

# Íslandsbanki hf. Base Prospectus

April 2016

# Íslandsbanki hf.

*(Incorporated in Iceland as a limited liability company)*

## **ISK 100,000,000,000 Bond Programme**

*Under this ISK 100,000,000,000 Bond Programme, Íslandsbanki hf. (the "Issuer") may issue in a continuous and repeated manner bonds (the "Bonds") denominated in any Specified Currency.*

*The Bonds may be issued in bearer form ("Bearer Bonds"), registered form ("Registered Bonds"), uncertificated book entry form cleared through the Icelandic Securities Depository (the "ISD") or any other clearing system as decided by the Issuer.*

*The maximum aggregate nominal amount outstanding of all Bonds issued under the Programme will not exceed ISK 100,000,000,000 (or its equivalent in other currencies calculated as described herein). The Bonds may be issued on a continuing basis.*

*This Base Prospectus has been approved by the Financial Supervisory Authority Iceland (the "FME"), in its capacity as competent authority under the Act on Securities Transactions, as a base prospectus for the purposes of Article 5(4) of Directive 2003/71/EC (the "Prospectus Directive") and Article 45 of the Act on Securities Transactions No. 108/2007 for the purpose of giving information with regard to the issue of Bonds under the Programme during a period of at least twelve months from the date of its publication. An application will be submitted to NASDAQ OMX Iceland hf. for Bonds issued under the Programme to be admitted to trading on NASDAQ OMX Iceland's Main Market, the regulated market of the NASDAQ OMX Iceland. References in this Base Prospectus to Bonds being listed (and all related references) shall mean that such Bonds have been admitted to trading on the regulated market of the NASDAQ OMX Iceland. The regulated market of the NASDAQ OMX Iceland is a regulated market for the purposes of Directive 2004/39/EC (the "MIFID") which has been implemented in Iceland through the Act on Securities Transactions and Act on Stock Exchanges No. 110/2007. The Issuer may list the Bonds on additional regulated markets.*

*Notice of the aggregate nominal amount of Bonds, interest (if any) payable in respect of Bonds, the issue price of Bonds and any other terms and conditions not contained herein which are applicable to each Tranche (as defined under Terms and Conditions of the Bonds) of Bonds will be set out in the Final Terms which, with respect to Bonds to be listed on NASDAQ OMX Iceland, will be delivered to the NASDAQ OMX Iceland and can be found on the Issuer's website <http://www.islandsbanki.is/english/investor-relations/funding/>*

***Prospective investors should refer to the factors described in the section entitled "Risk Factors" in this Base Prospectus for a discussion of risk factors to be considered in connection with an investment in the Bonds.***

*The Bonds have not been and will not be registered under the U.S. Securities Act of 1933, as amended (the "US Securities Act") and are subject to U.S. tax law requirements. Subject to certain exceptions, Bonds may not be offered, sold or delivered within the United States or to U.S. persons.*

*The Issuer may decide that Bonds may be issued in a form not contemplated by the Terms and Conditions of the Bonds described herein, in which event, a supplement to the Base Prospectus, if appropriate, will be made available which will describe the effect of the agreement reached in relation to such Bonds.*

**Íslandsbanki hf.**

The date of this Base Prospectus is 12 April 2016

The Issuer hereby declares that having taken all reasonable care to ensure that such is the case, the information contained in this Base Prospectus is, to the best of its knowledge, in accordance with the facts and contains no omission likely to affect its import.

Copies of Final Terms relating to Bonds which are admitted to trading on NASDAQ OMX Iceland's regulated market will be available on the website of the Issuer <http://www.islandsbanki.is/english/investor-relations/funding/> and at the registered office of the Issuer.

No person is or has been authorised by the Issuer to give any information or to make any representation of information not contained in or not consistent with this Base Prospectus or any other information supplied in connection with the Programme or the Bonds and, if given or made, such information or representation must not be relied upon as having been authorised by the Issuer.

Neither this Base Prospectus nor any other information supplied in connection with the Programme or any Bonds (i) is intended to provide the basis of any credit or other evaluation or (ii) should be considered as a recommendation by the Issuer that any recipient of this Base Prospectus or any other information supplied in connection with the Programme or any Bonds should purchase any Bonds. Each investor contemplating purchasing any Bonds should make its own independent investigation of the financial condition and affairs, and its own appraisal of the creditworthiness, of the Issuer. Neither this Base Prospectus nor any other information supplied in connection with the Programme or the issue of any Bonds constitutes an offer or invitation by or on behalf of the Issuer to any person to subscribe for or to purchase any Bonds.

Neither the delivery of this Base Prospectus nor the offering, sale or delivery of any Bonds shall in any circumstances imply that the information contained herein concerning the Issuer is correct at any time subsequent to the date hereof or that any other information supplied in connection with the Programme is correct as of any time subsequent to the date indicated in the document containing the same.

This Base Prospectus does not constitute an offer to sell or the solicitation of an offer to buy any Bonds in any jurisdiction to any person to whom it is unlawful to make the offer or solicitation in such jurisdiction. The distribution of this Base Prospectus and the offer or sale of Bonds may be restricted by law in certain jurisdictions. The Issuer does not represent that this Base Prospectus may be lawfully distributed, or that any Bonds may be lawfully offered, in compliance with any applicable registration or other requirements in any such jurisdiction, or pursuant to an exemption available thereunder, or assume any responsibility for facilitating any such distribution or offering. In particular, no action has been taken by the Issuer which would permit a public offering of any Bonds or distribution of this Base Prospectus in any jurisdiction where action for that purpose is required. Accordingly, no Bonds may be offered or sold, directly or indirectly, and neither this Base Prospectus nor any advertisement or other offering material may be distributed or published in any jurisdiction, except under circumstances that will result in compliance with any applicable laws and regulations. Persons into whose possession this Base Prospectus or any Bonds may come must inform themselves about, and observe any such restrictions on the distribution of this Base Prospectus and the offering and sale of Bonds. In particular, there are restrictions on the distribution of this Base Prospectus and the offer or sale of Bonds in the United States, the European Economic Area and Japan.

The language of this Base Prospectus is English. Certain legislative references and technical terms have been cited in their original language in order that the correct technical meaning may be ascribed to them under the applicable law. Capitalised terms used in this Base Prospectus have been defined in the section of the Terms and Conditions entitled "Definitions" or throughout this Base Prospectus. Accordingly, references to the Terms and Conditions shall be construed as references to the definitions found therein unless the context specifically states otherwise.

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## SUMMARY OF THE BASE PROSPECTUS

Summaries are made up of disclosure requirements known as 'Elements'. These elements are numbered in Sections A – E (A.1 – E.7).

This summary contains all the Elements required to be included in a summary for this type of securities and Issuer. Because some Elements are not required to be addressed, there may be gaps in the numbering sequence of the Elements.

Even though an Element may be required to be inserted in the summary because of the type of securities and Issuer, it is possible that no relevant information can be given regarding the Element. In this case a short description of the Element is included in the summary with the mention of 'not applicable'.

### A. INTRODUCTION AND WARNINGS

Element	Disclosure requirement	Information
A.1	Warnings	This summary must be read as an introduction to this Base Prospectus and any decision to invest in any Bonds should be based on a consideration of this Base Prospectus as a whole by the investor. Where a claim relating to the information contained in the Base Prospectus is brought before a court, the plaintiff investor might, under the national legislation of the Member States, have to bear the costs of translating the Base Prospectus before the legal proceedings are initiated. Following the implementation of the relevant provisions of the Prospectus Directive (Directive 2003/71/EC) in each Member State of the European Economic Area, a civil liability attaches only to those persons in any such Member States who have tabled the summary, including any translation thereof, but only if the summary is misleading, inaccurate or inconsistent when read together with the other parts of this Base Prospectus or it does not provide, when read together with the other parts of the Base Prospectus, key information in order to aid investors when considering whether to invest in such securities.
A.2	Consent by the Issuer to the use of prospectus in subsequent resale or final placement of Notes, indication of offer period and conditions to consent for subsequent resale or final placement and warning.	Not applicable; the Issuer does not consent to use of the Base Prospectus for subsequent resale.

### B ISSUER AND ANY GUARANTOR

Element	Disclosure requirement	Information
B.1	The legal and commercial name of the Issuer	The legal name of the Issuer is Íslandsbanki hf and the commercial name of the Issuer is Íslandsbanki.
B.2	The domicile and form of the Issuer	Íslandsbanki hf., ID no. 491008-0160, is a public limited company, having its registered office at Kirkjusandur 2, 155 Reykjavík, Iceland. The Issuer's operations are subject to the provisions of the Act on Public Limited Companies No. 2/1995 and the Act on Financial Undertakings No. 161/2002.

B.4b	A description of any known trends affecting the Issuer and the industries in which it operates	The Issuer does not recognise any specific trends affecting the Issuer and the industries in which it operates
B.5	A description of the group and the Issuer's position within the group	Íslandsbanki is fully owned by the Government of Iceland. The Issuer is not dependent upon other entities within the group.
B.9	Profit forecast	No profit forecast or estimate has been made for the Issuer.
B.10	Qualifications in the audit reports on the historical financial information	Not applicable
B.12	<p>-Selected historical key financial information</p> <p>-No material changes in the prospects of the Issuer</p> <p>-No material changes in the financial or trading position since the date of its last published financial statements</p>	According to the audited Consolidated Financial Statement for the Issuer's operations for the year 2015, profit amounted to ISK 20,578 million, which corresponds to a 10.8% return on equity. The Issuer has a total capital ratio of 30.1% and a Tier 1 ratio of 28.3% according to the Consolidated Financial Statement for 2015. The Issuer's total assets amounted to ISK 1,045,769 million at the end of the year.

## Consolidated Income Statement for the years 2013-2015

ISK million	2015	2014	2013
Interest income .....	53,414	50,816	54,333
Interest expense .....	( 25,404)	( 23,711)	( 25,903)
<b>Net interest income</b>	<b>28,010</b>	<b>27,105</b>	<b>28,430</b>
Fee and commission income .....	20,737	17,984	16,695
Fee and commission expense .....	( 7,567)	( 6,501)	( 6,262)
<b>Net fee and commission income</b>	<b>13,170</b>	<b>11,483</b>	<b>10,433</b>
Net financial income .....	3,881	1,568	4,612
Net foreign exchange gain (loss) .....	( 1,490)	165	( 2,423)
Other net operating income .....	1,102	2,122	1,545
<b>Other net operating income</b>	<b>3,493</b>	<b>3,855</b>	<b>3,734</b>
<b>Total operating income</b>	<b>44,673</b>	<b>42,443</b>	<b>42,597</b>
Administrative expenses .....	( 23,760)	( 22,901)	( 25,551)
Impairment of goodwill .....	-	-	-
Contribution to the Depositors' and Investors' Guarantee Fund .....	( 1,067)	( 1,055)	( 1,016)
Bank tax .....	( 2,878)	( 2,444)	( 2,321)
<b>Total operating expenses</b>	<b>( 27,705)</b>	<b>( 26,400)</b>	<b>( 28,888)</b>
<b>Profit before loan impairment charges and net valuation c</b>	<b>16,968</b>	<b>16,043</b>	<b>13,709</b>
Loan impairment charges and net valuation changes .....	8,135	8,810	16,299
<b>Profit before tax</b>	<b>25,103</b>	<b>24,853</b>	<b>30,008</b>
Income tax .....	( 5,851)	( 6,239)	( 7,866)
<b>Profit for the year from continuing operations</b>	<b>19,252</b>	<b>18,614</b>	<b>22,142</b>
Profit from discontinued operations, net of income tax .....	1,326	4,136	927
<b>Profit for the year</b>	<b>20,578</b>	<b>22,750</b>	<b>23,069</b>

The group has changed its presentation in the consolidated income statement as follows:

- Interest income has been changed from ISK 51,006 million to ISK 50,816 million and interest expense has been changed from ISK (23,901) million to ISK (23,711) million 2014. Reclassification of the interest owned by HFF (Íbúðalánasjóður).
- The line item Share of profit or loss of associates has been included in the line item other operating income.
- The line item Administrative expenses has been split up into two lines: Salaries and related expenses and other operating expenses.

## Consolidated Statement of Financial Position

ISK million	31.12.2015	31.12.2014	31.12.2013
<b>Assets</b>			
Cash and balances with Central Bank .....	216,760	103,389	111,779
Bonds and debt instruments .....	78,606	87,347	75,186
Shares and equity instruments .....	18,320	10,531	9,208
Derivatives .....	1,981	1,810	843
Loans to credit institutions .....	35,534	35,072	44,078
Loans to customers .....	665,711	634,799	554,741
Investments in associates .....	716	570	1,563
Property and equipment .....	7,344	7,402	8,772
Intangible assets .....	1,331	619	299
Other assets .....	6,674	8,140	12,434
Non-current assets and disposal groups held for sale .....	12,792	21,649	47,106
<b>Total Assets</b>	<b>1,045,769</b>	<b>911,328</b>	<b>866,009</b>
<b>Liabilities</b>			
Deposits from Central Bank and credit institutions .....	25,631	25,796	29,689
Deposits from customers .....	593,245	529,447	489,331
Derivative instruments and short positions .....	6,981	3,963	11,176
Debt issued and other borrowed funds .....	150,308	96,889	89,193
Subordinated loans .....	19,517	21,306	21,890
Tax liabilities .....	8,358	8,388	10,826
Other liabilities .....	36,677	37,262	37,130
Non-current liabilities and disposal groups held for sale .....	2,825	2,790	9,456
<b>Total Liabilities</b>	<b>843,542</b>	<b>725,841</b>	<b>698,691</b>
<b>Equity</b>			
Share capital .....	10,000	10,000	10,000
Share premium .....	55,000	55,000	55,000
Other reserves .....	6,002	2,535	2,471
Retained earnings .....	127,288	116,288	98,548
<b>Total equity attributable to the equity holders of Isla</b>	<b>198,290</b>	<b>183,823</b>	<b>166,019</b>
Non-controlling interests .....	3,937	1,664	1,299
<b>Total Equity</b>	<b>202,227</b>	<b>185,487</b>	<b>167,318</b>
<b>Total Liabilities and Equity</b>	<b>1,045,769</b>	<b>911,328</b>	<b>866,009</b>

The Group has changed its presentation in the consolidated statement of financial position as follows:

- The line item Deferred tax assets has been included in the line item Other assets
- The line items Deposits from Central Bank and Deposits from credit institutions have been combined into one line: Deposits from Central Bank and credit institutions
- The line items Current tax liabilities and Deferred tax liabilities have been combined into one line: Tax liabilities

To the Issuer's best knowledge, there has been no material adverse change in the prospects of the Issuer since the date of its last published audited Financial Statements for the financial year ended 31 December 2015 published 23 February 2016.

To the Issuer's best knowledge, no significant changes have occurred in



		the financial position of the Issuer since the end of the last financial period.
B.13	Recent events particular to the Issuer which are to a material extent relevant to the evaluation of the Issuer's solvency	To the Issuer's best knowledge there have been no recent events particular to the Issuer which are to a material extent relevant to the evaluation of the Issuer's solvency.
B.14	Dependency upon other entities within the group	The Issuer is not dependent upon other entities within the group
B.15	The Issuer's principal activities	The Issuer is licensed as a commercial bank in Iceland, that offers comprehensive services to the retail and corporate sectors and is one of the country's three main banks
B.16	Ownership of the Issuer	Íslandsbanki hf. is fully owned by the Government of Iceland.  The Issuer's Board of Directors consists of seven members. Two alternate members are also appointed.
B.17	Credit ratings assigned to the Issuer or its debt securities	The Bonds may be rated or unrated.  The Issuer has been assigned a credit rating by two rating agencies; S&P and Fitch. S&P rate the issuer as BBB-/A3 with positive outlook. Fitch rate the issuer as BBB-/F3 with stable outlook.

