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FJÁRMÁLAEFTIRLITIÐ
THE FINANCIAL SUPERVISORY AUTHORITY, ICELAND

Commission de Surveillance du Secteur Financier
Attn: Mendaly RIES
110, route d'Arlon
L-2991
LUXEMBOURG

22 January 2010
Ref: 2009020054

Case referral: Dealings involving Kaupþing banki hf., Kaupthing Bank Luxembourg S.A., Marple Holdings S.A., and Lindsor Holdings Corporation

In the course of investigations into suspicious trading activity during the collapse of Kaupþing banki hf. ("Kaupthing Iceland") of Iceland, commonly referred to in English as Kaupthing Bank, Fjármálaeftirlitið ("FME"), the Financial Supervisory Authority of Iceland, has identified several potential violations of Luxembourg law and additional items of interest involving Kaupthing Bank Luxembourg S.A. ("Kaupthing Luxembourg"), Marple Holdings S.A. ("Marple"), and Lindsor Holdings Corporation ("Lindsor"). FME would like to express its appreciation to the Commission de Surveillance du Secteur Financier ("CSSF") for its cooperation to date in unraveling this case, and now refers relevant pieces of the case back to CSSF for further investigation.

FME will refer relevant pieces of this case to the Office of the Special Prosecutor ("the Special Prosecutor") in Iceland for further investigation and potential prosecution under Icelandic law.

This case potentially covers embezzlement, fraud, conspiracy, forgery, coordinated trading, and misrepresentation of facts to CSSF, among other potential violations. The case revolves around trading in debt securities issued by Kaupthing Iceland ("Kaupthing bonds") and traded by Marple, Lindsor, and employees of Kaupthing Luxembourg during 2008.

Note on Icelandic language

The Icelandic language has several characters that are no longer in use in modern English or the modern Scandinavian languages. For precision, Icelandic proper names are spelled here with these characters. These characters are commonly Anglicized per the table that follows.

Þ, þ	Th, th
Ð, ð	D, d
Ö, ö	O, o
Æ, æ	Ae, ae

Relevant agreements on cooperation

This case referral is made on the grounds of a Directive of the European Union, where the obligation for competent authorities that have been designated the role of supervision are requested to provide one another with information in relation to the conduct of their supervision. The following article, part of Annex IX to the EEA Agreement, may apply to the situation.

Directive 2003/6/EC

According to paragraph 1 of Article 16 of Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse), competent authorities shall cooperate with each other whenever necessary for the purpose of carrying out their duties, making use of their powers whether set out in the Directive or in national law. Competent authorities shall render assistance to competent authorities of other Member States. In particular, they shall exchange information and cooperate in investigation activities.

CESR MoU

FME also references the Committee of European Securities Regulators ("CESR") Multilateral Memorandum of Understanding on the Exchange of Information and Surveillance of Securities Activities ("CESR MoU"). The CESR MoU was partly put in place with reference to provisions of European Union Directives relating to the financial markets. These state that the closest cooperation should take place between the competent authorities of Member States for the purpose of carrying out their duties. According to Article 3 of the CESR MoU, Authorities shall provide each other with the fullest mutual assistance in any matters, within the competence of the Authorities.

Background and key points of the case

During much of the current decade, Kaupthing Iceland was the largest bank in Iceland and the single largest share issue trading on ICEX, the Iceland Stock Exchange (later renamed NASDAQ OMX Iceland). Kaupthing Iceland has since been delisted from the exchange and is in receivership pending liquidation of its assets and resolution of obligations to its creditors. Kaupthing Iceland held around $83 billion in assets in mid-2008, making the insolvency of the bank one of the largest corporate failures in world history: Kaupthing Iceland was around 30% larger than the Enron bankruptcy in the United States and nearly the same size as the recent bankruptcy of General Motors, measured by assets.

Following is a description of each of the major pieces of the Kaupthing-Marple-Lindsor case that FME has identified for referral to CSSF.

1. Marple May 2008 embezzlement

According to CSSF, Marple Holdings S.A. was established in Luxembourg on 30 June 2006 and that company was subsequently taken over by Skúli Þorvaldsson (Thorvaldsson) on 20 June 2007. Skúli was the beneficial owner of Marple, and he was also a large shareholder in Kaupthing Iceland and a longstanding client of the bank. Marple received a EUR 100 million credit line from Kaupthing Luxembourg on 4 February 2008.

Starting on 16 April 2008, Marple accumulated Kaupthing bonds denominated in EUR at a discount. This buying continued through 19 May 2008 with the prices rising on each trade.

On 20 May 2008, Marple sold all of the EUR Kaupthing bonds it had acquired at a discount in April and May at par, while the market price of the bonds would have been deeply discounted. This netted a profit to Marple of EUR 11,3 million.

