

Central Bank of Iceland
c/o Mr. Már Guðmundsson, Governor
Kalkofnsvegi 1
150 Reykjavík

and

The Minister of Finance and Economic Affairs
Mr. Benedikt Jóhannesson
Arnarhvoli við Lindargötu
101 Reykjavík

Reykjavík, 14 February 2017

Re: 1. Updated request for confirmation due to a sale to non-residents
2. Request to make payment in USD /EUR

Introduction

Kaupthing ehf., id. no. 560882-0419, (**Kaupthing**) through its subsidiary Kaupskil ehf., kt. 580609-0150 (**Kaupskil**) owns 87% of the shares in Arion Banki hf., id. no. 581008-0150 (**Arion**). Kaupthing has been preparing a sale of its shares in Arion. Reference is made to the Central Bank of Iceland's (**CBI**) exemption dated 15 January 2016, reference number 1507075, (the **Exemption**) in the context of such a sale and specifically to condition ii) on page 24 of the Exemption (the **Condition**). Reference is also made to the Shareholders' Proceeds Apportionment Agreement dated 13 January 2016 between CBI, Kaupskil and Kaupthing (**SPAA**) and the secured bond in the principal amount of ISK 84 billion (**Secured Note**) granted by Kaupthing in favour of the CBI on or around the date of that agreement.

According to the Condition the sale and resale of Kaupskil's 87% share in Arion to non-residents, in part or in whole, is subject to a confirmation of the CBI and the Minister of Finance and Economic Affairs (the **Minister**). In substance, the CBI and the Minister need to confirm that the sale or resale does not jeopardise monetary, exchange rate, or financial stability.

On 24 November 2016 Kaupthing submitted a request for confirmation due to a contemplated sale to non-residents as per the Condition. With this updated request we hereby inform you that a sale to certain of the parties referred to in the November confirmation request has taken place, subject to the CBI's confirmation, among other conditions. In that context Kaupthing i.a. refers to condition j. on page 27 of the Exemption, whereby it will immediately upon any sale in a private placement, confirm the terms of the sale.

Terms of the Sale

On 12 February 2017 it was decided at board meetings of both Kaupthing and Kaupskil to enter into agreements with respect to sale of up to 22.57% of Arion's outstanding shares (**Private Placement**) with funds under the management and control of the following entities:

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- Attestor Capital LLP (**Attestor**), purchasing through Trinity Investment Designated Activity Company) for 10% less one share.
- Taconic Capital Advisors UK LLP (**Taconic**), purchasing through TCA New Sidecar III s.a.r.l.) for up to 10% less one share.
- Goldman Sachs International (**Goldman Sachs**), purchasing through ELQ Investors II Ltd.) for up to¹ 2.57%.

Entities managed or represented by Attestor, Taconic and Goldman Sachs are all current shareholders in Kaupthing.

The price per share in the agreements is ISK 83.811 representing 0.81x book value as of 30 September 2016 (the latest published Arion accounts as at 12 February 2017) and will therefore not require any notification to the CBI with respect to the "step-in right" of the CBI in the SPAA. In addition the investors will receive a call option from Kaupskil for up to 6 months over 0.75x additional shares per purchased share on Arion at [REDACTED] latest book value (subject, as applicable, to receipt of any necessary authorisations of the FME). [REDACTED]

At the outset, a Private Placement to these three investors will lead to an inflow of foreign currency of approx. USD320m (approx. 36.3bn ISK) that would go to pay down the Secured Note to the Government in accordance with the SPAA.