### C SECURITIES

Element	Disclosure requirement	Information
C.1	A description of the type and the class of the securities being offered and/or admitted to trading	<p>The Bonds will be issued in Series. Each Series may comprise one or more Tranches issued on different issue dates. The Bonds of each Series will all be subject to identical terms, except that the issue date, the date of the first payment of interest (if any), the amount, and/or the issue price thereof may be different in respect of different Tranches.</p> <p>Each Tranche will be the subject of the Final Terms which, for the purposes of that Tranche only, completes the Terms and Conditions of the Bonds and this Base Prospectus and must be read in conjunction with this Base Prospectus.</p> <p>Bonds may provide for interest based on a fixed rate ("<b>Fixed Rate Bonds</b>"). Bonds may provide for interest based on a floating rate ("<b>Floating Rate Bonds</b>"). Bonds may provide for payments of interest to be linked to an index ("<b>Inflation-Linked Interest Bonds</b>").</p> <p>Bonds may provide that no interest is payable ("<b>Zero Coupon Bonds</b>"). Zero Coupon Bonds will be offered and sold at a discount to their nominal amount and will not bear interest.</p>
C.2	Currency of the securities	Bonds may be denominated in any currency or currencies, subject to compliance with all applicable legal and/or regulatory and/or central

		bank requirements (each a “ <b>Specified Currency</b> ”). Payments in respect of Bonds may, subject to such compliance, be made in and/or linked to, any currency or currencies other than the currency in which such Bonds are denominated
C.5	A description of any restrictions on the free transferability of the securities	The Central Bank of Iceland has implemented capital controls which have the purpose of limiting the flow of foreign currencies in Iceland and prohibiting certain transactions with securities. These currency/capital controls could adversely affect the ability of investors to invest in and trade with the Bonds
C.4, C.8 and C.9	Description of the rights attached to the securities	<p>Each relevant Bond constitutes unsubordinated obligations and ranks <i>pari passu</i> among themselves and any unsecured Senior Debt (if any). The Bonds and any unsecured Senior Debt (if any) will rank <i>pari passu</i> with the claims of all other unsubordinated creditors of the Issuer (other than those preferred by law) in all other respects. In the event of the establishment of an administration estate for the Issuer, the costs and debt (if any) of such administration will rank ahead of claims for payments of the Bonds and of the relevant Senior Debt (if any).</p> <p>Interest will be payable on Fixed Rate Bonds on such date or dates as may be agreed by the Issuer (as specified in the applicable Final Terms) and on redemption.</p> <p>Floating Rate Bonds will bear interest at a rate determined:</p> <ul style="list-style-type: none"> <li>• on the same basis as the floating rate under a notional interest-rate swap transaction in the relevant Specified Currency governed by an agreement incorporating the ISDA Definitions; or</li> <li>• on the basis of a reference rate appearing on the agreed screen page of a commercial quotation service; or</li> <li>• on such other basis as may be agreed by the Issuer, as specified in the applicable Final Terms.</li> </ul> <p>The margin (if any) relating to such floating rate will be agreed by the Issuer for each Series of Floating Rate Bonds.</p> <p>Payments of principal in respect of Inflation-Linked Interest Bonds will be calculated by reference to such index and/or formula or to such other factors as the Issuer may decide (as specified in the applicable Final Terms).</p> <p>Interest on Floating Rate Bonds and Inflation-Linked Interest Bonds in respect of each Interest Period, as agreed prior to issue by the Issuer, will be payable on such Interest Payment Dates and will be calculated on the basis of such Day Count Fraction as may be decided by the Issuer</p> <p>The applicable Final Terms will indicate the scheduled maturity date of such Bonds (the “<b>Maturity Date</b>”) and will also indicate whether such Bonds can be redeemed prior to their stated maturity for taxation reasons or whether such Bonds will be redeemable at the option of the Issuer (“<b>Call Option</b>”) which, in case upon giving not less than fifteen nor more than thirty days’ irrevocable notice (or such other notice period (if any) as is specified in the applicable Final Terms) to the Bond holders or the Issuer, as the case may be, on a date or dates specified in the applicable Final Terms, at the maturity and at a price or prices and on such terms as are specified in the applicable Final Terms.</p>

C.21	Indication of the market where the securities will be traded and for which prospectus has been published	<p>This Base Prospectus has been approved by FME as a base prospectus. Application will be made to the NASDAQ OMX Iceland for the Bonds issued under the Programme to be admitted to trading on the NASDAQ OMX Iceland regulated market.</p> <p>Bonds issued under the Programme may be listed or admitted to trading, as the case may be, on such other or further securities exchanges or markets as may be determined by the Issuer in relation to each Series. Bonds that are neither listed nor admitted to trading on any market may also be issued.</p> <p>The applicable Final Terms will state whether or not the relevant Bonds are to be listed and/or admitted to trading and, if so, on which stock exchanges and/or markets</p>
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#### D Risks

Element	Disclosure requirement	Information
D.2	Key information on the key risks that are specific to the Issuer	<p>The Issuer faces a variety of risks. The Issuer considers the management of such risks one of its core focuses. Considerable resources are spent on developing procedures and tools to match the best practices in risk management. The Issuer identifies and manages the following main categories of risk:</p> <p>Credit risk:</p> <ul style="list-style-type: none"> <li>• Third parties that owe the Issuer money, securities or other assets may be unable to meet their obligations towards the Issuer.</li> <li>• The Issuer's loan portfolio was exposed to concentration in certain industry sectors, namely households, real estate, seafood and commerce. The Issuer's financial condition is sensitive to downturn in these industries.</li> </ul> <p>Market risk:</p> <ul style="list-style-type: none"> <li>• To the extent that any of the instruments and strategies the Issuer uses to hedge or otherwise manage its exposure to market or credit risk are not effective, it may not be able to mitigate effectively its risk exposures in particular market environments or against particular types of risk.</li> <li>• The Issuer has an investment portfolio. A fall in the price of securities could substantially reduce the value of the Issuer's securities portfolio and the amount of income attributable to trading gains.</li> </ul> <p>Operational risk:</p> <ul style="list-style-type: none"> <li>• The Issuer, like all financial institutions, is exposed to many types of operational risk, including the risk of fraud or other</li> </ul>

		<p>misconduct by employees or outsiders, unauthorised transactions by employees or operational errors, including clerical or record keeping errors or errors resulting from faulty computer or telecommunications systems. Given the Issuer's high volume of transactions, certain errors may be repeated or compounded before they are discovered and successfully rectified</p> <ul style="list-style-type: none"> <li>Any significant interruption, degradation, failure or lack of capacity of the Issuer's IT systems could cause it to fail to complete transactions on a timely basis or at all and materially affect the Issuer.</li> </ul> <p>Liquidity risk:</p> <ul style="list-style-type: none"> <li>Concerns about, or a default by, one financial institution could lead to significant liquidity problems, losses or defaults by other financial institutions because the commercial soundness of many financial institutions may be closely related as a result of credit, trading, clearing or other relationships between these institutions.</li> </ul> <p>Legal risk:</p> <ul style="list-style-type: none"> <li>The Issuer is subject to banking and financial services laws and government regulation. Regulatory agencies have broad administrative power over many aspects of the financial services business, which may include liquidity, capital adequacy and permitted investments, ethical issues, money laundering, privacy, record keeping, and marketing and selling practices. Banking and financial services laws, regulations and policies currently governing the Issuer and its subsidiaries may change at any time in ways which may have a material effect on the Issuer's business</li> </ul> <p>The Issuer will at all times attempt to properly manage risks. The Issuer's risk management may, however, not at all times be able to protect the Issuer against certain risks, especially risks that have not been identified or anticipated.</p>
D.3	Key information on the key risks that are specific to the securities	<p>The Issuer identifies the following main risks associated with the Bonds that may affect its ability to fulfill its obligations under the Programme.</p> <ul style="list-style-type: none"> <li>The Issuer is subject to financial services laws, regulations, administrative actions and policies in Iceland. Changes in supervision and regulation could materially affect the Issuer's business, the products and services offered or the value of its assets;</li> <li>an investment in the Bonds involves a reliance on the creditworthiness of the Issuer. The Bonds are not guaranteed by any third party. In addition, an investment in the Bonds involves the risk that subsequent changes in the actual or perceived creditworthiness of the Issuer may adversely affect the market value of the Bonds;</li> </ul>

		<ul style="list-style-type: none"> <li>• The Bonds may be rated or unrated. In the case of rated Bonds, any rating agency may lower its rating or withdraw its rating if, in the sole judgement of the rating agency, the credit quality of the Bonds has declined or is in question. If any rating assigned to the Bonds is lowered or withdrawn, the market value of the Bonds may be reduced. ; and</li> <li>• while the Bonds have been traded, to some extent, on the secondary market there can be no assurance that an active and liquid secondary market for the Bonds will develop in the future.</li> </ul>
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**E OFFER**

<b>Element</b>	<b>Disclosure requirement</b>	<b>Information</b>
E.4	A description of any interest that is material to the issue/offer	The Issuer has not recognised any interest, or conflict of interests, that is material to the issue of Bonds.
E.7	Estimated expenses charged to the investor by the Issuer/offeror	No expenses will be charged to the investor by the Issuer or the offeror.

## RISK FACTORS

*Prospective investors should read the entire Base Prospectus, including relevant Final Terms and any additional supplements, and reach their own views prior to making any investment decision.*

*The Issuer believes that the following factors may affect its ability to fulfil its obligations to investors under Bonds issued under the Programme. Most of these factors are contingencies which may or may not occur and the Issuer is not in a position to express a view on the likelihood of any such contingency occurring.*

*Factors which the Issuer believes may be material for the purpose of assessing the market risks associated with Bonds issued under the Programme are also described below.*

*To the best of the Issuer's knowledge the factors described below represent the principal risks inherent in investing in Bonds issued under the Programme, but the inability of the Issuer to pay interest, principal or other amounts on or in connection with any Bonds may occur for other reasons, such as reasons which may not be considered significant risks by the Issuer based on information currently available to it or which it may not currently be able to anticipate. Prospective investors should also read the detailed information set out elsewhere in this Base Prospectus and reach their own views prior to making any investment decision.*

*This section of the Base Prospectus is divided into three main sections: Risk Factors relating to the Issuer, Risk Factors relating to the Bonds and General Risk Factors.*

*The following is a general discussion of risks typically associated with the Issuer and the acquisition and ownership of Bonds. In particular, it does not consider an investor's specific knowledge and/or understanding about risks typically associated with the Issuer and the acquisition and ownership of Bonds, whether obtained through experience, training or otherwise, or the lack of such specific knowledge and/or understanding, or circumstances that may apply to a particular investor.*

### **RISK FACTORS RELATING TO THE ISSUER, INCLUDING THE ABILITY OF THE ISSUER TO FULFIL ITS OBLIGATIONS UNDER THE BONDS**

#### **THE ISSUER'S RESULTS MAY BE ADVERSELY AFFECTED BY GENERAL ECONOMIC CONDITIONS AND OTHER BUSINESS CONDITIONS**

The Issuer's results are affected by general economic and other business conditions. These conditions include changing economic cycles that affect demand for investment and banking products. These cycles are also influenced by global political events, such as terrorist acts, war and other hostilities as well as by market specific events, such as shifts in consumer confidence and consumer spending, the rate of unemployment, industrial output, labour or social unrest and political uncertainty.

In particular, the Issuer's business, financial condition and results of operations are affected directly by economic and political conditions in Iceland.

The Issuer was incorporated in Iceland on 14 October 2008 when it acquired the majority of domestic operations and related assets and liabilities of Glitnir.

There is great uncertainty concerning economic development in Iceland's main trading partner countries and concerning the downturn in consumption occurring throughout the world. Expected loss rates are, among other factors, dependent upon unemployment, inflation and exchange rates as well as possible changes in legislation and compliance. The recovery rates also depend on asset price evolvment and legislation changes concerning liquidation of assets.

#### **CHANGES IN INTEREST RATES MAY IMPACT THE ISSUER'S RESULTS**

The results of the Issuer's operations are affected by its management of interest rate sensitivity. Interest rate sensitivity refers to the relationship between changes in market interest rates and changes in net interest income and investment income. The composition of the Issuer's assets and liabilities, and any gap position resulting from the composition, causes the interest income to vary as interest rates change. In addition, variations in interest rate sensitivity may exist within the re-pricing periods or between the different currencies in which the Issuer holds interest rate positions. A mismatch of interest earning assets and interest bearing liabilities in any given period may, in the event of changes in interest rates, have a material effect on the financial condition or result from operations of the Issuer's business. The Issuer might in some cases have

limited ability to raise interest rates and margins on loans, without it resulting in increased impairments at the same time.

**THE ISSUER'S PERFORMANCE IS SUBJECT TO SUBSTANTIAL COMPETITIVE PRESSURES THAT COULD ADVERSELY AFFECT ITS RESULTS OF OPERATIONS**

There is substantial competition for the types of banking and other products and services that the Issuer provides in the regions in which it conducts its business. Such competition is affected by consumer demand, technological changes, and impact of consolidation, regulatory actions and other factors. The Issuer expects competition to intensify as continued merger activity in the financial services industry produces larger, better-capitalised companies that are capable of offering a wider array of products and services, and at more competitive prices. If the Issuer is unable to provide attractive products and services that are profitable, it may lose market share or incur losses on some or all activities.

**THE ISSUER'S LOAN PORTFOLIO IS CONCENTRATED IN CERTAIN INDUSTRIES AND BORROWERS**

At year end 2015, the Issuer's loan portfolio was exposed to concentration in certain industry sectors, namely households, commerce, real estate and seafood industry. The Issuer's financial condition is sensitive to downturn in these industries and the consequent inability of the Issuer's customers to meet their obligations towards the Issuer. Declines in the financial condition of the Issuer's largest borrowers could also materially affect the Issuer's business, financial condition and results of operations.

**THE ISSUER IS SUBJECT TO CREDIT RISK AND MAY BE UNABLE TO SUFFICIENTLY ASSESS CREDIT RISK OF POTENTIAL BORROWERS AND MAY PROVIDE ADVANCES TO CUSTOMERS THAT INCREASE CREDIT RISK EXPOSURE**

Third parties that owe the Issuer money, securities or other assets may be unable to meet their obligations towards the Issuer. Accurate and comprehensive financial information and other credit information may be limited for certain types of borrowers, for example small enterprises or individuals. In spite of any credit risk determination procedures the Issuer has in place, the Issuer may be unable to evaluate correctly the current financial condition of each prospective borrower to determine their long-term financial viability. Failure to address any risks associated with any borrower may lead to higher risk and could materially affect the Issuer's business.

**PRICE FLUCTUATIONS OF FINANCIAL INVESTMENTS IN THE ISSUER'S PORTFOLIO COULD MATERIALLY AFFECT THE ISSUER'S RESULTS OF OPERATIONS AND FINANCIAL CONDITION**

The Issuer has an investment portfolio that includes mainly debt securities. A fall in the price of these securities could substantially reduce the value of the Issuer's securities portfolio and the amount of income attributable to trading gains. These securities are measured at their fair value at the end of each financial period, and declines in the market value of the portfolio could accordingly materially affect the Issuer's profitability, even if those declines have not been realised through the sale of the relevant securities. Price fluctuations could also materially affect the Issuer's regulatory capital and the capital ratios that the Issuer is required to maintain under applicable law, as unrealised gains or losses for specific types of securities are recognised as equity.

**REGULATORY CHANGES OR ENFORCEMENT INITIATIVES COULD MATERIALLY AFFECT THE ISSUER'S BUSINESS**

The Issuer is subject to banking and financial services laws and government regulation. Regulatory agencies have broad administrative power over many aspects of the financial services business, which may include liquidity, capital adequacy and permitted investments, ethical issues, money laundering, privacy, record keeping, and marketing and selling practices. Banking and financial services laws, regulations and policies currently governing the Issuer and its subsidiaries may change at any time in ways which may have a material effect on the Issuer's business. Furthermore, the Issuer cannot predict the timing or form of any future regulatory initiatives. Changes in existing banking and financial services laws and regulations may materially affect the way in which the Issuer conducts its business, the products or services it may offer and the value of its assets. If it fails to address, or appears to fail to address, appropriately these changes or initiatives, its reputation could be harmed and it could be subject to additional legal risk, which could, in turn, increase the

size and number of claims and damages asserted against it or subject it to enforcement actions, fines and penalties. Regulatory agencies have the power to bring administrative or judicial proceedings against the Issuer, which could result, among other things, in suspension or revocation of its licenses, cease and desist orders, fines, civil penalties, criminal penalties or other disciplinary action which could materially harm its results of operations and financial condition.