Also on this day, Marple did "up-and-down" trades in EUR and USD Kaupthing bonds, meaning that it bought and sold the bonds on the same day. It bought the bonds at a discount from Kaupthing Luxembourg and sold them right back at par. These trades netted one-day profits of EUR 4,4 million and USD 3,6 million, respectively.

Also on this day Marple sold back to Kaupthing Luxembourg ISK Kaupthing bonds it had acquired earlier in May, also at a large profit, but this trade was reversed at the end of June 2008.

Trades whereby Marple sold back discounted Kaupthing bonds at par, on the same trading day, do not represent normal trading practice, nor normal price movement for fixed income securities. These trades appear to represent embezzlement of funds; Kaupthing Luxembourg appears to have used these trades to funnel large amounts of money to Marple.

Marple also traded equity shares during 2008 and perhaps before that time. FME respectfully recommends that CSSF review all transactions of Marple to identify other potential irregularities. In addition, Skúli Þorvaldsson owned a series of investment companies, such as Holt Investment Group Ltd, Holly Beach S.A., and Murry Holding S.A. These companies were all managed by Kaupthing Luxembourg, were domiciled in Luxembourg or BVI, and are detailed in Appendix 2 of the "Kaupthing Bank Luxembourg S.A. Report on the Credit Activity" of 31 March 2008, prepared by KPMG in Luxembourg.

2. Marple end-Q2 2008 purchases

On 30 June 2008 (with some trades booked on 1 July 2008 but back-dated to 30 June) Marple purchased 9 EUR Kaupthing bond issues from Kaupthing Luxembourg at a cost of EUR 60,5 million. Marple also purchased 3 USD Kaupthing bond issues at a cost of USD 33,6 million and one JPY bond issue at a cost of JPY 1,4 billion. These bonds were purchased at varying discounts to par ranging from 68 cents to 96 cents.

It is unclear what the purpose of these large bond buys was, but the timing on the last day of Q2 is likely not a coincidence. There are at least three possibilities:

1. This was a way to boost the apparent price or liquidity of Kaupthing bonds at quarter-end (this could have been used to improve the balance sheet of Kaupthing Luxembourg by increasing the value of available-for-sale securities, for example)

2. Kaupthing Luxembourg did not want these bonds on its trading book (balance sheet) at quarter-end, or

3. A third party did not want these bonds on its balance sheet at quarter-end, and unloaded them to Kaupthing Luxembourg, who unloaded them to Marple.

All of these bonds were purchased back from Marple by Kaupthing Luxembourg in August and October 2008 (see next section), with the overall result being quite generous for Marple.

In light of the extensive dealings in Kaupthing Iceland bonds that occurred on non-commercial terms at Kaupthing Luxembourg, FME respectfully recommends that CSSF undertake a full review of Kaupthing Luxembourg trading involving Kaupthing bonds, or perhaps all trading data for Kaupthing bonds issued in Luxembourg. Marple may be but one piece of a larger puzzle.

3. Marple sells its positions to Kaupthing Luxembourg

Kaupthing Luxembourg bought back some Kaupthing bonds from Marple during the final weeks of August 2008, at a small overall loss to Marple.

On 6 October 2008, Alþingi (Icelandic Parliament) passed an emergency act granting new powers to FME to intervene in the operation of the Icelandic banks. This followed a failed bail-out of Glitnir banki hf. ("Glitnir") in late September 2008 by the Icelandic Central Bank and debt downgrades of the three large Icelandic banks, including Kaupthing Iceland, by Fitch. (The following day, FME assumed control of Landsbanki hf. and Glitnir, and two days later control of Kaupthing Iceland was assumed by FME.)

It was against this backdrop of extreme uncertainty that Kaupthing Luxembourg bought back all remaining Kaupthing bonds from Marple on 6 October 2008, leaving the securities account of Marple held at Kaupthing Luxembourg completely free of Kaupthing debt. It bought these bonds back on terms largely favorable to Marple, leaving Marple with an overall profit on trades in Kaupthing bonds of EUR 17,7 million.

