5 million is capital stock. The Savings Banks have provided Icebank with guarantees equal to the amount of the capital stock which the Board of Icebank is authorised to call on at any time. These guarantees have the purpose of supporting the bank in its capacity as the international front of the Icelandic Savings Banks. Adding the guarantees to the equity brings the effective capital of the bank to ISK 2,463 million.

The capital adequacy ratio of the bank is 9.3%. This ratio has been on the decline, mainly owing to the rapid increase in the bank's total assets from ISK 16.8 billion by year end 1997 to the ISK 41.5 billion by mid year 2000, an increase of almost 150% in two and a half years.

All of Icebank's capital is Tier 1.

The Economic Environment

The first half of this year was characterised by rapid economic growth. The money supply (M3) increased by 7.4% and the economy showed many signs of overheating. The Central Bank

hiked interest rate three times by a total of 1.6%, both to maintain the interest rate differential between the Icelandic krona and the currency basket, and to signal strongly to the market that the Bank would maintain a tight monetary policy to prevent inflation.

However, the rate of inflation in the first half of the year was over 5%, but there are prospects for a significantly lower inflation in the second half of the year.

The yield on Government Bonds increased heavily in March, rising from 4.14% to 5.11% on 15-year benchmark bonds. The main reason for this rise is a relaxation in the regulations governing pension funds investments abroad. This resulted in a greatly reduced interest in domestic bonds, but at the same time the supply of Government bonds, especially housing bonds, increased. The trading volume in the market dropped dramatically and market makers announced their reluctance to continue trading in the Exchange. This led to a fresh agreement between the banks and the respective Government institutions to maintain steady trade in the bond market. This has already increased the liquidity in the market and narrowed the spread, and yield has started to show signs of coming down again.

The foreign exchange market has also been under pressure, with high volatility in a shallow market, often causing fluctuations of over 2% in the rate of exchange within the day. The krona came under a speculative attack in July resulting in a close of the market for two hours on 13 July. At the time of closure there was heavy demand on market makers for foreign currency against the krona, which had spiralling effects on the fx-index and the Central Bank, the only source for increased liquidity in the market, was not active enough at the time.

Volatility in the fx-market has calmed down considerably in the months of August and September.

Prospects for the Remainder of Year:

Indicative figures for 8 months show a slight improvement in the profitability of the bank, as well as a turn in the book value of the securities portfolio by some ISK 45 million.

Action has been taken to increase the net interest margin of the bank, which is expected to have positive impact on the bank's profits in the second half of the year.

Subsidiary companies continue to contribute well, and it is envisaged that Kaupthing hf. will be listed on the Icelandic Stock Exchange before the end of the year.

The offices of Icebank have been undergoing complete renovation, which is expected to be finalised by mid-November. By then, the bank and the Federation of Savings Banks will occupy the whole building at Raudararstigur 27 and the office space double in size, improving working facilities of the employees significantly.

This Interim Report has been prepared in the rules and regulations pertaining to the Icelandic Banking Act and is fully consistent with the accounting principles hitherto applied to Icebank's Annual Reports.

Reykjavik, September 2000

Sigurður Hafstein,
Managing Director.