**THERE IS OPERATIONAL RISK ASSOCIATED WITH THE ISSUER'S INDUSTRY WHICH, WHEN REALISED, MAY HAVE A MATERIAL IMPACT ON ITS RESULTS**

The Issuer, like all financial institutions, is exposed to many types of operational risk, including the risk of fraud or other misconduct by employees or outsiders, unauthorised transactions by employees or operational errors, including clerical or record keeping errors or errors resulting from faulty computer or telecommunications systems. Given the Issuer's high volume of transactions, certain errors may be repeated or compounded before they are discovered and successfully rectified. In addition, its dependence upon automated systems to record and process its transactions may further increase the risk that technical system flaws or employee tampering or manipulation of those systems will result in losses that are difficult to detect. The Issuer may also be subject to disruptions of its operating systems, arising from events that are wholly or partially beyond its control (including, for example, computer viruses or electrical or telecommunication outages), which may cause suspension of services to customers and loss to or liability to the Issuer. The Issuer is further exposed to the risk that external vendors may be unable to fulfil their contractual obligations to the Issuer (or will be subject to the same risk of fraud or operational errors by their respective employees as the Issuer), and to the risk that its (or its vendors') business continuity and data security systems prove not to be sufficiently adequate. The Issuer also faces the risk that the design of its controls and procedures prove inadequate, or are circumvented, thereby causing delays in detection of errors in information. The Issuer has implemented an operational risk management framework in accordance with the Operational Risk Management Policy, approved by the Issuer's Board of Directors. Nevertheless, the Issuer has suffered losses from operational risk in the past, and may in the future suffer further losses from operational risk which may be material in amount.

**THE ISSUER'S RISK MANAGEMENT METHODS MAY LEAVE THE ISSUER EXPOSED TO UNIDENTIFIED, UNANTICIPATED, OR INCORRECTLY QUANTIFIED RISKS, WHICH WOULD LEAD TO MATERIAL LOSSES OR MATERIAL INCREASES IN LIABILITIES**

The Issuer will at all times attempt to properly manage risks. The Issuer's risk management may, however, not at all times be able to protect the Issuer against certain risks, especially risks that have not been identified or anticipated. The risk management methods may not take all risks into account, and it is possible that the methods are incorrect or based on wrong information. Unanticipated or incorrectly quantified risk exposures could materially affect the Issuer's business, financial condition and results of operations.

**THE ISSUER IS SUBJECT TO CREDIT AND MARKET RISK**

To the extent that any of the instruments and strategies the Issuer uses to hedge or otherwise manage its exposure to market or credit risk are not effective, it may not be able to mitigate effectively its risk exposures in particular market environments or against particular types of risk. The Issuer's trading revenues and interest rate risk depend upon its ability to identify properly, and mark to market, changes in the value of its financial instruments caused by changes in market prices or rates. Its earnings will also depend upon how effectively its critical accounting estimates prove accurate and upon how effectively it determines and assesses the cost of credit and manages its risk concentrations. To the extent its assessments of migrations in credit quality and of risk concentrations, or its assumptions or estimates used in establishing its valuation models for the fair value of its assets and liabilities or for its loan loss reserves, prove inaccurate or not predictive of actual results, it could suffer higher-than anticipated losses.

**SYSTEMIC RISK COULD MATERIALLY AFFECT THE ISSUER'S BUSINESS**

Concerns about, or a default by, one financial institution could lead to significant liquidity problems, losses or defaults by other financial institutions because the commercial soundness of many financial institutions may be



closely related as a result of credit, trading, clearing or other relationships between these institutions. This risk is sometimes referred to as “systemic risk” and may materially affect financial intermediaries, such as clearing agencies, clearing houses, banks, securities firms and exchanges with which the Issuer interacts on a daily basis, and could materially affect the Issuer.

#### **INCREASES IN THE ISSUER’S LOAN LOSSES OR ALLOWANCES FOR LOAN LOSSES MAY HAVE A MATERIAL EFFECT ON ITS RESULTS**

The Issuer’s banking businesses establish provisions for loan losses, which are reflected in the provision for credit losses on its income statement, in order to maintain its allowance for loan losses at a level which is deemed to be appropriate by management based upon an assessment of prior loss experience, the volume and type of lending being conducted by each entity, industry standards, past due loans, economic conditions and other factors related to the collectability of the loan portfolio. Although management uses its best efforts to establish the provision for loan losses, that determination is subject to significant judgement, and the Issuer’s banking businesses may have to increase or decrease their provisions for loan losses in the future as a result of increases or decreases in non-performing assets or for other reasons. Any increase in the provision for loan losses, any loan losses in excess of the previously determined provisions with respect thereto or changes in the estimate of the risk of loss inherent in the portfolio of non-impaired loans could have a material effect on the Issuer’s results of operations and financial condition.

#### **THE ISSUER DEPENDS ON THE ACCURACY AND COMPLETENESS OF INFORMATION ABOUT CUSTOMERS AND COUNTERPARTIES**

In deciding whether to extend credit or enter into other transactions with customers and counterparties, the Issuer may rely on information furnished to it by or on behalf of customers and counterparties, including financial statements and other financial information. It may also rely on representations of customers and counterparties as to the accuracy and completeness of that information and, with respect to financial statements, on reports of independent auditors. For example, in deciding whether to extend credit, it may assume that a customer’s audited financial statements conform with generally accepted accounting principles and present fairly, in all material respects, the financial condition, results of operations and cash flows of the customer. It may also rely on the audit report covering those financial statements. The Issuer’s financial condition and results of operations could be negatively affected by relying on financial statements that do not comply with generally accepted accounting principles or that are materially misleading.

#### **THE ISSUER IS VULNERABLE TO THE FAILURE OF IT SYSTEMS AND BREACHES OF SECURITY SYSTEMS**

Any significant interruption, degradation, failure or lack of capacity of the Issuer’s IT systems could cause it to fail to complete transactions on a timely basis or at all and materially affect the Issuer.

The secure transmission of confidential information is a critical element of the Issuer’s operations. The Issuer cannot guarantee that existing security measures will prevent security breaches, including break-ins, viruses or disruptions. Persons that circumvent the security measures could use the Issuer’s or its customers’ confidential information wrongfully, which would expose the Issuer to loss, adverse regulatory consequences or litigation.

#### **CATASTROPHIC EVENTS, TERRORIST ATTACKS AND OTHER ACTS OF WAR COULD HAVE A NEGATIVE IMPACT ON THE ISSUER’S BUSINESS AND RESULTS**

Catastrophic events, terrorist attacks, other acts of war or hostility, and responses to those acts may create economic and political uncertainties, which could have a negative impact on economic conditions in the regions in which the Issuer operates and, more specifically, on the Issuer’s business and results in ways that cannot be predicted.

#### **THE ISSUER’S INSURANCE COVERAGE MAY NOT ADEQUATELY COVER LOSSES RESULTING FROM THE RISKS FOR WHICH IT IS INSURED**

The Issuer maintains customary insurance policies for the Issuer’s operations, including insurance for liquid assets, money transport and directors’ and officers’ liability. Due to the nature of the Issuer’s operations and the nature of the risks that the Issuer faces, there can be no assurance that the coverage that the Issuer maintains is adequate.

#### **THE ISSUER IS SUBJECT TO LEGAL RISK WHICH MAY HAVE A MATERIAL IMPACT ON ITS RESULTS**

It is inherently difficult to predict the outcome of possible litigation, regulatory proceedings and other adversarial proceedings involving the Issuer's businesses, particularly cases in which the matters may be brought on behalf of various classes of claimants, seeking damages of unspecified or indeterminate amounts or involving novel legal claims. In presenting the Issuer's consolidated financial statements, its management makes estimates regarding the outcome of legal, regulatory and arbitration matters and takes a charge to income when losses with respect to such matters are deemed probable and can be reasonably estimated. Estimates, by their nature, are based on judgement and currently available information and involve a variety of factors, including but not limited to the type and nature of the litigation, claim or proceeding, the progress of the matter, the advice of legal counsel and other advisers, possible defences and previous experience in similar cases or proceedings. Changes in these estimates may have a material effect on the Issuer's results.

#### **FOLLOWING IS A LIST OF PENDING OR THREATENED PROCEEDINGS AGAINST THE ISSUER WHICH MIGHT HAVE SIGNIFICANT EFFECTS ON THE ISSUER'S FINANCIAL POSITION OR PROFITABILITY IF NOT RULED IN FAVOUR OF THE ISSUER.**

##### **VARIABLE RATE LOANS**

In September 2014, the Consumer Appellate Committee (the "Committee") published its decision on a matter regarding the terms of, and information relating to the granting of, a consumer mortgage contract with interest reset terms granted by the Bank in 2005. The Committee found the terms offered by the Bank and its predecessor, regarding the method and conditions of resetting interest rates, to be in breach of Articles 6 and 9 of Act no. 121/1994 on Consumer Credit (superseded in November 2013). The Committee found the terms to be insufficient as to the explanation of how or what can affect the decision for the interest rate being revised. A 2009 Committee decision was quoted as a precedent. Subsequent to the Committee's decision, the Bank decided to postpone a scheduled interest rate reset and customers were given the option to have their loans restructured with appropriate documentation, fully adapted to the new law on consumer credit.

The Bank has stated officially that it disagrees with the Committee's decision in that the law requires a more detailed explanation with regards to the outcome from a reset of interest rates. The terms explicitly state the time period during which the Bank can reset the interest rate and, moreover, that the borrower can settle the loan without a pre-settlement charge if he or she is not content with the terms. The 2009 precedent referred to by the Committee did not involve pre-settlement terms. Article 12 of the former Act on Consumer Credit stipulates that in the cases of credit contracts containing clauses allowing variations in the rate of interest and the amount or level of other charges contained in the annual percentage rate of charge (APR), but unquantifiable at the time when the payment schedule is presented, the APR shall be calculated on the assumption that the price level, interest rate and other charges will remain unchanged until the end of the credit agreement. The Bank's payment schedule accordingly states that the schedule is based on the current Consumer Price Index ("CPI") and the interest rates and service charges in effect at the Bank at the time of issuance. Similar terms were applied by all major financial institutions serving the mortgage loan market at the time, including the Housing Financing Fund.

The Bank has referred the matter to the courts. The court proceedings are expected to be concluded in late 2016. The consequences of an adverse outcome for the Bank are not easily quantifiable. At present, the Bank has not recognised any provision against a possible loss due to this litigation. In part this is due to the fact that early payments and refinancing is rapidly decreasing the number of contracts in question.

##### **FOREIGN CURRENCY-LINKED LOAN CONTRACTS**

The Supreme Court of Iceland has passed several rulings starting in 2010 when many foreign currency-linked loan contracts were found to be in violation of the 2001 Act on Interest and Indexation. Several rulings found no fault in other contract forms, including the most common type of mortgage contract. The combined court rulings to date have greatly reduced uncertainty in relation to these contracts and how they should be

recalculated. The Bank's corrective process concerning the affected loan contracts is in its final stages, the last ones being corporate finance lease contracts.

The majority of the remaining court cases concern foreign currency-linked loan contracts with minor deviations in terms from those which have already repeatedly been ruled to be legal contracts. Most of these cases will be closed in the District Courts and the Supreme Court in 2016, but a few will not be concluded until the first quarter of 2017. However, as some of the cases involve similar contracts, precedent could result in other cases being settled out of court. The Bank therefore considers the likelihood of having to perform another round of mass-recalculation of foreign currency-linked loan contracts to be remote.

The effect of these court rulings and the subsequent recalculation of loan contracts is reflected in the value of loans in the Bank's Consolidated Financial Statements as at 31 December 2015 where the Bank has recognised a total provision of ISK 1,665 million.

#### **SETTLEMENT OF THE 2011 BYR ACQUISITION**

The Bank acquired Byr hf. ("Byr"), a former savings bank, in 2011 from the Byr Winding-up Committee ("Committee") and the Icelandic Ministry of Finance and Economic Affairs ("Ministry"). According to standard practice, the Bank retained the right to re-evaluate the fair value of the net assets acquired and to demand a refund if the fair value of the net assets was not in line with what was presented in the Byr's financial statements. Based on this, the Bank filed a claim amounting to ISK 6,943 million plus interest with the Committee in June 2013. The claim is filed as a priority claim, according to Article 110 of the Act on Bankruptcy no. 21/1991. The Committee rejected the claim with a letter dated 30 September 2013. At a creditors' meeting in December 2013 it was decided that the Committee would refer the dispute to the District Court of Reykjavík. A formal claim amounting to ISK 911 million plus interest was filed with the Ministry on 24 September 2014. Both claims have now been filed with the District Court of Reykjavík. Furthermore, at the request of the Bank, the District Court has appointed two independent professionals to perform a formal evaluation of the Bank's claim on the Ministry and the Committee. The evaluation is expected to be completed before the second quarter of 2016. Court proceedings will therefore presumably commence in the second or third quarter of 2016. The Bank has not recognised any revenues relating to this claim.

The District Court of Reykjavík confirmed the Composition Agreement of Byr Savings Bank on January 8 2016. The Agreement includes reservations due to Islandsbanki's claim and is not expected to impact the proceedings described above.

#### **FORMAL INVESTIGATION BY THE ICELANDIC COMPETITION AUTHORITY REGARDING ALLEGED VIOLATION OF COMPETITION LAW BY ÍSLANDBANKI**

The Icelandic Competition Authority ("ICA") has initiated an investigation concerning alleged violations of the Competition Law no. 44/2005 by the Bank. Details of the investigation remain confidential.

The ICA has requested and received information from the Bank and has, following its review, presented an opposition document. The ICA considers the violations to be extensive, to have been in existence for a considerable period of time and to concern important markets. The opposition document is one stage in the processing of the case and does not comprise a final administrative decision.

The Bank strongly disagrees with the ICA's findings and has presented its objections. However, should the ICA's findings be final, sanctions may come into consideration, in accordance with Article 37 of the Competition Act. The Bank has not recognised a provision in relation to this matter.

#### **FORMAL REQUEST FOR INFORMATION BY THE EFTA SURVEILLANCE AUTHORITY INTO ALLEGED UNLAWFUL STATE AID**

On 22 October 2013, the EFTA Surveillance Authority ("ESA"), following a complaint, formally requested information on alleged unlawful state aid granted to the Bank through long-term funding at favourable interest rates by the Central Bank of Iceland. The funding was in the form of an ISK 55 billion bond with a ten-year tenure, issued to the Central Bank. It is alleged that the funding was provided on terms more favourable than the then current market terms.

The Icelandic authorities and the Bank have sent all relevant information and their observations as per the ESA request, in order to determine whether or not the measures involve state aid based on the interpretation of Article 61 of the European Economic Area ("EEA") Agreement, or if they qualify for an exemption under Article 61(2) or (3). Both parties, the Bank and the Icelandic authorities, state that the measures cannot be considered state aid within the meaning of Article 61(1), as the funding in question was provided at what has to be considered market rates at the time and were indeed favourable to the Central Bank. However, should the ESA disagree, the measures must be considered state aid compatible with the functioning of the EEA Agreement under Article 61(3) (b) and the Bank may have to reimburse the Central Bank with an amount equal to the difference between market terms and the terms of the Bond. The Bank has not recognised a provision in relation to this matter.

## **RISK FACTORS RELATING TO THE BONDS**

### **THE BONDS MAY NOT BE A SUITABLE INVESTMENT FOR ALL INVESTORS**

Each potential investor of Bonds must determine the suitability of that investment in light of its own circumstances. In particular, each potential investor should:

- i. have sufficient knowledge and experience to make a meaningful evaluation of the relevant Bonds, the merits and risks of investing in the relevant Bonds and as may be amended by any applicable supplements to this Base Prospectus;
- ii. have access to, and knowledge of, appropriate analytical tools to evaluate, in the context of its particular financial situation, an investment in the relevant Bonds and the impact such investment will have on its overall investment portfolio;
- iii. have sufficient financial resources and liquidity to bear all of the risks of an investment in the Bonds, including Bonds with principal or interest payable in one or more currencies, or where the currency for principal or interest payments is different from the currency in which such potential investor's financial activities are principally denominated;
- iv. understand thoroughly the terms of the relevant Bonds and be familiar with the behaviour of any relevant indices and financial markets; and
- v. be able to evaluate (either alone or with the help of a financial adviser) possible scenarios for economic development, interest rate and other factors that may affect its investment and its ability to bear the applicable risks.

Some Bonds are complex financial instruments and such instruments may be purchased as a way to reduce risk or enhance yield with an understood, measured, appropriate addition of risk to the investor's overall portfolio. A potential investor should not invest in Bonds which are complex financial instruments unless he has the expertise (either alone or with the assistance of a financial adviser) to evaluate how the Bonds will perform under changing conditions, the resulting effects on the value of such Bonds and the impact this investment will have on the potential investor's overall investment portfolio.