At the time it bought back these Kaupthing bonds from Marple, the high prices paid by Kaupthing Luxembourg (often the exact price Marple had paid for the bonds on 30 June 2008) were not indicative of a deal on commercial terms:

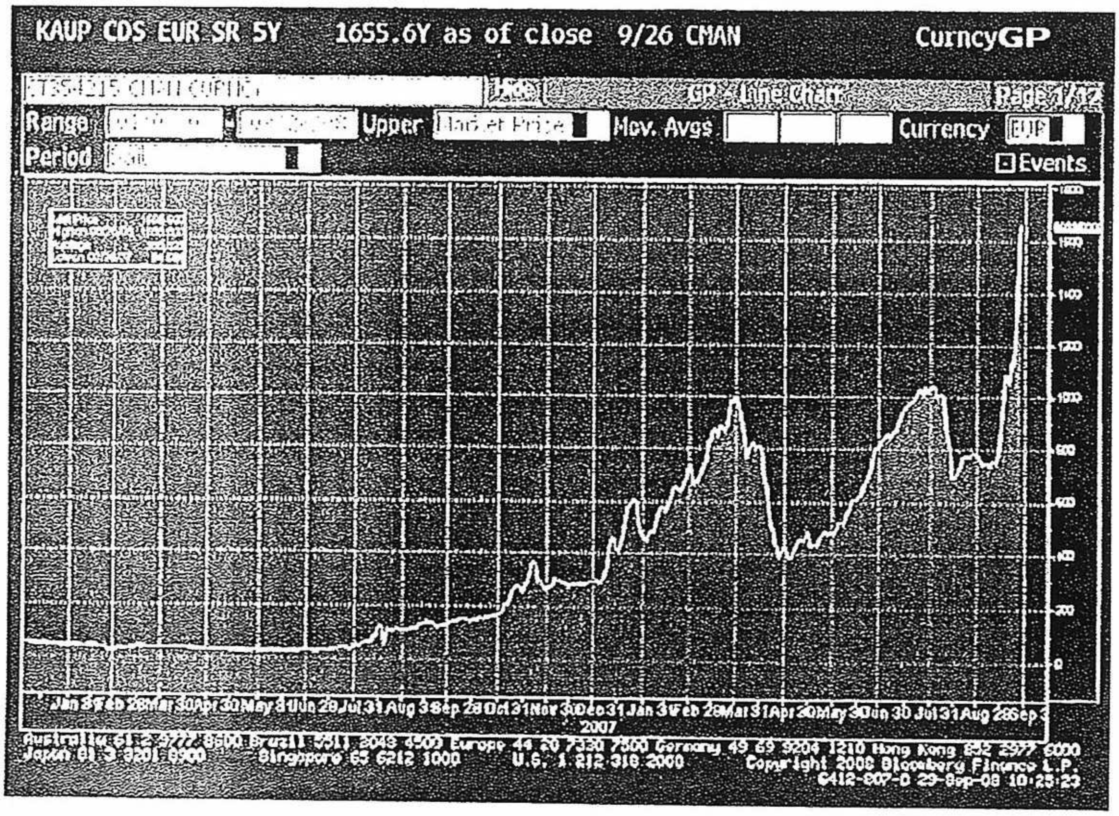
1. CDS spreads* on Kaupthing debt had widened significantly between the end of June and end of September 2008, moving from around 800 bps to over 1600 bps on senior EUR 5-year credit protection. This corresponds to an increase in required Kaupthing bond yields of 8 percentage points. This substantial increase in demanded yield corresponds to a substantial decline in market price**.

2. Just three days after these purchases, Kaupthing Iceland was effectively declared bankrupt when its operations were taken over by FME.

On 6 November 2008, an ISDA auction of outstanding CDS protection on Kaupthing determined that Kaupthing senior bonds would pay back only 6,625% of par. Given this valuation, the actual total profit to Marple on Kaupthing bonds is conservatively estimated at EUR 74,8 million, assuming all of the bonds Marple sold back were senior bonds. These likely were not senior bonds; FME has quite limited product information on many of the bonds described in this letter as FME used cash account records (rather than trading slips) helpfully provided by CSSF to recreate the trading history.

The EUR 74,8 million was money Marple should have lost (if forced to hold the bonds to maturity, for example) but the loss was instead assumed by Kaupthing Luxembourg, and then passed on to Lindsor (see subsequent section). Note that the estimated payout rate for Kaupthing senior debt is today closer to 25%, but even at those levels Marple would have lost nearly as much if forced to hold its Kaupthing bonds.

*Following is a Bloomberg graph of CDS spreads for Kaupthing EUR-denominated senior 5-year debt. The graph runs from 2 January 2007 to 26 September 2008. Note that the spreads for subordinated Kaupthing debt were still higher on this time period.



**CDS spreads are a clear measure of the likelihood of a debt default by a debt issuer. The cost of debt financing (yield of issued bonds) increases with increasing CDS spread. CDS spreads indicate the relative cost of finance for a debt issuer such as Kaupthing.