| | <i>ICEBANK LTD.</i> | | | | <i>SAVINGS BANKS</i> |
|---|-----------------------------|-----------------------------|---------------------|---------------------------|---------------------------|
| Profit & Loss Account (ISK '000) | | | | | |
| | Jan. - Jun. 2000 | Jan. - Jun. 1999 | Change % | Full year 1999 | Full year 1999 |
| Financial income | 1.510.254 | 975.568 | 54.8% | 2.205.518 | 11.400.876 |
| Financial expenses | 1.379.560 | 804.196 | 71.5% | 1.874.849 | 7.002.905 |
| Net interest income | 130.694 | 171.372 | -23.7% | 330.669 | 4.397.971 |
| Other operating income | 111.853 | 153.861 | -27.3% | 479.095 | 3.352.294 |
| Net operating income | 242.547 | 325.234 | -25.4% | 809.764 | 7.750.265 |
| Salaries and related expenses | 105.571 | 75.097 | 40.6% | 164.260 | 2.123.302 |
| Other operating expenses | 92.308 | 102.293 | -9.8% | 205.824 | 2.620.885 |
| Provision for losses | 30.000 | 30.000 | 0.0% | 121.134 | 1.291.156 |
| Profit before taxes | 14.668 | 117.844 | -87.6% | 318.546 | 1.714.922 |
| Profit for the period | 14.668 | 77.415 | -81.1% | 206.875 | 1.204.022 |
| Balance Sheet (ISK '000) | | | | | |
| | Jun. 30 2000 | Jun. 30 1999 | Change % | Dec. 31 1999 | Dec. 31 1999 |
| <i>Assets</i> | | | | | |
| Cash and treasury bills | 809.596 | 512.311 | 58.0% | 2.117.751 | 1.553.546 |
| Credit institutions | 24.579.714 | 21.198.695 | 15.9% | 23.405.456 | 11.681.397 |
| Loans to customers | 8.572.460 | 6.242.116 | 37.3% | 7.709.259 | 83.604.942 |
| Securities | 7.176.662 | 4.168.896 | 72.1% | 7.169.615 | 16.305.138 |
| Other assets | 386.790 | 613.104 | -36.9% | 277.168 | 3.284.946 |
| | 41.525.222 | 32.735.122 | 26.9% | 40.679.249 | 116.429.969 |
| <i>Liabilities and Equity</i> | | | | | |
| Credit institutions | 30.890.877 | 25.802.851 | 19.7% | 29.911.397 | 17.322.270 |
| Deposits | 2.284.446 | 1.089.562 | 109.7% | 3.358.499 | 60.741.344 |
| Borrowings | 6.236.341 | 4.037.794 | 54.4% | 5.268.035 | 21.275.156 |
| Other liabilities | 252.715 | 299.956 | -15.7% | 339.130 | 6.440.039 |
| Equity | 1.860.843 | 1.504.959 | 23.6% | 1.802.188 | 10.651.160 |
| | 41.525.222 | 32.735.122 | 26.9% | 40.679.249 | 116.429.969 |
| <i>Off-Balance Sheet Items</i> | 1.012.873 | 1.048.888 | -3.4% | 765.563 | 4.601.192 |
| Key Indicators (%) | | | | | |
| | Jun. 30 2000 | Jun. 30 1999 | | Dec. 31 1999 | Dec. 31 1999 |
| Operating income / Operating expenses | 81.6% | 54.5% | | 45.7% | 61.2% |
| Return on equity (ROE) | 1.6% | 10.3% | | 11.5% | 11.3% |
| Capital adequacy ratio (CAD) | 9.3% | 10.4% | | 10.2% | 11.4% |
| Loss and provision ratio | 0.1% | 0.1% | | 0.4% | 1.4% |
| Interest rate margin | 0.3% | 0.5% | | 0.8% | 3.9% |
| Full time equivalent employees | 46 | 35 | | 43 | 597 |

The Icelandic Savings Banks

There are 25 Savings Banks in Iceland operating a branch network of 56 offices throughout the country and jointly representing nearly a quarter of the banking market. Some of the Savings Banks have been operating for over a century, and some are among the youngest banking institutions in Iceland.

Each of the Savings Banks is an independent entity, each with its own Board of Directors and firmly rooted in its local community. The respective municipal authorities appoint two out of five board members with the remaining three elected by the Annual General Meeting.

In many instances, they are the only financial institutions in their area of operation and render services to individuals as well as corporate entities and local authorities.

The Icelandic Savings Banks Association was established in 1967 and started, albeit on a modest scale, co-operation between the Savings Banks who had until then been working totally independently of each other. The co-operation has increased year by year, initially mainly in administrative and legislative matters.

With the establishment of Icebank and The Savings Banks Guarantee Fund (mutual guarantee on deposits) in 1986, close financial co-operation was started. That cooperation has resulted in an increased market share from some 15% in 1986 to a current market share of approximately 24% in

terms of total deposits. Recent regulatory changes regarding the aforementioned Savings Banks Guarantee Fund allow for the merger of the fund with other similar guarantee funds, to form an industry-wide deposit guarantee fund.

The role of Icebank is to be the central banking institution for the Icelandic Savings Banks and their subsidiaries with all the related tasks involved, such as liquidity administration, interbank lending and international service and representation.

Besides their ownership of Icebank, the Savings Banks are the sole owners of Kaupthing Ltd., a securities house and investment bank, the leasing company SP Fjármögnun Ltd., the life insurance company Althjoda liftryggingafelagið Ltd. and jointly they operate the Computer Center of the Icelandic Savings Banks. The Savings Banks, in cooperation with the Icelandic commercial banks, operate a joint clearing house and data processing center, the Icelandic Banks Data Center. The Savings Banks also hold a quarter share of VISA Iceland and Europay Iceland. Icebank also belongs to The Banker's Association of Iceland.

The close co-operation of the Savings Banks has made them a significant and solid group of interrelated and modern financial institutions representing a large proportion of the Icelandic banking market.



ICEBANK LTD.

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