### **THE ISSUER IS LIABLE TO MAKE PAYMENTS WHEN DUE ON THE BONDS**

The Issuer is liable to make payments when due on the Bonds. The obligations of the Issuer under the Bonds are direct, unsecured, unconditional and unsubordinated obligations, ranking *pari passu* without any preference amongst themselves and equally with its other obligations of the Issuer that have been provided the same priority as debt instruments.

### **BONDS ISSUED UNDER THE PROGRAMME**

Bonds issued under the Programme will either be fungible with an existing Series of Bonds or have different terms to an existing Series of Bonds (in which case they will constitute a new Series). All Bonds issued from time to time will rank *pari passu* with each other.

#### **BONDS SUBJECT TO OPTIONAL REDEMPTION BY THE ISSUER**

An optional redemption feature is likely to limit the market value of Bonds. During any period when the Issuer may elect to redeem Bonds, the market value of such Bonds generally will not rise substantially above the price at which they can be redeemed. This also may be true prior to any redemption period. The Issuer may be expected to redeem Bonds when its cost of borrowing is lower than the interest rate on the Bonds. At those times, an investor generally would not be able to reinvest the redemption proceeds at an effective interest rate as high as the interest rate on the Bonds being redeemed and may only be able to do so at a significantly lower rate. Potential investors should consider reinvestment risk in light of other investments available at that time.

#### **OBLIGATIONS UNDER THE BONDS**

The Bonds will constitute obligations of the Issuer. An investment in the Bonds involves a reliance on the creditworthiness of the Issuer. The Bonds are not guaranteed by any third party. In addition, an investment in the Bonds involves the risk that subsequent changes in the actual or perceived creditworthiness of the Issuer may adversely affect the market value of the Bonds.

The Bonds will not represent an obligation or be the responsibility of any other party to the Programme, their officers, members, directors, employees, security holders or incorporators, other than the Issuer. The Issuer will be liable solely in its corporate capacity for its obligations in respect of the Bonds and such obligations will not be the obligations of their respective officers, members, directors, employees, security holders or incorporators.

#### **ABSENCE OF SECONDARY MARKET**

While the bonds have been traded to some extent on the secondary market, there can be no assurance that an active and liquid secondary market for the Bonds will continue for the life of the Bonds or it may not provide Bond holders with liquidity of investment with the result that a Bondholder may not be able to find a buyer to buy its Bonds readily or at prices that will enable the Bond holder to realise a desired yield.

#### **GENERAL RISK FACTORS**

##### **EU SAVINGS DIRECTIVE**

Under the European Council Directive 2003/48/EC on the taxation of savings income, Member States are required, from 1 July 2005, to provide to the tax authorities of another Member State details of payments of interest (or similar income) paid by a person within its jurisdiction to an individual resident in that other Member State. However, for a transitional period, Belgium, Luxembourg and Austria are instead required (unless during that period they elect otherwise) to operate a withholding system in relation to such payments (the ending of such transitional period being dependent upon the conclusion of certain other agreements relating to information exchange with certain other countries). A number of non-EU countries and territories including Switzerland have agreed to adopt similar measures (a withholding system in the case of Switzerland) with effect from the same date. Iceland is neither a Member State nor has it agreed to adopt similar measures.

If a payment were to be made or collected through a Member State which has opted for a withholding system and an amount of, or in respect of, tax were to be withheld from that payment the Issuer or any other person would be obliged to pay additional amounts with respect to any Bond as a result of the imposition of such withholding tax.

##### **CHANGES OF LAW**

The terms and conditions of the Bonds, in case of ISD System Bonds, are based on Icelandic law in effect as at the date of this Base Prospectus. No assurance can be given as to the impact of any possible judicial decision or change to Icelandic law or administrative practice after the date of this Base Prospectus.

#### **CURRENCY/CAPITAL CONTROLS**

The Central Bank of Iceland has implemented capital controls which have the purpose of limiting the flow of foreign currencies in Iceland and prohibiting certain transactions with securities. These currency/capital controls could adversely affect the ability of investors to invest in and trade with the Bonds.

#### **EXCHANGE RATE RISKS**

The Issuer will pay principal and interest on the Bonds in the Specified Currency. This presents certain risks relating to currency conversions if an investor's financial activities are denominated principally in a currency or currency unit (the "Investor's Currency") other than the Specified Currency. These include the risk that exchange rates may significantly change (including changes due to devaluation of the Specified Currency or revaluation of the Investor's Currency). An appreciation in the value of the Investor's Currency relative to the Specified Currency would decrease

- i. the Investor's Currency-equivalent yield on the Bonds;
- ii. the Investor's Currency-equivalent value of the principal payable on the Bonds; and
- iii. the Investor's Currency-equivalent market value of the Bonds.

#### **INTEREST RATE RISKS**

Investment in Fixed Rate Bonds involves the risk that subsequent changes in market interest rates may adversely affect the value of the Fixed Rate Bonds.

#### **INFLATION RISK**

The payments and the principal of Bonds issued under the programme may or may not be indexed to the Consumer Price Index ("CPI"). Investment in indexed linked Bonds involves the risk that subsequent changes in the CPI may adversely affect the value of the index linked Bonds.

#### **LIQUIDITY RISK**

The Issuer faces liquidity risk. This includes the risk of not having liquidity to meet coupon payments of the Bonds as well as the risk of not being able to refinance the principal of the Bonds at maturity.

#### **GENERAL LEGAL INVESTMENT CONSIDERATIONS**

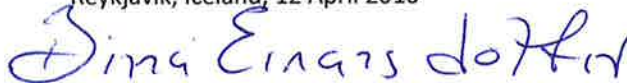
The investment activities of certain investors are subject to legal investment laws and regulations, or review or regulation by certain authorities. Each potential investor should consult its legal advisers to determine whether and to what extent (i) Bonds are legal investments for it, (ii) Bonds can be used as collateral for various types of borrowing and (iii) other restrictions apply to its purchase or pledge of any Bonds. Financial institutions should consult their legal advisers or the appropriate regulators to determine the appropriate treatment of Bonds under any applicable risk-based capital or similar rules.

## STATEMENTS

### ISSUER'S AND ARRANGER'S STATEMENT

The Chief Executive Officer and the Board of Directors of Íslandsbanki hf. ID number 491008-0160, registered office being Kirkjusandur 2, 155 Reykjavík, Iceland, on behalf of the Issuer, hereby declare that having taken all reasonable care to ensure that such is the case, the information contained in this Base Prospectus is, to the best of their knowledge, in accordance with the facts and contains no omission likely to affect its import. Furthermore, The Chief Executive Officer and the Board of Directors of the Issuer hereby declare that Íslandsbanki has managed the Bonds admission to trading on a regulated market cf. Article 52 of the Act on Securities Transactions.

Reykjavík, Iceland, 12 April 2016




Birna Einarsdóttir

Chief Executive Officer

Icelandic ID No. 130761-3729

On behalf of Íslandsbanki hf. Board of Directors



Friðrik Sophusson

Chairman of the Board of Directors

Icelandic ID No. 181043-4669

### INDEPENDENT AUDITORS' REPORT ON THE SELECTED CONSOLIDATED FINANCIAL INFORMATION FOR THE FINANCIAL YEARS ENDED 31 DECEMBER 2013, 2014

The auditor of the Issuer for the years 2013 and 2014 was Deloitte ehf. and bears the registration number 491008-0160 The registered office of the auditor is at Smáratorg 3, 201 Kópavogur.

#### To the readers of this base prospectus

We have audited the annual reports for the financial year 2013 and 2014 presented and published by Management of Íslandsbanki hf., from which the consolidated financial information on pages 83-110 have been extracted. We conducted our audit of the consolidated financial statements and the financial statements in accordance with International Standards on Auditing. Our independent audit opinion on the consolidated financial statements, 2013 and 2014 for Íslandsbanki hf. can be found on the website: <http://www.islandsbanki.is/english/investor-relations/financials/>.

We did not carry out any additional audit procedures after sign off of the annual report 2014, on 23 February 2015.

#### Management's responsibility for the consolidated financial information

Management is responsible for the correct extraction of the consolidated financial information on pages 83-110 from the annual reports for the financial years 2013 and 2014. Our responsibility is based on our work to express an opinion on the extraction of the financial information from the published annual reports.

#### Basis of conclusion

We have planned and performed our work in accordance with the ISAE 3000 "Assurance Engagements Other Than Audits or Reviews of Historical Financial Information" to obtain reasonable assurance that the financial

information on pages 83-110 are, in all material respects, in accordance with the published annual reports, from which they have been extracted.

#### Conclusion

In our opinion, the consolidated financial information presented on pages 83-110 are, in all material respects, in accordance with the published annual reports for the financial year 2013 and 2014, from which they have been extracted, taken into account the changes in presentation and reclassifications described on pages 83-110.

Kópavogur, Iceland, 12 April 2016

On behalf of Deloitte hf.

*Pálína Arnadóttir*  
*Gunnar Þorvarðarson*

Pálína Arnadóttir State Authorised Public Accountant  
Gunnar Þorvarðarson State Authorised Public Accountant

#### INDEPENDENT ASSURANCE REPORT ON THE SELECTED CONSOLIDATED FINANCIAL INFORMATION FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2015

The auditor of the Issuer for the year 2015 was Ernst & Young ehf. and bears the registration number 520902-2010. The registered office of the auditor is at Borgartún 30, 105 Reykjavík.

#### Management's and the Board of Directors responsibilities for the consolidated financial information

Management and the Board of Directors are responsible for the correct extraction of the consolidated financial information on pages 83-110 from the consolidated financial statements for the financial year 2015.

#### To the Board of Directors of Íslandsbanki hf.

We have audited the consolidated financial statements for the financial year 2015 presented and published by Management and the Board of Directors of Íslandsbanki hf. from which the consolidated financial information on pages 83-110 have been extracted. We conducted our audit of the consolidated financial statements in accordance with International Standards on Auditing. Our Independent audit opinion on the consolidated financial statements 2015 for Íslandsbanki hf. can be found on the website: <http://www.islandsbanki.is/english/investor-relations/financials/>.

The firm applies International Standard on Quality Control 1 and accordingly maintains a comprehensive system of quality control including documented policies and procedures regarding compliance with ethical requirements, professional standards and applicable legal and regulatory requirements.

We have complied with the independence and other ethical requirements of the Icelandic Law on Auditors and other ethical requirements from the Code of Ethics for Professional Accountants issued by the International Ethics Standards Board for Accountants, which is founded on fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behaviour.

Our responsibility is based on our work to express a conclusion on the extraction of the financial information from the published consolidated financial statements.

We did not carry out any additional audit procedures after sign off of the consolidated financial statements for 2015 on 22 February 2016.

#### Basis of conclusion



We have planned and performed our work in accordance with the ISAE 3000 "Assurance Engagements Other Than Audits or Reviews of Historical Financial Information" to obtain reasonable assurance that the financial information on pages 83-110 are, in all material respects, in accordance with the published consolidated financial statements from which they have been extracted.

Our work primarily consisted of comparing the financial information presented on pages 83-110 to financial information in the consolidated financial statements for 2015.

#### **Conclusion**

Our conclusion is that the consolidated financial information presented on pages 83-110 are, in all material respects, in accordance with the published consolidated financial statements for the financial year 2015 from which they have been extracted, taken into account the reclassifications described on pages 83-110.

Reykjavík, Iceland, 12 April 2016  
On behalf of Ernst & Young ehf



#### **THIRD PARTY INFORMATION**

This Base Prospectus is not based on the statements of external specialists or another third party other than publicly available information published by governmental entities. In such instances the information has been accurately reproduced and as far as the Issuer is aware and is able to ascertain no facts have been omitted which would render the reproduced information inaccurate or misleading.

## NOTICE TO INVESTORS

This document constitutes a base prospectus for the purposes of Article 5 of Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 ("the Prospectus Directive") and Article 45 of the Act on Securities Transactions No. 108/2007 and relevant regulations thereto.

The Base Prospectus is not being distributed in, and must not be mailed or otherwise distributed or sent in or into, any country in which distribution would require any additional registration measures or other measures to be taken, other than as applicable under Icelandic law and regulations, or would be in conflict with any law or regulation in such country. The Base Prospectus may be passported in accordance with the provisions of the Prospectus Directive into other jurisdictions within the European Economic Area.

The admission to trading will proceed pursuant to Icelandic law and regulations. Financial Supervisory Authority, Iceland has scrutinised and approved this Base Prospectus, which is published in English only.

This Base Prospectus has been prepared to provide clear and thorough information on the consolidated company Íslandsbanki hf. Investors are encouraged to acquaint themselves thoroughly with this Base Prospectus. They are advised to pay particular attention to the Risk Factors. This Base Prospectus should by no means be viewed or construed as a promise by the Issuer or other parties of future success either in operations or return on investments. Investors are reminded that investing in securities entails risk, as the decision to invest is based on expectations and not promises. Investors must rely primarily on their own judgement regarding any decision to invest in the Issuer's securities, bearing in mind *inter alia* the business environment in which it operates, anticipated profits, external conditions and the risk inherent in the investment itself. Prospective investors are advised to contact experts, such as licensed financial institutions, to assist them in their assessment of the securities issued by the Issuer as an investment option. Investors are advised to consider their legal status, including taxation issues that may concern the purchase or sale of the Issuer's securities and seek external and independent advice in that respect.

Notwithstanding a special statement to the contrary references to any laws, acts or regulations are references to acts passed by the Icelandic parliament and regulations issued by Icelandic governmental agencies unless otherwise clear from the context.

## APPLICABLE FINAL TERMS

Set out below is the form of Final Terms which will be completed for each Tranche of Bonds issued under the Programme.

[Date]

**ÍSLANDBANKI HF.**  
**Issue of [Aggregate Nominal Amount of Tranche] [Title of Bonds]**  
**under the ISK 100,000,000,000**

**Bond Programme**

**PART A – CONTRACTUAL TERMS**

Terms used herein shall be deemed to be defined as such for the purposes of the Terms and Conditions of the Bonds (the **Terms and Conditions**) set forth in the Base Prospectus dated 12 April 2016. This document constitutes the Final Terms of the Bonds described herein for the purposes of Article 5(4) of the Prospectus Directive and Article 45 of Act on Securities Transactions and must be read in conjunction with the Base Prospectus and any supplements if applicable which constitute a base prospectus for the purposes of the Prospectus Directive. Full information on the Issuer and the offer of the Bonds is only available on the basis of the combination of these Final Terms, the Base Prospectus and any supplements, if applicable. Copies of said Base Prospectus and any supplements, if applicable, are available for viewing on the Issuer's webpage, <http://www.islandsbanki.is/english/investor-relations/funding//> and at the office of the Issuer at Kirkjusandur 2, 155 Reykjavík, Iceland.