4. Kaupthing Luxembourg employee trades and cover-up

On 12 August 2008, three employees of Kaupthing Luxembourg purchased the same EUR Kaupthing bond issue at a discount from Kaupthing Luxembourg. They are Björn Jónsson, Anne Rassel, and Gabriel Rindone. The latter two bought the bonds 100% on credit from their employer, while Björn Jónsson bought the bond partially on credit. The three received coupon payments on this bond on 30 September 2008.

On 18 August 2008, Kaupthing Luxembourg employee Kristján Ágústsson was approved for a credit line of EUR 1,4 million from Kaupthing Luxembourg. Three days later, he used up almost EUR 1 million of that credit line purchasing a EUR Kaupthing bond issue at a discount.

It is unclear why these employees purchased Kaupthing bonds from their employer. None traded Kaupthing bonds previously, given the personal account statements available to FME. It is also unclear why the first three all purchased the same bond issue on the same day. A thorough accounting of Kaupthing Luxembourg trading positions for these bonds might serve to better illuminate this issue.

On Friday 3 October 2008, on the eve of the collapse of the three large Icelandic banks, Anne Rassel sold her Kaupthing bonds, at effectively the same price she had paid (an 18% discount to par). It is inconsistent with fair market pricing that she should have been able to sell back the bond at the same price, given that CDS spreads on Kaupthing debt had more than doubled (from 700 bps to over 1600 bps) in the time she held the bonds, and given the downgrade of Kaupthing debt that happened during her holding period. Had she been forced to hold this bond to maturity, for example, she would have lost EUR 394 thousand based on estimated recovery rates for senior Kaupthing bonds in effect in November 2008. If her Kaupthing bonds were subordinated debt, she would have lost still more.

On 6 October 2008, the day of the Emergency Act in Iceland, Björn Jónsson and Gabriel Rindone sold their Kaupthing bonds back to Kaupthing Luxembourg at par plus accrued interest, netting trading profits of EUR 138 thousand and EUR 173 thousand, respectively. Since they had bought the bonds at a discount, these amounted to substantial profits. At this point these bonds were worth not only significantly less than par but also significantly less than what they had been when these employees purchased them (see note on CDS spreads above).

On 8 October 2008, Kristján Ágústsson sold his Kaupthing bonds back to his employer at par for a profit of EUR 497 thousand. This trade was back-dated to show a trading date of 6 October. On 7 October 2008 (the previous day), FME had taken over operations at the two other Icelandic banks, and on the same day the British Financial Services Authority had frozen operations at Kaupthing Singer and Friedlander in the U.K. By the 8 October 2008, the bonds that this employee sold back were worth far below par value, and far below the value where he purchased them. Based on the rapid increase in senior CDS spreads (around 1000 basis points) between his purchase and sale date, this employee should have recognized a loss of at least 36%, according to a simple analysis by FME.

The sales trades conducted by these four employees of Kaupthing Luxembourg appear to be a bail-out for these employees, preventing them from having to take what should have been steep losses on securities they had borrowed money to buy. In the case of the latter three employees, the trades additionally appear to be a way to funnel additional money from Kaupthing Luxembourg to these employees.

On 15 October 2008, FME instructed the resolution committee of Kaupthing Iceland to hire an outside specialist to investigate, among other things, abnormal money transfers between companies and countries during the fall of the bank. It was this investigation, performed by PriceWaterhouseCoopers in Iceland, that first brought the Lindsor issue to light.

Perhaps news of this investigation reached Luxembourg because in November 2008, it appears that parties at Kaupthing Luxembourg acted to "cover up" the huge trading gains made by three employees by unwinding the trades done in early October. The three employees who had made huge trading gains – Björn Jónsson, Gabriel Rindone, and Kristján Ágústsson – had their trades at par backed out (cancelled) but then reinstated at the original purchase prices (86 cents in the case of the first two employees, and 66 cents in the case of the third). This kept the three employees from losing any money on these positions. By this point, of course, it was clear to any prudent party that the value of Kaupthing bonds was negligible, as the Icelandic banking crisis was more than month-old news.

By reinstating the trades at such high values, Kaupthing Luxembourg took losses – of EUR 844 thousand, EUR 756 thousand, and EUR 605 thousand – compared with the residual value in holding senior Kaupthing bonds set by the market at that time, and the three employees profited by at least these same amounts. Kaupthing Luxembourg had however already passed these losses on to Lindsor (refer to next section) and, by only correcting the employees' sales to the bank and not the onward sale to Lindsor in November 2008, actually came out ahead.

FME does not know if related-party trades (in this case done by employees in the bonds of the parent company of their employer) are "disclosable events" under Luxembourg law, but that may represent one avenue for further investigation by CSSF.