In the same meetings the boards of Kaupthing and Kaupskil resolved that they wished to accept an offer from Och-Ziff Capital Investments LLC (**Och-Ziff**), through Sculptor Investments s.a.r.l.) for Arion shares purchased for consideration of USD100m. The offer includes the same terms as for the above-mentioned agreements with the exception that it will only be capable of acceptance by Kaupthing / Kaupskil in the event that the CBI grants full, unqualified and irrevocable permission for Sculptor Investments s.a.r.l. to put in place Icelandic Krona (ISK): US dollar (US) hedging arrangements to hedge Sculptor Investment s.a.r.l.'s ISK currency exposure in respect of its offer to purchase and hold Arion shares. This permission would also need to apply to the other three investors, as under the terms of their agreements Kaupskil would be required to offer this possibility to them in the event it is afforded to any other investor. Accordingly, should the CBI grant such an exemption, which Kaupthing applied for on 23 December 2016, a definitive agreement could be entered into with Och-Ziff. It should be noted that entities managed or represented by Och-Ziff are also shareholders in Kaupthing.

We furthermore note that pursuant to (1) Section 2.6 of the SPAA, in the event that Kaupthing pursues a Monetisation (as defined in the SPAA), other than by way of an initial public offering and as further described in the SPAA, of any portion of the Arion Stake in a sale to any Kaupthing Claimant (as defined in the SPAA), Kaupthing shall, on the reasonable request of the Central Bank, obtain an Independent Opinion (as defined in the SPAA) confirming that the terms of such sale are on an arm's length basis. The CBI Observer (as defined in the SPAA) has confirmed that such an opinion is required.

To comply with Section 2.6 of the SPAA, Kaupthing has requested that the international investment bank [REDACTED] render to it a written opinion as to whether the terms of the Private Placement are on an arm's length basis. Confidential copies of the opinion will be provided to the Central Bank of Iceland and Ministry of Finance no later than 21 February 2017.

¹ Note that GS's participation will be capped at the lower of USD 40m or 2.57%.

Request for Confirmation

In light of the terms of the sale and the analysis of its impact on monetary, exchange rate, or financial stability, it is hereby requested that the CBI and the Minister confirm that the Private Placement as described above to foreign investors is a permitted sale in the context of the Exemption as per the Condition. As the confirmation is a conditions precedent in the signed agreements for a sale to take place it is kindly requested that the matter is dealt with as expediently as possible.

Request to make a payment in USD/EUR

The investors have the right, under the terms of the agreements of the Private Placement, if they wish, to make a payment under the agreements in USD/EUR. It is a condition precedent of the agreements, to be satisfied no later than 28 February 2017, that the investors be able to make a payment in USD / EUR if they desire. That would leave Kaupthing with proceeds of the monetization in either USD or EUR, as the case may be. We note that this is a condition precedent under the agreements.

To be able to facilitate that request, authorization from the Central Bank of Iceland is required and Kaupthing would also either request that the Central Bank of Iceland would agree to a FX transaction with the CBI directly (or through an appointed broker) to convert proceeds into ISK to fulfill an installment of the Secured Note in ISK into the Treasuries' stability contribution current account with the CBI. Or, alternatively, the Ministry of Finance could accept to receive the payment on the Secured Note in USD / EUR at an agreed foreign exchange reference rate. We furthermore note that the prior approach would be in line with arrangement when Kaupthing made the first interest payment under the Secured Note in January 2017.

Either route, if agreed to by the Icelandic authorities, would in our opinion limit any risk of foreign exchange or monetary instability deriving from the Private Placement and form the same basis as when Kaupthing granted the Secured Note of ISK 84bn in favour of the Icelandic authorities as part of the Stability Contribution. It would also be in line with previous precedents regarding distributions from failed banking entities that have concluded winding-up proceedings with a composition.

Conclusion

Kaupthing and Kaupskil are delighted that they have been able to reach agreements with the 3 abovementioned investors and that they have received an offer on similar terms from the fourth investor, which they also wish to accept. However, taking into account that the agreements and the offer are conditional upon the matters referred to herein we kindly request that the relevant confirmations are granted as soon as practically possible. We note i.a that this is an important step in enabling Kaupthing to make the first principal payment under the Secured Note which should be to the mutual benefit of both Kaupthing and the CBI and Ministry of Finance.

Respectfully,

On behalf of Kaupthing ehf.



Paul Copley, CEO