*[Include whichever of the following apply or specify as "Not Applicable" (N/A). Note that the numbering should remain as set out below, even if "Not Applicable" is indicated for individual paragraphs or subparagraphs. Italics denote directions for completing the Final Terms.]*

*[When adding any other final terms or information consideration should be given as to whether such terms or information constitute "significant new factors" and consequently trigger the need for a supplement to the Base Prospectus under Article 16 of the Prospectus Directive and Article 46 of Act on Securities Transactions.]*

- |   |   |
|---|---|
| <b>1. Issuer:</b>                           | Íslandsbanki hf.  |
| <b>2.</b>                                   |   |
| i. Series Number:                           | [ ]   |
| ii. Tranche Number:                         | [ ]   |
|   | <i>(If fungible with an existing Series, details of that Series, including the date on which the Bonds become fungible)</i> |
| iii. Ticker:                                | [ ]   |
| <b>3. Specified Currency or Currencies:</b> | [ ]   |
| <b>4. Aggregate Nominal Amount:</b>         |   |
| I. Series:                                  | [ ]   |
| II. Tranche:                                | [ ]   |

5. **Issue Price:** [ ] per cent. of the Aggregate Nominal Amount  
[plus accrued interest from *[insert date]* (if applicable)]
6. **Specified Denominations:** [ ]
- 7.
- i. **Issue Date:** [ ]
- ii. **Interest Commencement Date:** [ ]
- 8.
- i. **Maturity Date:** [*Fixed rate – specify date/Floating rate – Interest Payment Date falling in or nearest to [specify month and year]*]
- 9.
- i. **Interest Basis to Maturity Date:** [Inflation Linked Interest]  
[[ ] per cent. Fixed Rate]  
[[LIBOR/EURIBOR/REIBOR] +/- [ ] per cent. Floating Rate]  
[Zero Coupon]  
[specify other]  
(further particulars specified below)
10. **Redemption/Payment Basis:** [Annuity]  
[Redemption at par]  
[Equal principal payments]  
[Instalment]  
[specify other]
- i. **Payment Basis:** [ ]
- ii. **Instalment Amounts:** [ ]
- iii. **Instalment Dates:** [ ]
11. **Change of Interest Basis or Redemption/Payment Basis:** [*Specify details of any provision for change of Bonds into another Interest Basis or Redemption/Payment Basis*]
12. **Call Option:** [Issuer Call/ Not Applicable]

[(further particulars specified below)]

**13. Status of the Bonds:** Senior.

**14. Approval for issuance of the Bonds:**

[Date of [Board] approval for issuance of Bonds obtained]: [Date/ Not Applicable] (N.B. Only relevant where Board (or similar) authorisation is required for the particular Tranche of Bonds)

**15. Method of distribution:** [Syndicated/Non-syndicated]

#### PROVISIONS RELATING TO INFLATION LINKED ANNUITY BONDS

**16. Inflation Linked Annuity Bonds:** [Applicable/Not Applicable]

(if not applicable, delete the remaining subparagraphs of this paragraph)

- i. Rate(s) of Interest to Maturity Date: [ ] per cent. per annum [payable [annually/semi-annually/quarterly/monthly] in arrear]
- ii. Number of Interest Payment Dates: [ ]
- iii. Interest Payment Date(s): [The [ ] day in the months of [] and [] in each year up to and including the Maturity Date]. First Interest Payment Date being [].
- iv. Day Count Fraction: [30/360] [specify other]
- v. Principal Repayment(s): An amount calculated by the Issuer on each Interest Payment Date by multiplying the nominal amount on the Issue Date with the Index Ratio and with the factor A, which is calculated according to the following formula:

$$A = \frac{r * (1 + r)^{k-1}}{(1 + r)^n - 1}$$

Where

A = Principal repayment factor

$$r = \frac{c}{f}$$

c = The rate of interest of the relevant bond

f = The number of interest payments per year

n = Number of Interest Payment Dates

k = the number of payments that have already been made (k=0 on the Issue Date, k=1 on the first Interest Payment Date, k=n on the last Interest Payment Date, etc.)

vi. Interest Payment(s):

Interest is calculated on each Interest Payment date as the nominal amount on the Issue Date multiplied with the Index Ratio and with the factor  $I_k$ , which is calculated according to the following formula:

$$I_k = \frac{r * [(1+r)^n - (1+r)^{k-1}]}{(1+r)^n - 1}$$

Where

$I_k$  = Interest repayment factor for period k

$$r = \frac{c}{f}$$

c = The rate of interest of the relevant bond

f = The number of interest payments per year

n = Number of Interest Payment Dates

k = the number of payments that have already been made (k=0 on the Issue Date, k=1 on the first Interest Payment Date, k=n on the last Interest Payment Date, etc.)

- vii. Payment(s): On each Interest Payment Date the sum of the relevant Principal Repayment and the Interest Payment.
- viii. Calculation Agent: [Issuer] [specify other]
- ix. Index Ratio: The value of the Index Ratio (IR) on the relevant Interest Payment Date shall be the value of the Reference Index (RI) applicable to the relevant Interest Payment Date divided by the value of the Base Index (BI) as calculated by the Issuer:

$$IR = \frac{RI_t}{BI}$$

where:

**Reference Index** or  $RI_t$  means on each Interest Payment Date:

For each day in the calendar month and number RI rounded to 5 decimals:

$$RI = CP_{t-2} + \left[ \frac{d-1}{D} * (CP_{t-1} - CP_{t-2}) \right]$$

where:

$CP_{t-1}$  = CPI value for the first day of the preceding calendar month

$CP_{t-2}$  = CPI value for the first day of the calendar month 2 months earlier

$d$  = the relevant calendar date

$D$  = number of calendar days in the relevant calendar month

Provided that if the Reference Index is lower than the Base Index, the Reference Index shall equal the Base Index.

And

**Base Index** means [to be inserted], being the value of the CPI on [to be inserted].

If at any time a new index is substituted for the CPI, as of the calendar month from and including that in which such substitution takes effect:

- (i) the Reference Index shall be deemed to refer to

the new index; and

(ii) the new Base Index shall be the product of the existing Base Index and the Reference Index immediately following such substitution, divided by the Reference Index immediately prior to such substitution.



PROVISIONS RELATING TO INFLATION LINKED EQUAL

PRINCIPAL PAYMENT BONDS

17. Inflation Linked Equal Principal Payment

Bonds:

[Applicable/Not Applicable]

*(if not applicable, delete the remaining subparagraphs of this paragraph)*

- i. Rate(s) of Interest to Maturity Date: [ ] per cent. per annum payable annually in arrears
  
- ii. Number of Interest Payment Dates: [number of dates]
- iii. Interest Payment Date(s): [The [ ] day in [month] up to and including the Maturity Date]
- iv. Number of Principal Payment Dates: [Number of Interest Payment Dates/1]
- v. Principal Payment Date(s): [On each Interest Payment Date/Maturity Date]
- vi. Day Count Fraction: [Act/Act] *[specify other]*
- vii. Principal Repayment(s): An amount calculated by the Issuer on each Principal Payment Date by multiplying the Principal Amount Outstanding on the Issue Date with the Index Ratio and dividing with the number of principal Payment Dates.
- viii. Interest Payment(s): Interest is calculated on each Interest Payment date as the Principal Amount Outstanding on each Interest Payment Date multiplied with the Rate of Interest and, the appropriate Day Count Fraction.
- ix. Payments(s): On each Interest Payment Date the sum of the relevant Principal Repayment and the Interest Payment.
- x. Calculation Agent: [Issuer] *[specify other]*
- xi. Principal Amount Outstanding: On the relevant Interest Payment Date, the Principal Amount Outstanding is calculated based on the following formula:

$$PAO_t = (PAO_{t-1} - PR_{t-1}) \frac{IR_t}{IR_{t-1}}$$

where:

PAO<sub>t</sub> means the Principal Amount Outstanding on the relevant Interest Payment Date.

PAO<sub>t-1</sub> means the Principal Amount Outstanding on the preceding Interest Payment Date.

PR<sub>t-1</sub> means the Principal Repayment on the preceding Interest Payment Date.

IR<sub>t</sub> means the Index Ratio on the relevant Interest Payment Date.

IR<sub>t-1</sub> means the Index Ratio on the preceding Interest Payment Date (Issue Date for the first Interest Payment Date).

xii. Index Ratio:

The value of the Index Ratio (IR) on the relevant Interest Payment Date shall be the value of the Reference Index (RI) applicable to the relevant Interest Payment Date divided by the value of the Base Index (BI) as calculated by the Issuer:

$$IR = \frac{RI_t}{BI}$$

where:

**Reference Index** or RI<sub>t</sub> means on each Interest Payment Date:

For each day in the calendar month and number RI rounded to 5 decimals:

$$RI = CP_{t-2} + \left[ \frac{d-1}{D} * (CP_{t-1} - CP_{t-2}) \right]$$

where:

CP<sub>t-1</sub> = CPI value for the first day of the preceding calendar month

CP<sub>t-2</sub> = CPI value for the first day of the calendar month 2 months earlier

d = the relevant calendar date

D = number of calendar days in the relevant calendar month

Provided that if the Reference Index is lower

than the Base Index, the Reference Index shall equal the Base Index.

And

**Base Index** means *[to be inserted]*, being the value of the CPI on *[to be inserted]*.

If at any time a new index is substituted for the CPI, as of the calendar month from and including that in which such substitution takes effect:

- i. the Reference Index shall be deemed to refer to the new index; and
- ii. the new Base Index shall be the product of the existing Base Index and the Reference Index immediately following such substitution, divided by the Reference Index immediately prior to such substitution.

#### PROVISIONS RELATING TO INTEREST (IF ANY) PAYABLE

##### 18. Fixed Rate Bond Provisions:

[Applicable/Not Applicable]

*(If not applicable, delete the remaining subparagraphs of this paragraph)*

- i. Rate(s) of Interest to Maturity Date: [ ] per cent. per annum [payable [annually/semi-annually/quarterly] in arrear]
- ii. Interest Payment Date(s): [[ ] in each year up to and including the Maturity Date]/ [specify other]  
  
*(N.B. This will need to be amended in the case of long or short coupons)*
- iii. Day Count Fraction: [Actual/Actual (ISMA)/[specify other]]
- iv. Other terms relating to the method of calculating interest for Fixed Rate Bonds: [None/Give details]

##### 19. Floating Rate Bond Provisions:

[Applicable/Not Applicable]

*(If not applicable, delete the remaining*

*subparagraphs of this paragraph)*

- i. Specified Period(s)/Specified Interest Payment Dates:
- ii. Business Day Convention: [Floating Rate Convention/Following Business Day Convention/Modified Following Business Day Convention/Preceding Business Day Convention/  
[specify other]]
- iii. Additional Business Centre(s): [Specify/None ]
- iv. Manner in which the Rate of Interest and Interest Amount is to be determined: [Screen Rate Determination/ISDA Determination/*specify other*]
- v. Party responsible for calculating the Rate of Interest and Interest Amount: [ Issuer/*Other*]
- vi. Screen Rate Determination:
  - Reference Rate:   
*(Either LIBOR, EURIBOR, REIBOR or other, although additional information is required if other)*
  - Interest Determination Date(s):   
*(Second London Business day prior to the start of each Interest Period if LIBOR (other than Sterling or euro LIBOR), first day of each Interest Period if Sterling LIBOR and the second day on which the TARGET System is open prior to the start of each Interest Period if EURIBOR or euro LIBOR) and second Reykjavik Business Day of each interest period if REIBOR*
  - Relevant Screen Page:   
*(In the case of EURIBOR, if not Telerate Page 248 ensure it is a page which shows a composite rate or amend the fallback provisions appropriately)*
- vii. ISDA Determination:
  - Floating Rate Option:
  - Designated Maturity:

- Reset Date: [ ]
- viii. Margin(s) to Maturity Date: [+/-] [ ] per cent. per annum
- ix. Minimum Rate of Interest: [[ ] per cent. per annum/Not Applicable]
- x. Maximum Rate of Interest: [[ ] per cent. per annum/Not Applicable]
- xi. Day Count Fraction:
  - [Actual/Actual
  - Actual/365
  - Actual/365 (Fixed)
  - Actual/365 (Sterling)
  - Actual/360
  - 30/360
  - 30E/360
  - Other]
  - (See Condition 5.6 for alternatives)
- xii. Fallback provisions, rounding provisions and any other terms relating to the method of calculating interest on Floating Rate Bonds, if different from those set out in the Terms and Conditions: [ ]

**20. Zero Coupon Bond Provisions:**

[Applicable/Not Applicable]

*(If not applicable, delete the remaining subparagraphs of this paragraph)*

- i. Accrual Yield:  per cent. per annum
- ii. Reference Price:
- iii. Any other formula/basis of determining amount payable:
- iv. Day Count Fraction in relation to Early Redemption Amounts and late payment:  [Conditions 7.6.b) and 7.10 apply/specify other]

**PROVISIONS RELATING TO REDEMPTION**

**21. Issuer Call:**

[Applicable/Not Applicable]

*(If not applicable, delete the remaining subparagraphs of this paragraph)*

*(N.B. For Inflation Linked Annuity Bonds and Inflation Linked Equal Principal Payment Bonds, select "Applicable")*

- i. Optional Redemption Date(s):   
*(N.B. For Inflation Linked Annuity Bonds and Inflation Linked Equal Principal Payment Bonds, select "Each Interest Payment Date")*
- ii. Optional Redemption Amount of each Bond and method, if any, of calculation of such amount(s):  per Bond of  Specified Denomination] *[specify formula]* [Condition 7.6 (a) applies]  
  
*(N.B. For Inflation Linked Annuity Bonds and Inflation Linked Equal Principal Payment Bonds, select "Condition 7.6 a) applies")*
- iii. Early Redemption Amount:  [ As set out in Condition 7.6 ]
- iv. If redeemable in part:
- v. Minimum Redemption Amount:
- vi. Maximum Redemption Amount:
- vii. Notice period (if other than as set out in the Terms and Conditions):

*(N.B. If setting notice periods which are different to*

*those provided in the Terms and Conditions, the Issuer is advised to consider the practicalities of distribution of information through intermediaries, for example, clearing systems and custodians, as well as any other notice requirements which may apply)*

**22. Final Redemption Amount of each Bond:**

[ ] per Bond of [ ] Specified Denomination/specify other/see Appendix] [Not Applicable]

*(N.B. For Inflation Linked Annuity Bonds and Inflation Linked Equal Principal Payment Bonds, select "Not Applicable")*

*(N.B. In relation to any issue of Bonds which are expressed at paragraph 6 above to have a minimum denomination and tradable amounts above such minimum denomination which are smaller than it the following wording should be added: "For the avoidance of doubt, in the case of a holding of Bonds in an integral multiple of [ ] in excess of [ ] as envisaged in paragraph 6 above, such holding will be redeemed at its nominal amount.")*

## GENERAL PROVISIONS APPLICABLE TO THE BONDS

**23. New Global Bond:** [Yes/No]

**24. Form of Bonds:** [VS System Bonds]

[Temporary Bearer Global Bond exchangeable for a Permanent Bearer Global Bond which is exchangeable for definitive Bonds [on 60 days' notice given at any time/only after an Exchange Event]

[Temporary Bearer Global Bond exchangeable for definitive Bonds on and after the Exchange Date]

[Permanent Bearer Global Bond exchangeable for definitive Bonds [on 60 days' notice given at any time/only after an Exchange Event]]<sup>1</sup>

[Registered Bond]

**25. Additional Financial Centre(s) or other special provisions relating to Payment Days:**

[Not Applicable/*give details*]

*(Note that this item relates to the place of payment and not Interest Period end dates)*

**26. Talons for future Coupons or Receipts to be attached to definitive Bonds (and dates on which such Talons mature):**

[Yes/No. *(If yes, give details)*]

---

<sup>1</sup> The option to exchange a Temporary or Permanent Global Bond for a Definitive Bond on 60 days' written notice which may be given at any time will only be available to Bondholders where (a) drawdowns are issued in denominations that are a multiple of the minimum denomination traded by Euroclear and Clearstream, Luxembourg or (b) in circumstances where the Bondholder's share is an integral of the minimum denomination traded by Euroclear and Clearstream, Luxembourg.



**27. Details relating to Partly Paid Bonds:**  
amount of each payment comprising the Issue Price and date on which each payment is to be made and consequences of failure to pay, including any right of the Issuer to forfeit the Bonds and interest due on late payment:

[Not Applicable/give details. N.B. a new form of Temporary Global Bond and/or Permanent Global Bond may be required for Partly Paid issues]

**28. Details relating to Instalment Bonds:**

i. Instalment Amount(s):

[Not Applicable/give details]

ii. Instalment Date(s):

[Not Applicable/give details]

**29. Redenomination applicable:**

Redenomination [not] applicable

*(if Redenomination is applicable, specify the applicable Day Count Fraction and any provisions necessary to deal with floating rate interest calculation (including alternative reference rates))*

**30. Other final terms:**

[Not Applicable/give details]

*(When adding any other final terms consideration should be given as to whether such terms constitute "significant new factors" and consequently trigger the need for supplements to the Base Prospectus under Article 16 of the Prospectus Directive and Article 46 of Act on Securities Transactions.)*

## DISTRIBUTION

**31.**

i. If syndicated, names of Managers :

[Not Applicable/give names ]

ii. Stabilising Manager (if any):

[Not applicable/give name]

**32. If non-syndicated, name of relevant Dealer:**

[ ]

**33. Additional selling restrictions:**

[Not Applicable/give details]

**[LISTING AND ADMISSION TO TRADING APPLICATION**

These Final Terms comprise the final terms required to list and have admitted to trading, the issue of Bonds described herein pursuant to the ISK 100,000,000,000 Bond Programme of Íslandsbanki hf.]