5. Lindsor Holdings Corporation

Lindsor is a company created in Tortola, British Virgin Islands on 18 July 2008. FME believes that the purpose of Lindsor was to create a "rubbish bin" that was used to dispose of all of the Kaupthing bonds still on the books of Kaupthing Luxembourg as the mother company, Kaupthing Iceland, was going bankrupt. Lindsor was funded with a EUR 171 million loan, paid out on 6 October 2008, from Kaupthing Iceland.

Lindsor appears to FME to be a way to both reimburse favored Kaupthing bondholders (Marple and Kaupthing Luxembourg employees) as well as remove losses from the balance sheet of Kaupthing Luxembourg. These losses were transferred to Lindsor, an entity wholly owned by Kaupthing Iceland, and Kaupthing Iceland was at the time going out of business.

The amount of the loan made to Lindsor, exactly EUR 171 million, is of interest as it is a transfer of a round sum of money and does not thus appear to be directly connected to funding of specific transactions. Rather, it appears to be a "catch-all" sum allowing for some cash "cushion". This loan was granted at a time when Kaupthing Iceland was suffering a severe liquidity shortage. On the same day as it granted the loan, the bank had received a EUR 500 million rescue credit line from the Central Bank of Iceland, with one of its European subsidiaries as collateral.

Most if not all of the documents establishing the legal links between Kaupthing Iceland, Kaupthing Luxembourg, and Lindsor (such as an Acquisition Agreement establishing Kaupthing Iceland as the owner of Lindsor and a Corporate Service Agreement between Kaupthing Iceland and Kaupthing Luxembourg) were not signed until December 2008, but forged to appear as though they had been signed in September 2008. Employees in both Kaupthing Luxembourg and Kaupthing Iceland appear to have been complicit in this forgery.

More on this follows in a subsequent section of this letter.

Lindsor opened cash accounts at Kaupthing Luxembourg on 2 October 2008. Its listed representatives were: Andri Vilhjálmur Sigurðsson, Magnus Palmbäck, and Gianni de Bortolli. Andri Sigurðsson and Magnus Palmbäck both worked in the legal department of Kaupthing Luxembourg at this time, and perhaps the third representative was an employee of that institution as well.

On 6 October 2008, the day it received its loan payment, Lindsor purchased EUR 84,0 million and USD 95,1 million of Kaupthing bonds from Kaupthing Luxembourg, in addition to smaller amounts of JPY and ISK bonds (totaling around EUR 15,2 million, depending on the EUR/ISK exchange rate used). The intention to purchase some of the EUR- and USD-denominated bonds was set forth in two forward purchase contracts executed by Lindsor on 25 September 2008. These contracts appear to cover all the Kaupthing bonds then owned by Kaupthing Luxembourg, but do not include the bonds then held by Marple and the four employees of Kaupthing Luxembourg. These bonds appear to have been added in to the Lindsor purchase at the last minute.

As Lindsor bought these bonds from Kaupthing Luxembourg, the company sometimes paid different prices for the same bond on the same day. For example, it bought the bond "KAUP 5.901% 49-14" for 102 cents, 75 cents, and 63 cents in three trades on the same day. The first of these trades was a purchase from an employee, the second from Marple, and the third from an unknown party, perhaps from inventory. This substantial price mismatch (unheard of in fixed income products) reinforces the belief of FME that Lindsor was a "rubbish bin" that paid back each investor his price, regardless of fair market price.

On 31 October 2008, the loan to Lindsor of EUR 171 million came due. Lindsor did not pay, having at this point only Kaupthing bonds and some small cash balance as assets. Further transactions did not transpire with Lindsor until FX trades were booked to pay down interest in the cash accounts in February and March 2009.

According to a valuation report printed from the accounting system of Kaupthing Luxembourg on 17 December 2008, by that date the bonds held by Lindsor were worth only EUR 11 million, including accrued interest. This represents a 94% loss in portfolio value in just over two months.

FME plans to refer the business decision by Kaupthing Iceland to set up Lindsor and use it to buy bonds on terms unfavorable for Kaupthing Iceland to the Special Prosecutor. The information on Lindsor is provided here above to 1) illuminate for CSSF that Lindsor was the ultimate recipient of Kaupthing bonds and ultimate source of cash and 2) to aid CSSF in any investigation CSSF deems worthy in connection with Lindsor. Most of the transactions involving Lindsor were executed in Luxembourg, although it was ultimately Kaupthing Iceland shareholders and bondholders who lost out on the Lindsor deal.

In addition, FME respectfully recommends that CSSF investigate whether there were other Lindsor-like entities formed by Kaupthing Luxembourg during this time period. Lindsor may be one of several similar entities.

6. Money movements from Kaupthing Luxembourg

In connection with the activity described above, there are several suspicious cash transfers. The largest involves Marple. On 7 October 2008, as FME was taking over operations at Kaupthing Iceland's two competitors, Marple cleaned out all of its various currency accounts at Kaupthing Luxembourg, transferring funds to its GBP account at Kaupthing Luxembourg.

The following day, 8 October 2008, an unknown party withdrew GBP 10,4 million from the GBP cash account. The transfer is marked simply "Out" on the bank statement. This amount represents most of the profits that Marple took from its trading in Kaupthing bonds. If the trades of May 2008 represented embezzlement of funds to Marple from Kaupthing Luxembourg, this cash transfer was the removal of that money from the bank.

On 6 October 2008, the day he sold back his Kaupthing bonds at par, Björn Jónsson made two cash transfers of EUR 434 thousand and EUR 301 thousand to "100271-0" and "100271-2". FME does not know if these recipients are accounts at Kaupthing Luxembourg or elsewhere.

Finally, also at the time of the Icelandic banking crisis, two Kaupthing Luxembourg employees transferred funds from their personal accounts to an entity called My Mariu. "Mariu" is a super-yacht commissioned for Giorgio Armani. FME believes the yacht was later owned by an Isle of Man company (My Mariu Ltd) originally set up by Steingrímur Kárason, Chief Risk Officer of Kaupthing Iceland. ("My" is ostensibly a mis-transcribed version of "M/Y", the abbreviation for "Motor Yacht".)

It is the belief of FME that the ownership of My Mariu was later transferred to Ágúst and Lýður Guðmundsson, two brothers who, via several holding companies such as Exista hf. and subsidiary Exista B.V. were among the largest individual shareholders in Kaupthing Iceland at the time.

On 7 October 2008, Björn Jónsson transferred EUR 195 700, an amount slightly more than his trading profits, to My Mariu from his personal account. The following day, Anne Rassel transferred EUR 750 000 to the same company from her personal account, enough for almost four weeks of charter time based on online rates for the vessel. It is not known if either employee went on a cruise.

FME respectfully recommends that CSSF undertake an investigation of money movements to and from personal bank accounts located in Luxembourg for every participant named in this letter, both employees of Kaupthing Luxembourg and related parties such as Skúli Þorvaldsson, Hreiðar Már Sigurðsson, Steingrímur Kárason, and Sigurður Einarsson.

7. Kaupthing Luxembourg aids Kaupthing Iceland in cover-up and forgery

A major effort involving employees of both Kaupthing Iceland and Kaupthing Luxembourg was undertaken in November and December 2008 to make the sale of bonds to Lindsor appear legitimate. In fact, there appear to have been no signed documents establishing the relationship between Kaupthing Iceland, Kaupthing Luxembourg, and Lindsor at this point. These documents were likely signed and dated to appear as though they had been executed in September 2008. These documents included a Lindsor Shareholder's Resolution, an Acquisition Agreement, a Beneficial Owner document, and a Corporate Service Agreement. Some of these documents had to be updated from their original unsigned form to correctly reflect the Lindsor bond sale done two months previously and that "fixing" of documents was the subject of several emails back and forth.

This effort appears to have involved Kaupthing Luxembourg employees Magnús Guðmundsson (CEO), Eggert Hilmarsson (Managing Director, Legal Department), Doriane Rossignol (Legal Officer), and Andri Sigurðsson (Senior Lawyer).

(For Kaupthing Iceland, Guðný Arna Sveinsdóttir (former CFO, at the time sitting on the resolution committee of Kaupthing Iceland), Helgi Sigurðsson (Managing Director, Legal Services and Attorney at Law), and Bjarki Diego (Group Credit Officer) appear to have been involved.)

The key documents were ultimately signed by Eggert Hilmarsson and Hreiðar Már Sigurðsson, who had resigned as CEO of Kaupthing Iceland in late October 2008. They appear to have been finalized on 15 December 2008.

FME possesses copies of the email thread between the various employees of Kaupthing Luxembourg and Kaupthing Iceland to show the unfolding of the forgery of these documents. FME will also refer this forgery to the Special Prosecutor.

8. Marple "guarantee" payments

On 31 December 2008, GBP 13,7 million and ISK 672 million were withdrawn from the Marple currency accounts held by Kaupthing Luxembourg. These payments were back-dated to 3 October 2008.

According to a letter dated 9 April 2009 from Magnús Guðmundsson, CEO Kaupthing Luxembourg, to CSSF, these payments were to compensate Kaupthing Luxembourg for losses it had taken on the sales of bonds to Lindsor. However, these payments appear suspicious for several reasons:

1. The guarantee letter he references (dated 31 July 2008) does not appear to cover trading losses but rather credit extended to Marple.