**RESPONSIBILITY**

The Issuer accepts responsibility for the information contained in these Final Terms. [[ ] has been extracted from [ ]. The Issuer confirms that such information has been accurately reproduced and that, so far as it is aware and is able to ascertain from information published by [ ], no facts have been omitted which would render the reproduced information inaccurate or misleading].

Signed on behalf of the Issuer:

By: .....

*Duly authorised*

## PART B – OTHER INFORMATION

### 1. LISTING

- i. Listing: [NASDAQ Iceland/other (*specify*)/None]
- ii. Admission to trading: [Application has been made for the Bonds to be admitted to trading on [ ] [with effect from [ ] ].] [Not Applicable.]

### 2. RATING

[Not Applicable/The Bonds to be issued have been rated:

[S & P: [•]]

[Moody's: [•]]

[Fitch: [•]]

[Other: [•]]

[*Need to include here a brief explanation of the meaning of the ratings if this has previously been published by the rating provider.*]

[*The above disclosure should reflect the rating allocated to Bonds of the type being issued under the Programme generally or, where the issue has been specifically rated, that rating.*]

### 3. NOTIFICATION

[The [*name of competent authority in home Member State*] [has been requested to provide/has provided – *include first alternative for an issue which is contemporaneous with the establishment or update of the Programme and the second alternative for subsequent issues*] the [*names of competent authorities of host Member States*] with a certificate of approval attesting that the Base Prospectus has been drawn up in accordance with the Prospectus Directive. / Not Applicable]

### 4. INTERESTS OF NATURAL AND LEGAL PERSONS INVOLVED IN THE ISSUE

[Save for any fees payable to the [Managers/Dealer/Advisor], so far as the Issuer is aware, no person involved in the issue of the Bonds has an interest material to the issue. – *Amend as appropriate if there are other interests*]

### 5. USE OF PROCEEDS, ESTIMATED NET PROCEEDS AND TOTAL EXPENSES

- i. Use of proceeds: [For general funding purposes of the Issuer]
- ii. Estimated net proceeds: [ ]
- iii. Estimated total expenses: [ ]

### 6. YIELD (*Fixed Rate Bonds only*)

Indication of yield: [ ]



[Calculated as on the Issue Date.

The yield is calculated at the Issue Date on the basis of the Issue Price. It is not an indication of future yield.]

## 7. HISTORIC INTEREST RATES *(Floating Rate Bonds Only)*

Details of historic [LIBOR/EURIBOR/REIBOR/other] rates can be obtained from [Telerate].

## 8. PERFORMANCE OF CPI, EXPLANATION OF EFFECT ON VALUE OF INVESTMENT AND ASSOCIATED RISKS AND OTHER INFORMATION CONCERNING THE UNDERLYING *(Inflation Linked Annuity Bonds and Inflation Linked Equal Principal Payment Bonds Only)*

The general cash-flow of the Bonds is determined in real terms on the Issue Date. The nominal value of each future payment depends on the development of the CPI as demonstrated by the formula in paragraph 16 and 17 of Part A of this Final Terms.

Based on data from Statistics Iceland, the year to year inflation, measured as changes in the CPI, has been positive for the last 30 years ranging from 1.5 per cent. in 1994 to 32.4 per cent. in 1986. The average value over the period is 7.1 per cent. with standard deviation of 6.7 per cent. The same statistics for the last 10 years is an average inflation rate of 5.8 per cent. and standard deviation of 3.7 per cent.

The development of the CPI over the past eight years is set out in the table below:

	2009	2010	2011	2012	2013	2014	2015	2016
<b>January</b>	334.8	356.8	363.4	387.1	403.3	415.9	419.3	428.3
<b>February</b>	336.5	360.9	367.7	391.0	409.9	418.7	422.1	
<b>March</b>	334.5	362.9	371.2	395.1	410.7	419.7	426.4	
<b>April</b>	336.0	363.8	374.1	398.2	411.5	421.0	427.0	
<b>May</b>	339.8	365.3	377.6	398.1	411.3	421.3	428.2	
<b>June</b>	344.5	364.1	379.5	400.1	413.5	422.8	429.3	
<b>July</b>	345.1	361.7	379.9	397.2	412.4	422.1	430.0	
<b>August</b>	346.9	362.6	380.9	396.6	413.8	423.1	432.3	
<b>September</b>	349.6	362.6	383.3	399.6	415.2	422.6	430.6	
<b>October</b>	353.6	365.3	384.6	400.7	415.2	423.1	430.9	
<b>November</b>	356.2	365.5	384.6	402.0	416.7	420.9	429.4	
<b>December</b>	357.9	366.7	386.0	402.2	418.9	422.2	430.8	

*Source: Iceland Statistics (Icelandic Hagstofa Íslands). No facts have been omitted which would render the reproduced information inaccurate or misleading.*

The development of the 12 month inflation (in percentage terms) over the past eight years is set out in the table below:

	2009	2010	2011	2012	2013	2014	2015	2016
<b>January</b>	18.6	6.6	1.8	6.5	4.2	3.1	0.8	2.1
<b>February</b>	17.6	7.3	1.9	6.3	4.8	2.1	0.8	
<b>March</b>	15.2	8.5	2.3	6.4	3.9	2.2	1.6	
<b>April</b>	11.9	8.3	2.8	6.4	3.3	2.3	1.4	
<b>May</b>	11.6	7.5	3.4	5.4	3.3	2.4	1.6	
<b>June</b>	12.2	5.7	4.2	5.4	3.3	2.2	1.5	
<b>July</b>	11.3	4.8	5.0	4.6	3.8	2.4	1.9	
<b>August</b>	10.9	4.5	5.0	4.1	4.3	2.2	2.2	
<b>September</b>	10.8	3.7	5.7	4.3	3.9	1.8	1.9	
<b>October</b>	9.7	3.3	5.3	4.2	3.6	1.9	1.8	
<b>November</b>	8.6	2.6	5.2	4.5	3.7	1.0	2.0	
<b>December</b>	7.5	2.5	5.3	4.2	4.2	0.8	2.0	

*Source: Iceland Statistics (Icelandic Hagstofa Íslands). No facts have been omitted which would render the reproduced information inaccurate or misleading.*

The main target of monetary policy is price stability. A formal inflation target was adopted on March 27, 2001<sup>2</sup>. The Central Bank of Iceland aims to maintain an average rate of inflation, measured as the annual 12-month increase in the CPI, of as close to 2.5 per cent. as possible.

If inflation deviates by more than  $\pm 1.5$  percentage point from the target, the Central Bank of Iceland is obliged to submit a report to the Government of Iceland explaining the reasons for the deviations from the target, how the Central Bank of Iceland intends to react and how long it will take to reach the inflation target again in the bank's assessment. The report shall be made public.

The Central Bank of Iceland shall publish an inflation forecast, projecting inflation two years into the future, which will be outlined in its Monetary Bulletin. This shall also contain the Bank's assessment of the main uncertainties pertaining to the inflation forecast. The Bank shall also publish its assessment of the current economic situation and outlook.

Since monetary policy aims at maintaining price stability, it will not be applied to achieve other economic targets such as a balanced current account or a high level of employment, except insofar as these are compatible with the Central Bank's inflation target.

If policy changes or if the Icelandic economy runs into long-term stagnation it is possible that the level of the CPI will go down over time resulting in individual future payments on the Bonds being reduced in nominal terms and can become lower than the real value of the same payment on the Issue Date.

Information about the CPI can be obtained from <http://www.statice.is/Statistics/Prices-and-consumption/Consumer-price-index>

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<sup>2</sup> <http://www.cb.is/monetary-policy/>

## 9. OPERATIONAL INFORMATION

- i. ISIN Code: [ ]
- ii. Common Code: [ ]
- iii. Any clearing system(s) other than Euroclear Bank S.A./N.V. or Clearstream Banking, société anonyme and the relevant identification number(s): [Not Applicable/give name(s) and number(s)]
- iv. Delivery: Delivery [against/free of] payment
- v. Names and addresses of additional Paying Agent(s) (if any): [ ]
- vi. Intended to be held in a manner which would allow Eurosystem eligibility: [Yes][No].  
[Note that the designation “yes” simply means that the Bonds are intended upon issue to be deposited with one of the ICSDs as common safekeeper and does not necessarily mean that the Bonds will be recognised as eligible collateral for Eurosystem monetary policy and intra-day credit operations by the Eurosystem either upon issue or at any or all times during their life. Such recognition will depend upon satisfaction of the Eurosystem eligibility criteria.][include this text if “yes” selected in which case the Bonds must be issued in NGN form]

## TERMS AND CONDITIONS OF THE BONDS

*The following are the Terms and Conditions of the Bonds which will be incorporated by reference into each Bond (as defined below). The applicable Final Terms in relation to any Tranche of Bonds may specify other terms and conditions which shall, to the extent so specified or to the extent inconsistent with the following Terms and Conditions, replace or modify the following Terms and Conditions for the purpose of such Bonds. Reference should be made to "Form of the Bonds" for a description of the content of Final Terms which will specify which of such terms are to apply in relation to the relevant Bonds.*

This Bond is one of a Series (as defined below) of Bonds issued by Íslandsbanki hf. (the **Issuer**).

**Interest bearing Bonds:** Interest bearing definitive Bearer Bonds have interest coupons (**Coupons**) and, if specified in the applicable Final Terms, talons for further Coupons (**Talons**) attached on issue. Any reference herein to Coupons or coupons shall, unless the context otherwise requires, be deemed to include a reference to Talons or talons. Bonds repayable in instalments have receipts (**Receipts**) for the payment of the instalments of principal (other than the final instalment) attached on issue.

**Final Terms:** The final terms for this Bond (or the relevant provisions thereof) are set out in Part A of the Final Terms which are (except in the case of VS System Bonds) attached to or endorsed on this Bond. The Final Terms (or such relevant provisions thereof) must be read in conjunction with these Terms and Conditions and may specify other terms and conditions which shall, to the extent so specified or to the extent inconsistent with the Terms and Conditions, replace or modify the Terms and Conditions for the purposes of this Bond. References to **the applicable Final Terms** are to Part A of the Final Terms (or the relevant provisions thereof).

As used herein, **Tranche** means Bonds which are identical in all respects (including as to listing and admission to trading) and **Series** means a Tranche of Bonds together with any further Tranche or Tranches of Bonds which are (i) expressed to be consolidated and form a single series and (ii) identical in all respects (including as to listing and admission to trading) except for their respective Issue Dates, Interest Commencement Dates and/or Issue Prices.

Copies of the applicable Final Terms are available for viewing at the office of the Issuer at Kirkjusandur 2, 155 Reykjavík, Iceland and on the Issuer's website: <http://www.islandsbanki.is/english/investor-relations/funding/>. Copies may be obtained from the Issuer.

Except where the context otherwise requires, capitalised terms used and not otherwise defined in these Terms and Conditions (including the preceding paragraphs) shall bear the meanings given to them in the applicable Final Terms.

### 1 DEFINITIONS

Interpretation: In these Conditions:

- 1.1 Bonds and Bondholder shall be deemed to include references to Coupons and Coupon-holders, respectively, where relevant;
- 1.2 If Talons are specified in the relevant Final Terms as being attached to the Bonds at the time of issue, references to Coupons shall be deemed to include references to Talons;
- 1.3 If Talons are not specified in the relevant Final Terms as being attached to the Bonds at the time of issue, references to Talons are not applicable;
- 1.4 Any reference to principal shall be deemed to include Final Redemption Amount, any additional amounts in respect of principal which may be payable under Condition 8 (Taxation), any premium payable in respect of a Bond and any other amount in the nature of principal payable pursuant to these Conditions;
- 1.5 Any reference to interest shall be deemed to include any additional amounts in respect of interest which may be payable under Condition 8 (Taxation) and any other amount in the nature of interest payable pursuant to these Conditions;



- 1.6 If an expression is stated in Condition 1 (Definitions) to have the meaning given in the relevant Final Terms, but the relevant Final Terms gives no such meaning or specifies that such expression is “not applicable” then such expression is not applicable to Bonds;
- 1.7 VS System Bonds are in dematerialised form, and any references in these Terms and Conditions to Coupons and Talons shall not apply to VS System Bonds and no global or definitive Bonds will be issued in respect thereof; and
- 1.8 If the Bonds are Zero Coupon Bonds, references to Coupons and Couponholders are not applicable.

<b>Accrual Period</b>	In accordance with Condition 5.6(c)(i), the relevant period from (and including) the most recent Interest Payment Date (or, if none, the Interest Commencement Date) to (but excluding) the relevant payment date
<b>Accrual Yield</b>	In relation to a Zero Coupon Bond, the meaning given in the applicable Final Terms
<b>Act on Contracts</b>	The Icelandic Act on Contracts, Agency and Void Legal Instruments No. 7/1936, which came into effect 1 February 1936, as amended ( <i>Icelandic: Lög um samninga, umboð og ógilda löggerninga nr. 7/1936</i> )
<b>Act on Interest and Price Indexation</b>	The Icelandic Act on Interest and Price Indexation No. 38/2001, which came into effect 1 July 2001, as amended ( <i>Icelandic: Lög um vexti og verðtryggingu nr. 38/2001</i> )
<b>Act on Financial Undertakings</b>	The Icelandic Act on Financial Undertakings No. 161/2002 which came into effect 1 January 2003, as amended ( <i>Icelandic: Lög um fjármálafyrirtæki nr. 161/2002</i> )
<b>Act on Securities Transactions</b>	The Icelandic Act on Securities Transactions No. 108/2007 which came into effect 1 November 2007, as amended ( <i>Icelandic: Lög um verðbréfavíðskipti 108/2007</i> )
<b>Additional Business Centre</b>	The meaning (if any) given in the applicable Final Terms
<b>Additional Financial Centre</b>	The meaning (if any) given in the applicable Final Terms
<b>Amortised Face Amount</b>	The meaning given in Condition 7.6(b)
<b>Agency Agreement</b>	Shall mean the agency agreement to be entered into between the Issuer, Fiscal Agent and other agents.
<b>Annuity Amount</b>	The meaning given in Condition 6.1(a)
<b>Annuity Bonds</b>	Bonds which will be redeemed in Annuity Amounts (subject to adjustment for indexation in accordance with the provisions specified in the applicable Final Terms) on one or more Interest Payment Dates as specified in the applicable Final Terms

<b>Bankruptcy Act</b>	The Icelandic Act on Bankruptcy etc., No. 21/1991 which came into effect 1 July 1992, as amended ( <i>Icelandic: lög um gjaldþrotaskipti o.fl. nr. 21/1991</i> )
<b>Bearer Bond</b>	Means Bonds issued in bearer form
<b>Business Day</b>	As defined in Condition 5.6(a)
<b>Business Day Convention</b>	<i>In respect of a Tranche of Bonds and either the Specified Periods or the Interest Payments Dates, the business day convention specified in the applicable Final Terms and determined in accordance with conditions 5.6(b)</i>
<b>Calculation Agent</b>	The meaning (if any) given in the applicable Final Terms
<b>Clearstream, Luxembourg</b>	Clearstream Banking, société anonyme, 42 Avenue JF KennedyL-1855,Luxembourg, or its successors
<b>Common Depository</b>	The common depository for Euroclear and Clearstream, Luxembourg
<b>CPI</b>	The consumer price indexation, as calculated by Statistics Iceland in accordance with the Act on Price Indexation No. 12/1995 ( <i>Icelandic:Lög um vísitölu neysluverðs nr. 12/1995</i> ) and published monthly in the Legal Gazette ( <i>Icelandic: Lögbirtingablaðið</i> ) in Iceland
<b>Couponholders</b>	The holders of the Coupons (which expression shall, unless the context otherwise requires, include the holders of the Talon)
<b>Coupons</b>	Interest coupons in respect of definitive Bonds
<b>Member States</b>	A state which is a party to the Agreement on the European Economic Area or the European Free Trade Association Treaty, or the Faroe Islands
<b>Bond</b>	The Bonds issued or to be issued by the Issuer under the Programme
<b>Bondholders</b>	The holders for the time being of the Bonds
<b>Bond Legislation</b>	Act on Securities Transactions, any relevant executive orders and appurtenant regulations as may be supplemented, amended, modified or varied from time to time (as well as any judicial decisions and administrative pronouncements, all of which are subject to change, including with retroactive effect),
<b>Dealer</b>	Any dealer appointed by the Issuer (if any)
<b>Designated Maturity</b>	The meaning given in the ISDA Definitions
<b>Determination Date</b>	The meaning given in the applicable Final Terms
<b>Determination Period</b>	The meaning given in condition 5.6(d)