2. Further, the guarantee letter makes no mention of Lindsor, but in his explanation he references Lindsor.

3. The guarantee letter discusses a guarantee between Kaupthing Iceland and Kaupthing Luxembourg, so it is not at all clear that Kaupthing Luxembourg had authority to remove money from the account of Marple to pay out the guarantee, if this is indeed what transpired.

4. Magnús Guðmundsson provides no connection between the (high) amount of these payments and specific trading losses by Kaupthing Luxembourg, nor between the currencies (GBP and ISK) of these payments and the currencies of bonds traded. (For example, Marple never traded any bonds denominated in GBP.)

5. The guarantee letter was signed only by Hreiðar Már Sigurðsson and there is no record of this guarantee in the Kaupthing Iceland Credit Committee minutes of 2008, so it is possible that this guarantee letter was later forged along with the other documents.

6. It is not clear from the account statements in possession of FME what actually became of this money.

The actual disposition of these "guarantee" funds is a subject for potential follow-up by CSSF.

9. Explanation letter from Hreiðar Már Sigurðsson

In a letter dated 17 February 2009, Hreiðar Már Sigurðsson, former CEO of Kaupthing Iceland, set out an explanation for the Lindsor transaction. FME received this letter as part of a package of data from CSSF, dated 6 May 2009.

The letter states:

> *I, Hreiðar Már Sigurðsson, confirm that the following bonds issued by Kaupthing Bank hf. (KB)* [Kaupthing Iceland] *were bought based on my instruction* [sic] *to Kaupthing Bank Luxembourg* [Kaupthing Luxembourg, later referred to in the letter as "KTL"]. *The bonds were accumulated from summer until autumn 2008.*
>
> *The bonds were accumulated on verbal instructions given by myself. I gave KTL full discretion to buy the Bonds, The agreement with KTL was* [that] *the bank would not suffer losses from any of the transaction* [sic].
>
> *The Bonds were then acquired by Lindsor Holdings Corp. (Lindsor).*
>
> [Table of bonds bought, quantity, and cost price.]
>
> *In order to finance the acquisition KB granted a Loan to Lindsor that was advanced to the company on the 6th of October 2008, being EUR 171 million. The loan amount was credited to the account of Lindsor with KTL.*
>
> *All statements of account and portfolio valuation in relation to the aforementioned transactions are in accordance with what was agreed upon with KTL.*

The table of bonds included in the letter accurately reflects the Lindsor portfolio at the date of the letter, according to the best information of FME. However:

1. Lindsor purchased the bonds from Kaupthing Luxembourg at high prices, in some cases significantly higher than market price, which he does not address in the letter.

2. Hreiðar Már Sigurðsson does not address from whom the bonds were purchased, stating only that they were "accumulated". In the case of Marple and the four employees, the bonds were purchased from related parties on non-commercial terms.

3. The fact that Kaupthing Luxembourg did not suffer losses on the transaction means that Lindsor necessarily did. This lends further credence to the idea that Lindsor was effectively a "rubbish bin" designed to keep Kaupthing Luxembourg and other related parties from having to realize any losses on their bad investments in Kaupthing bonds: not only did Kaupthing Luxembourg not suffer any losses, but neither Marple nor the four Kaupthing Luxembourg employees suffered any losses on any of their bond purchases.

10. Potential misrepresentations made to CSSF

In his letter of 9 April 2009 to CSSF, Magnús Guðmundsson makes several potential misrepresentations:

1. That the Corporate Service Agreement and Acquisition Agreement for Lindsor were signed on 24 September 2008, when in fact the date og these documents were forged

in December 2008.

2. That a Lindsor shareholders' meeting was held on 28 September 2008, when in fact the date of that document was also forged in December 2008. (FME has evidence that Magnús Guðmudsson was possibly personally involved in this forgery: an email from Andri Sigurðsson on 3 December 2008 says that he changed the shareholders' resolution to be in line with what "MG" wanted.)

3. That the rationale for purchasing the bonds was ongoing debt repurchase by Kaupthing Iceland as per its Q1 presentation, when in fact the bond purchases were made via a shell company and on non-commercial terms unfavorable to both Kaupthing Iceland and Lindsor.

4. That the discrepancy between what bonds Lindsor purchased from Kaupthing Luxembourg and what was claimed on two forward agreements was solely due to bonds purchased from Marple, when in fact the total also included bonds purchased from four Kaupthing Luxembourg employees. The memo neglects to mention any employee trading in Kaupthing bonds.

5. That the Marple guarantee payments were executed on 3 October 2008, when in fact they were executed on 31 December 2008 and back-dated to 3 October.