<b>Directors</b>	The directors for the time being of the Issuer as defined in the Icelandic Act No. 2/1995, on Limited Liability Companies ( <i>Icelandic: lög um hlutafélög nr. 2/1995</i> )
<b>Distribution Compliance Period</b>	The period that ends 40 days after completion of the distribution of each Tranche of Bonds, as certified by the relevant Dealer
<b>Early Redemption Amount</b>	The amount calculated in accordance with Condition 7.6
<b>Equal Payment Amount</b>	The meaning given in Condition 6.1(b)
<b>Established Rate</b>	Means the rate for the conversion of the Specified Currency (including compliance with rules relating to roundings in accordance with applicable European Community regulations) into other Specified Currency
<b>EU</b>	The European Union
<b>EURIBOR</b>	Euro-zone inter-bank offered rate
<b>Euroclear</b>	Euroclear Bank S.A./N.V., 1, Boulevard du Roi Albert II B - 1210 Brussels, or its successor
<b>Final Redemption Amount</b>	The meaning given in the applicable Final Terms
<b>Final Terms</b>	Each Tranche will be the subject to the Final Terms which, for the purposes of that Tranche only, completes the Terms and Conditions of the Bonds and this Base Prospectus and must be read in conjunction with this Base Prospectus. The terms and conditions applicable to any particular Tranche of Bonds are the Terms and Conditions of the Bonds as completed, amended and/or replaced by the relevant Final Terms.
<b>Fiscal Agent</b>	Íslandsbanki hf., or any successor agent appointed as such
<b>Fixed Rate Bonds</b>	Bonds that pay a fixed rate of interest on such date or dates as may be agreed between the Issuer and the relevant Dealer and on redemption calculated on the basis of such Day Count Fraction as may be agreed between the Issuer and the relevant Dealer
<b>Floating Rate</b>	The meaning given in the ISDA Definitions
<b>Floating Rate Convention</b>	The meaning given in Condition 5.6(b)(i)
<b>Floating Rate Bonds</b>	Bonds which bear interest at a rate determined: <ul style="list-style-type: none"> <li>(I) on the same basis as the floating rate under a notional interest rate swap transaction in the relevant Specified Currency governed by an agreement incorporating the ISDA Definitions; or</li> <li>(II) on the basis of a reference rate appearing on the agreed screen page of a commercial quotation service; or</li> <li>(III) on such other basis as may be agreed between the Issuer and the relevant Dealer, or</li> </ul>

	as set out in the applicable Final Terms
<b>Following Business Day Convention</b>	The meaning given in Condition 5.6(b)(ii)
<b>FME</b>	Financial Supervisory Authority, Iceland (Fjármálaeftirlitið)
<b>Glitnir</b>	Glitnir hf., with its registered office at Sóltún 26, 105 Reykjavík Id.no. 550500-3530.
<b>Global Bonds</b>	Global Bonds comprising Temporary Global Bonds and Permanent Global Bonds
<b>Group</b>	The Issuer and its Subsidiaries
<b>IFRS</b>	International Financial Reporting Standards
<b>Inflation Linked Annuity Bonds</b>	Bonds, where the principal amount is adjusted for changes in the consumer price index according to the Final Terms, that pay an Annuity Amount on such date or dates as decided by the Issuer and set out in the Final Terms
<b>Inflation Linked Equal Principal Payment Bonds</b>	Bonds, where the principal amount is adjusted for changes in the consumer price index according to the Final Terms, that pay an Equal Payment Amount on such date or dates as decided by the Issuer and set out in the Final Terms
<b>Instalment Amounts</b>	In respect of Instalment Bonds, each amount specified as such in the applicable Final Terms
<b>Instalment Bonds</b>	Bonds which will be redeemed in Instalment Amounts and on the Instalment Dates specified in the applicable Final Terms
<b>Instalment Dates</b>	In respect of Instalment Bonds, each date specified as such in the applicable Final Terms
<b>Interest Amount</b>	The amount of interest payable on the Floating Rate Bonds in respect of each Specified Denomination for the relevant Interest Period, as calculated in accordance with Condition 5.4(d) or the amount of interest payable on Inflation Linked Annuity Bonds or Inflation Linked Equal Payment Bonds in respect of each Specified Denomination for the relevant Interest Period, as calculated in accordance with Conditions 5.1 and 5.2 respectively
<b>Interest Commencement Date</b>	In the case of interest-bearing Bonds, the date specified in the applicable Final Terms from (and including) which the relevant Bonds will accrue interest
<b>Interest Determination Date</b>	In respect of Floating Rate Bonds to which Screen Rate Determination is applicable, the meaning given in the applicable Final Terms
<b>Interest Payment Date</b>	In respect of Fixed Rate Bonds, Inflation Linked Annuity Bonds and Inflation Linked Equal Payment Bonds, the meaning given in the applicable Final Terms and in respect of Floating Rate Bonds the

	meaning given in Condition 5.4(a)
<b>Interest Period</b>	In accordance with condition 5.6(e) the period from (and including) an Interest Payment Date (or the Interest Commencement Date) to (but excluding) the next (or first) Interest Payment Date
<b>Investor's Currency</b>	The currency or currency unit that an investor's financial activities are denominated in, other than the Specified Currency
<b>ISD</b>	The Icelandic Securities Depository with its registered office at Laugavegur 182, 105 Reykjavík ( <i>Icelandic: Verðbréfasráning Íslands</i> )
<b>ISD System Account Manager</b>	Íslandsbanki hf. in its capacity as ISD system account manager and/or any other agent appointed by the Issuer from time to time in relation to the ISD System Bonds.
<b>ISD System Bonds</b>	Shall mean Bonds issued in a dematerialised, uncertified book entry form cleared through ISD.
<b>ISDA</b>	International Swaps and Derivatives Association, Inc.
<b>ISDA Definitions</b>	The meaning given in Condition 5.4(b)
<b>ISDA Determination</b>	If specified as applicable in the applicable Final Terms Document, the manner in which the Rate of Interest on Floating Rate Bonds is to be determined in accordance with Condition 5.4(b)
<b>ISDA Rate</b>	The meaning given in Condition 5.4(b)
<b>ISK or Icelandic Krona or krónur</b>	The lawful currency of the Republic of Iceland
<b>Issue Date</b>	Each date on which the Issuer issues a Tranche of Bonds under the Programme, as specified in the applicable Final Terms
<b>Issue Price</b>	The price, generally expressed as a percentage of the nominal amount of the Bonds, at which a Tranche of Bonds will be issued
<b>Issuer</b>	Íslandsbanki hf., ID.No. 491008-0160, having its registered office at Kirkjusandur 2, 155 Reykjavík, Iceland
<b>Issuer Call</b>	If specified as applicable in the applicable Final Terms, the provision by which the Issuer may redeem a Series of Bonds in accordance with Condition 7.3
<b>LIBOR</b>	London inter-bank offered rate
<b>Margin</b>	As specified in the applicable Final Terms (if any).
<b>Maturity Date</b>	As specified in the applicable Final Terms.
<b>Maximum Rate of Interest</b>	In respect of a Floating Rate Bond, the percentage rate per annum

	(if any) specified in the applicable Final Terms
<b>Maximum Redemption Amount</b>	The amount specified as such in the applicable Final Terms
<b>Member State</b>	A state which is a member of the European Economic Area
<b>Minimum Rate of Interest</b>	In respect of Floating Rate Bonds, the percentage rate per annum (if any) specified in the applicable Final Terms
<b>Minimum Redemption Amount</b>	The amount specified as such in the applicable Final Terms
<b>Modified Following Business Day Convention</b>	The meaning given in Condition 5.6(b)(iii)
<b>MiFID</b>	Market in Financial Instruments Directive 2004/39/EC ( <i>Icelandic: Tilskipun Evrópuþingsins og Ráðsins 2004/39/EB</i> )
<b>NASDAQ OMX Iceland</b>	The regulated market of the NASDAQ OMX Iceland hf. with its registered office at Laugavegur 182, 105 Reykjavík.
<b>Optional Redemption Amount</b>	The meaning (if any) given in the applicable Final Terms
<b>Optional Redemption Date</b>	The meaning (if any) given in the applicable Final Terms
<b>Paying Agents</b>	The Principal Paying Agent and any other paying agent appointed (if any)
<b>Payment Day</b>	The meaning given in Condition 6.4
<b>Preceding Business Day Convention</b>	The meaning given in Condition 5.6(b)(iv)
<b>Principal Amount Outstanding</b>	In accordance with condition 5.6(f) means in respect of a Bond, except an Inflation Linked Annuity Bond and an Inflation Linked Equal Principal Payment Bond on any day, the principal amount of that Bond on the relevant Issue Date thereof less principal amounts received by the relevant Bondholder in respect thereof on or prior to that day and in respect of an Inflation Linked Annuity Bond and an Inflation Linked Equal Payment Bond, the meaning given in the applicable Final Terms
<b>Principal Paying Agent</b>	The Issuer, Íslandsbanki hf.
<b>Programme</b>	ISK 100,000,000,000 bond programme established by the Issuer on the Issue Date
<b>Prospectus Directive</b>	Directive 2003/71/EC ( <i>Icelandic: Tilskipun Evrópuþingsins og Ráðsins 2003/71/EB</i> )
<b>Rate of Interest</b>	In respect of a Series of interest-bearing Bonds, the rate of interest payable from time to time in respect of such Bonds determined in accordance with the Terms and Conditions and the applicable Final Terms
<b>Redeemed Bonds</b>	The meaning given in Condition 7.3

<b>Reference Price</b>	In respect of a Zero Coupon Bond, the meaning given in the applicable Final Terms
<b>Reference Rate</b>	In respect of Floating Rate Bonds to which Screen Rate Determination applies, the meaning given in the applicable Final Terms
<b>Registrar</b>	Any registrar to be appointed in accordance with an Agency Agreement
<b>Registered Bond</b>	Means Bonds issued in registered form.
<b>Regulation S</b>	Regulation S under the US Securities Act
<b>REIBOR</b>	Reykjavík Inter Bank Offering Rate
<b>Relevant Screen Page</b>	In respect of Floating Rate Bonds to which Screen Rate Determination applies, the meaning given in the Final Terms
<b>Reset Date</b>	The Meaning given in the ISDA Definitions
<b>Resolution Committee</b>	Committee appointed under Act No. 125/2008, to maximise the recovery value of Glitnir's assets for the benefit of Glitnir's creditors
<b>EU Savings Directive</b>	The European Council Directive 2003/48/EC
<b>Screen Rate Determination</b>	If specified as applicable in the applicable Final Terms, the manner in which the Rate of Interest on Floating Rate Bonds is to be determined in accordance with Condition 5.4(b)
<b>Selection Date</b>	The meaning given in Condition 7.3
<b>Senior Debt</b>	Debt that takes priority over other unsecured or subordinated debt owed by the Issuer
<b>Series</b>	A Tranche of Bonds together with any further Tranche or Tranches of Bonds which are (a) expressed to be consolidated and form a single series and (b) identical in all respects (including as to listing and admission to trading) except for their respective Issue Dates, Interest Commencement Dates and/or Issue Prices
<b>Specified Currency</b>	Subject to any applicable legal or regulatory restrictions, ISK, euro, Sterling, U.S. Dollars and such other currency or currencies as may be agreed from time to time by the Issuer, the relevant Dealer and the Principal Paying Agent and specified in the applicable Final Terms.
<b>Specified Denomination</b>	In respect of a Series of Bonds, the denomination or denominations of such Bonds at the minimum amount of EUR 50,000 as specified in the applicable Final Terms
<b>Specified Interest Payment Date</b>	In respect of Floating Rate Bonds, the meaning (if any) given in the applicable Final Terms
<b>Subsidiary</b>	Means an entity from time to time of which the Issuer (a) has direct or indirect control or (b) owns directly or indirectly more than 50

per cent of the share capital or similar ownership; "control" for this purpose means the power to direct the management and the policies of the entity, whether through the ownership of voting capital, by contract or otherwise.

<b>Sub-Unit</b>	The meaning given in Condition 5.6(g)
<b>Talons</b>	Talons for further Coupons in respect of interest-bearing definitive Bonds
<b>TARGET System</b>	The meaning given in Condition 5.6(a)
<b>Temporary Bearer Global Bond</b>	The temporary global bond in bearer form which will initially represent the Bearer Bond of each Tranche
<b>Terms and Conditions or Conditions</b>	The terms and conditions of the Bonds
<b>US Securities Act</b>	U.S. Securities Act of 1933, as amended
<b>Tranche</b>	An issue of Bonds which are identical in all respects (including as to listing and admission to trading)
<b>VS System Bonds</b>	Means Bonds issued in uncertificated book entry form cleared through the ISD, Euroclear, Clearstream and/or, in relation to any Tranche of Bonds, any other clearing system as may be specified in the relevant Final Terms (as the case may be)
<b>VP LUX</b>	means VP Lux S.à. r.l., 32, Boulevard Royal, L-2449 Luxembourg, or its successors.
<b>Yen or JPY</b>	The lawful currency for the time being of Japan
<b>Zero Coupon Bonds</b>	Bonds which will be offered and sold at a discount to their nominal amount and which will not bear interest
<b>€, Euro or euro</b>	The currency introduced at the start of the third stage of European economic monetary union pursuant to the Treaty
<b>£ or Sterling</b>	The lawful currency for the time being of the United Kingdom of Great Britain and Northern Ireland
<b>\$, U.S.\$ or U.S. Dollars or US Dollars</b>	The lawful currency for the time being of the United States of America

## **2 FORM, DENOMINATION AND TITLE**

*Form of the Bonds:* The Bonds are issued in bearer form (the Bearer Bonds), or, in the case of VS System Bonds, uncertificated book entry form, as specified in the applicable Final Terms and, in the case of definitive Bonds, serially numbered, in the Specified Currency and the Specified Denomination(s). The Bonds are in Specified Currency and the Specified Denomination(s). Bonds of one Specified Denomination may not be exchanged for Bonds of another Specified Denomination.

The Bonds may be an Inflation Linked Annuity Bond, an Inflation Linked Equal Principal Payment Bond, a Fixed Rate Bond, a Floating Rate Bond, a Zero Coupon Bond or a combination of any of the foregoing, depending upon the Interest Basis and Redemption/Payment Basis shown in the applicable Final Terms.



Interest bearing definitive Bearer Bonds have interest coupons ("**Coupons**") and, if indicated in the applicable Final Terms, talons for further Coupons ("**Talons**") attached on issue. Any reference herein to Coupons or coupons shall, unless context otherwise requires, be deemed to include a reference to Talons or talons. Definitive Bearer Bonds repayable in instalments have receipts ("**Receipts**") for the payment of the instalments of principal (other than the final instalment) attached on issue.

Each Tranche of Bonds issued in the form of Bearer Bonds will initially be represented by a Temporary Bearer Global Bond without Coupons, Receipts or Talons which will (i) if the global Bonds are intended to be issued in a new global Bond form ("**NGBF**"), as specified in the applicable Final Terms, be delivered on or prior to the original issue date of the Tranche to a Common Safekeeper for Euroclear and Clearstream, Luxembourg; and (ii) if the global Bonds are not intended to be issued in NGBF, be delivered on or prior to the original issue date of the Tranche to a Common Depositary for, Euroclear and Clearstream, Luxembourg. Interests in the Temporary Bearer Global Bond will be exchanged either for interests in a Permanent Bearer Global Bond or, where specified in the applicable Final Terms (subject to such notice period as is specified in the Final Terms), for definitive Bearer Bonds on or after the date (the "**Exchange Date**") which is the later of (i) 60 days after the Temporary Bearer Global Bond is issued and (ii) 60 days after completion of the distribution of the relevant Tranche, as certified by the relevant Dealer (in the case of a non-syndicated issue) or the relevant lead manager (in the case of a syndicated issue). Such exchange will be made only upon delivery of written certification to Euroclear and/or Clearstream, Luxembourg, as the case may be, to the effect that the beneficial owner of such Bonds is not a U.S. person or other person who has purchased such Bonds for resale to, or on behalf of, U.S. persons and Euroclear and/or Clearstream, Luxembourg, as the case may be, and has given a like certification (based on the certification it has received) to the Fiscal Agent.