6. The entire justification of the Marple guarantee payments could be a misrepresentation, as per the section above.

7. The letter contains two Appendixes, one called "Excel Spreadsheet send [sic] to Iceland" and another called "Excel Spreadsheet with Sensitivity Analysis". The bond identifiers (names), quantities, and prices on these two data sets in many cases contradict each other. In particular, the spreadsheet sent to Iceland contains quite a few discrepancies with the bank's own bond tracking system, called Apsys, a printout from which is also sent as an Appendix to the same letter.

In a memo received via a letter from CSSF dated 5 October 2009, Tara Van Raepenbusch, Compliance Officer, Banque Havilland S.A. (formerly Kaupthing Luxembourg), discussing the trades by four Kaupthing Luxembourg employees, states: "All bonds bought at market price". This seems clearly to represent a misrepresentation as:

1. The Kaupthing bonds were initially bought back at par in 3 cases, far above "market" price for a bank in serious trouble as that bank was collapsing.

2. The trades appear to have been "corrected" only in November 2008 after the investigation had started (and then only back to purchase price).

3. A more than doubling in Kaupthing CDS spreads from purchase to sale date show that even the corrected prices on the trades do not square with a likely market price.

11. Other items

There are several other, smaller items FME uncovered in the course of the investigation for possible further investigation by CSSF. The first is that two Kaupthing Luxembourg employees (Kristján Ágústsson and Gabriel Rindone) received large cash grants (EUR 803 thousand and EUR 140 thousand respectively) in their personal accounts that are termed "write off approvals". These were credited at the time of the Kaupthing bond sales in early October 2008 but back-dated to 30 September 2008. These were in addition to their large trading profits and were subsequently reversed at the same time as the unwinding of the bond trades in November 2008. The rationale for these large cash transfers, in nature or amount, is not clear, nor is it clear who authorized these write-offs.

Another general point concerns the role of Andri Sigurðsson, lawyer for Kaupthing Luxembourg. In several instances, this employee also acted as a signatory for Lindsor, effectively sitting on both sides of the table at the same time in an inherent conflict of interest. (This is reminiscent of the role of Andrew Fastow at Enron, where he worked as both CFO of the company and signatory for off-balance sheet entities that purchased assets from Enron.) In one example, Andri Sigurðsson signed forward contracts for Lindsor to purchase bonds from Kaupthing Luxembourg on 25 September 2008, at the same time representing both his employer and Lindsor. His colleague Magnus Palmbäck appears to have also acted in a similar capacity.

Kaupthing Luxembourg had its own bond valuation system and a report printed by Magnús Guðmundsson on 17 December 2008 shows that the total assets of Lindsor (bonds and cash) are worth a mere EUR 11,6 million, against a EUR 171 loan granted that company only two months before to buy these assets. It would be interesting to see if any earlier valuation reports exist for any of these bonds. Such reports might reinforce the idea that Kaupthing Luxembourg knowingly traded Kaupthing bonds with its employees, Marple, and Lindsor on non-commercial terms.

Finally, Kristján Ágústsson appears to have sold Kaupthing Iceland equity shares ("KAUP SS") back to his employer on 23 October 2008, after the shares had become worthless. He netted 2,3 million SEK on this trade. The trade was cancelled but then reinstated on 29 October 2008 and then cancelled outright 11 November 2008.

Referrals to Special Prosecutor

FME will refer parts of this case to the Special Prosecutor. The referral will cover:

1. Kaupthing Iceland use of Lindsor entity to buy back its debt on non-commercial terms and at great cost to the shareholders and bondholders of the bank
2. Kaupthing Iceland loan to Lindsor of EUR 171 million, with no approval from the bank loan committee
3. Kaupthing Iceland blanket guarantee to Kaupthing Luxembourg for all debts owed by Marple
4. Two suspicious money wires, for ISK 3 billion (1 July 2008) and ISK 10 billion (3 October 2008) from Kaupthing Iceland to the Marple account at Kaupthing Luxembourg
5. Cover-up and forgery of documents, including restatements of Lindsor bond purchase quantity and amounts.

Conclusion

FME stands ready to provide additional information and assistance, or refer requests where appropriate to the Special Prosecutor, should CSSF desire to pursue its own investigation into the Luxembourg-listed debt issues detailed here above. As part of a planned visit to CSSF later this month, FME plans to provide additional data, analysis, and supporting documentation in electronic form. FME requests that, due to the ongoing investigation by the Special Prosecutor, CSSF maintain utmost confidentiality in this matter. FME looks forward to the opportunity to work cooperatively with CSSF.

A copy of this letter will be provided to the Special Prosecutor.

Yours sincerely,

FJÁRMÁLAEFTIRLITIÐ

Gunnar Þ. Andersen

Guðrún Jónsdóttir
Guðrún Jónsdóttir