If an interest or principal payment date for any Bonds occurs whilst such Bonds are represented by a Temporary Bearer Global Bond, the related interest or principal payment will be made only to the extent that certification of non-U.S. beneficial ownership has been received as described in the last sentence of the immediately preceding paragraph unless such certification has already been given. The holder of a Temporary Bearer Global Bond will not be entitled to collect any payment of interest or principal due on or after the Exchange Date unless, upon due certification, exchange of the Temporary Bearer Global Bond is improperly withheld or refused. Payment of principal or interest (if any) on a Permanent Bearer Global Bond will be made through Euroclear or Clearstream, Luxembourg (against presentation or surrender, as the case may be, of the Permanent Bearer Global Bond if the Permanent Bearer Global Bond is not intended to be issued in NGBF form) without any further requirement for certification. Pursuant to the Agency Agreement the Fiscal Agent shall arrange that, where a further Tranche of Bonds is issued, the Bonds of such Tranche shall be assigned a common code and ISIN by Euroclear and Clearstream, Luxembourg which are different from the common code and ISIN assigned to Bonds of any other Tranche of the same Series until at least expiry of the Distribution Compliance Period applicable to the Bonds of such Tranche.

The applicable Final Terms will specify that either (i) a Permanent Bearer Global Bond will be exchangeable (free of charge), in whole but not in part, for definitive Bearer Bonds with, where applicable, Receipts, Coupons and Talons attached upon not less than 60 days' written notice from Euroclear and (or Clearstream, Luxembourg (acting on the instructions of any holder of an interest in such Permanent Bearer Global Bond) to the Fiscal Agent as described therein or (ii) a Permanent Bearer Global Bond will be exchangeable (free of charge), in whole but not in part, for definitive Bearer Bonds with, where applicable, Receipts, Coupons and Talons attached only upon the occurrence of an Exchange Event as described therein. "Exchange Event" means (i) the Issuer has been notified that either Euroclear or Clearstream, Luxembourg has been closed for business for a continuous period of 14 days (other than by reason of holiday, statutory or otherwise) or has announced an intention permanently to cease business or has in fact done so and no alternative clearing system satisfactory to the Issuer, the Fiscal Agent, the other Paying Agents and the Bondholders is available or, unless otherwise specified in the applicable Final Terms, (ii) the Issuer has or will become obliged to pay additional amounts as provided for or referred to in Condition 8 (Taxation) which would not be required were the Bonds represented by the Permanent Bearer Global Bond in definitive bearer form and a certificate to such effect signed by two Directors of the Issuer has been given to the Fiscal Agent. The Issuer will promptly give notice to Bondholders in accordance with Condition 11 (Notices) if an Exchange Event occurs. In the event of the occurrence of an Exchange Event, Euroclear and/or Clearstream, Luxembourg (acting on the instructions of any

holder of an interest in such Permanent Bearer Global Bond) or the Bondholders may give notice to the Fiscal Agent requesting exchange and in the event of the occurrence of an Exchange Event as described in (ii) above, the Issuer may also give notice to the Fiscal Agent and the Bondholders requesting exchange. Any such exchange shall occur not later than 30 days after the date of receipt of the first relevant notice by the Fiscal Agent.

The following legend will appear on all bearer Bonds, Coupons, Receipts and Talons which have an original maturity of more than 365 days:

**“ANY UNITED STATES PERSON WHO HOLDS THIS OBLIGATION WILL BE SUBJECT TO LIMITATIONS UNDER THE UNITED STATES INCOME TAX LAWS INCLUDING THE LIMITATIONS PROVIDED IN SECTIONS 165(j) AND 1287 (a) OF THE INTERNAL REVENUE CODE.”**

The sections referred to provide that United States holders, with certain exceptions, will not be entitled to deduct any loss on bearer Bonds, receipts or interest coupons and will not be entitled to capital gains treatment of any gain on any sale, disposition, redemption or payment of principal in respect of bearer Bonds, Receipts or Coupons.

Unless otherwise provided with respect to a particular Series of Registered Bonds, the Registered Bonds of each Tranche of such Series offered and sold in reliance on Regulation S, which will be sold to non-U.S. persons outside the United States, will initially be represented by a Regulation S Global Bond which will be deposited with a custodian for, and registered in the name of a nominee of, a Depository Trust Company (the “DTC”) or common safekeeper as the case may be for the accounts of Euroclear and Clearstream, Luxembourg. Prior to expiry of the Distribution compliance Period applicable to each Tranche of Bond, beneficial interests in a Reg. S. Global Bond may not be offered or sold to, or for the account or benefit of, a U.S. person save as otherwise provided in Condition 2 (Form, Denomination and Title) and may not be held otherwise than through Euroclear or Clearstream, Luxembourg and such Reg. S Global Bond will bear a legend regarding such restrictions on transfer.

Registered Bonds of each Tranche of such Series may only be offered and sold in the United States or to U.S. persons in private transactions to Qualified Institutional Buyers (“QIB”). The Registered Bonds of each Tranche sold to QIBs will be represented by a Restricted Global Bond which will be deposited with a custodian for, and registered in the name of a nominee of, DTC.

Persons holding beneficial interests in Registered Global Bonds will be entitled or required, as the case may be, under the circumstances described below, to receive physical delivery of definitive Bonds in fully registered form.

Payments of principal on the Registered Bonds will be made on the relevant payment date to the persons shown on the Register at the close of business on the business day (being for this purpose a day on which banks are open for business in Brussels) immediately prior to the relevant payment date. Payments of interest on the Registered Bonds will be made on the relevant payment date to the person in whose name such Bonds, Receipts and Coupons) immediately preceding such payment date.

Payments of the principal of, and interest (if any) on, the Registered Global Bonds will be made to the nominee of DTC as the registered holder of the Registered Global Bonds. None of the Issuer, any Paying Agent and the Registrar will have any responsibility or liability for any aspect of the records relating to or payments made on account of beneficial ownership interests in the Registered Global Bonds or for maintaining, supervising or reviewing any records relating to such beneficial ownership interests.

For so long as any of the Bonds are represented by a Bearer Global Bond held on behalf of Euroclear and/or Clearstream, Luxembourg, or so long as DTC or its nominee is the registered holder of a Registered Global Bond or so long as the Bond is a VS Systems Bond, each person who is for the time being shown in the records of Euroclear and/or Clearstream, Luxembourg, DTC, or the ISD, as the case may be, as the holder of a particular nominal amount of such Bonds (in which regard any certificate or other document issued by Euroclear, Clearstream, Luxembourg, DTC or its nominee, or the ISD as to the nominal amount of such Bonds standing to the account of any person shall be conclusive and binding for all purposes save in the case of manifest error) shall be treated by the Issuer, the Fiscal Agent and any other Paying Agent as the holder of such nominal

amount of such Bonds for all purposes other than (in the case only of Bonds not being VS System Bonds) with respect to the payment of principal or interest on the Bonds, for which purpose, in the case of Bonds represented by a Bearer Global Bond, the bearer of the relevant Global Bearer Bond, or in the case of Bonds where DTC or its nominee is the registered holder of a Registered Global Bond, DTC or its nominee shall be treated by the Issuer, the Fiscal Agent and any other Paying Agent as the holder of such Bonds in accordance with and subject to the terms of the relevant global Bond (and the expressions “**Bondholder**” and “**holder of Bonds**” and related expressions shall be construed accordingly).

Bonds which are represented by a Bearer Global Bond will only be transferable in accordance with the rules and procedures for the time being of Euroclear or Clearstream, Luxembourg.

No beneficial owner of an interest in a Registered Global Bond will be able to exchange or transfer such interest, except in accordance with the applicable procedures of DTC, Euroclear and Clearstream, Luxembourg, in each case to the extent applicable.

Each Tranche of VS System Bonds will be issued in uncertificated and dematerialised book entry form. Legal title to the VS Systems Bonds will be evidenced by book entries in the records of ISD or VP LUX. Settlement of sale and purchase transactions in respect of VS System Bonds in the ISD or VP LUX will take place in accordance with market practice at the time of the relevant transaction. Transfers of interests in the relevant VS System Bonds will take place in accordance with the rules and procedures for the time being of the ISD or VP LUX.

Bonds that are represented by a global Bond and VS System Bonds will be transferable only in accordance with the rules and procedures for the time being of Euroclear, Clearstream, VP LUX and/or ISD, (as the case may be). References to Euroclear, Clearstream, VP LUX and/or the ISD, (as the case may be) shall, whenever the context so permits, be deemed to include a reference to any additional or alternative clearing system approved by the Issuer.

Title to the Bearer Bonds, Receipts and Coupons will pass by delivery. The Issuer may deem and treat the bearer of any Bearer Bond, Receipt of Coupon as the absolute owner thereof (whether or not overdue and notwithstanding any notice of ownership or writing thereon or notice of any previous loss or theft thereof) for all purposes. Title to the VS System Bond will pass by registration in the registers between the direct or indirect accountholders at the ISD or VP LUX in accordance with the rules and procedures of the ISD or VP LUX.

### **3 STATUS OF THE BONDS**

The Bonds constitute direct, unconditional, unsubordinated and unsecured obligations of the Issuer and rank pari passu among themselves and with all other obligations of the Issuer that have been provided the same priority (save for certain obligations required to be preferred by law) (other than subordinated obligations, if any), from time to time outstanding and will rank pari passu with the claims of all other unsubordinated creditors of the Issuer (other than those preferred by law) in all other respects. The cost of bankruptcy administration will rank ahead of claims for payments of the Bonds.

### **4 REDENOMINATION**

Where redenomination is specified in the applicable Final Terms as being applicable, the Issuer may, without the consent of the Bondholders, the Receiptholders and the Couponholders, but after at least 30 days' prior notice to the Bondholders in accordance with Condition 11, elect that, with effect from the Redenomination Date specified in the notice, the Bonds shall be redenominated in euro or other Specified Currency.

The election will have effect as follows:

- 4.1 the Bonds shall be deemed to be redenominated into euro or other Specified Currency in the denomination of euro 0.01 or as applicable to other Specified Currency with a principal amount for

each Bond equal to the principal amount of that Bond in the Specified Currency, converted into euro or other Specified Currency at the Established Rate, provided that, if the Issuer determines, that the then market practice in respect of the redenomination into euro or other Specified Currency of internationally offered securities is different from the provisions specified above, such provisions shall be deemed to be amended so as to comply with such market practice and the Issuer shall promptly notify the Bondholders, the stock exchange (if any) on which the Bonds may be listed of such deemed amendments;

- 4.2 save to the extent that an Exchange Notice has been given in accordance with paragraph 5.4 below, the amount of interest due in respect of the Bonds will be calculated by reference to the aggregate principal amount of Bonds presented for payment by the relevant holder and the amount of such payment shall be rounded down to the nearest euro 0.01 or as applicable in the relevant Specified Currency;
- 4.3 if definitive Bonds are required to be issued after the Redenomination Date, they shall be issued at the expense of the Issuer in the denominations as the Issuer shall determine and notify to the Bondholders;
- 4.4 if issued prior to the Redenomination Date, all unmatured Coupons denominated in the Specified Currency (whether or not attached to the Bonds) will become void with effect from the date on which the Issuer gives notice (the Exchange Notice) that replacement euro-denominated Bonds, Receipts and Coupons are available for exchange (provided that such securities are so available) and no payments will be made in respect of them. The payment obligations contained in any Bonds and Receipts so issued will also become void on that date although those Bonds and Receipts will continue to constitute valid exchange obligations of the Issuer. New redenominated Bonds, Receipts and Coupons will be issued in exchange for Bonds, Receipts and Coupons denominated in the Specified Currency in such manner as the Principal Paying Agent may specify and as shall be notified to the Bondholders in the Exchange Notice. No Exchange Notice may be given less than 15 days prior to any date for payment of principal or interest on the Bonds;
- 4.5 after the Redenomination Date, all payments in respect of the Bonds, other than payments of interest in respect of periods commencing before the Redenomination Date, will be made solely in the redenomination currency;
- 4.6 if the Bonds are Fixed Rate Bonds, Inflation Linked Annuity Bonds or Inflation Linked Equal Principal Payment Bonds, and interest for any period ending on or after the Redenomination Date is required to be calculated for a period ending other than on an Interest Payment Date, it will be calculated by applying the Rate of Interest to each Specified Denomination, multiplying such sum by the applicable Day Count Fraction, and rounding the resultant figure to the nearest sub-unit of the relevant Specified Currency, half of any such sub-unit being rounded upwards or otherwise in accordance with applicable market convention; and
- 4.7 if the Bonds are Floating Rate Bonds, the applicable Final Terms will specify any relevant changes to the provisions relating to interest.

## 5 INTEREST

### *5.1 Interest on Inflation Linked Annuity Bonds*

Each Inflation Linked Annuity Bond bears interest on its nominal amount outstanding from (and including) the Interest Commencement Date at the rate(s) per annum equal to the Rate(s) of Interest. Interest shall be calculated as defined under Interest Payment(s) in the applicable Final Terms and rounding the resultant figure to the nearest amount in the Specified Currency. Interest will be payable in arrear on the Interest Payment Date(s) in each year up to (and including) the Maturity Date.

If interest is required to be calculated for a period other than an Interest Period, such interest shall be calculated by using the same methodology as described for Interest Payment(s) in the applicable Final Terms.

### *5.2 Interest on Inflation Linked Equal Principal Payment Bonds*

Each Inflation Linked Equal Principal Payment Bond bears interest on its Principal Amount Outstanding from (and including) the Interest Commencement Date at the rate(s) per annum equal to the Rate(s) of Interest. Interest shall be calculated as defined under Interest Payment(s) in the applicable Final Terms and rounding the resultant figure to the nearest amount in the Specified Currency. Interest will be payable in arrear on the Interest Payment Date(s) in each year up to (and including) the Maturity Date.

If interest is required to be calculated for a period other than an Interest Period, such interest shall be calculated by using the same methodology as described for Interest Payment(s) in the applicable Final Terms.

### *5.3 Interest on Fixed Rate Bonds*

Each Fixed Rate Bond bears interest on its Principal Amount Outstanding from (and including) the Interest Commencement Date at the rate(s) per annum equal to the Rate(s) of Interest.

Interest shall be calculated as defined under Interest Payment(s) in the applicable Final Terms and rounding the resultant figure to to the nearest amount in the Specified Currency. Interest will be payable in arrear on the Interest Payment Date(s) in each year up to (and including) the Maturity Date.

The Issuer will calculate the amount of interest (each an Interest Amount) payable on the Fixed Rate Bonds in respect of each Specified Denomination for the relevant Interest Period. Each Interest Amount shall be calculated by applying the Rate of Interest to each Specified Denomination, multiplying such sum by the applicable Day Count Fraction, and rounding the resultant figure to the nearest sub-unit of the relevant Specified Currency, half of any such sub-unit being rounded upwards or otherwise in accordance with applicable market convention.

If interest is required to be calculated for a period other than an Interest Period, such interest shall be calculated by applying the Rate of Interest to each Specified Denomination, multiplying such sum by the applicable Day Count Fraction, and rounding the resultant figure to the nearest sub-unit of the relevant Specified Currency, half of any such sub-unit being rounded upwards or otherwise in accordance with applicable market convention.

### *5.4 Interest on Floating Rate Bonds*

#### a) Interest Payment Dates

Each Floating Rate Bond bears interest on its Principal Amount Outstanding from (and including) the Interest Commencement Date and such interest will be payable in arrear on either:

the Specified Interest Payment Date(s) in each year specified in the applicable Final Terms; or

if no Specified Interest Payment Date(s) is/are specified in the applicable Final Terms, each date (each such date, together with each Specified Interest Payment Date, an Interest Payment Date) which falls the number of months, or other period specified as the Specified Period in the applicable Final Terms, after the preceding Interest Payment Date or, in the case of the first Interest Payment Date, after the Interest Commencement Date.

Such interest will be payable in respect of each Interest Period (which expression shall, in these Terms and Conditions, mean the period from (and including) an Interest Payment Date (or the Interest Commencement Date) to (but excluding) the next (or first) Interest Payment Date)

**b) Rate of Interest**

The Rate of Interest payable from time to time in respect of Floating Rate Bonds will be determined in the manner specified in the applicable Final Terms.

*ISDA Determination for Floating Rate Bonds*

Where ISDA Determination is specified in the applicable Final Terms as the manner in which the Rate of Interest is to be determined, the Rate of Interest for each Interest Period will be the relevant ISDA Rate plus or minus (as indicated in the applicable Final Terms) the Margin (if any). For the purposes of this subparagraph (i), **ISDA Rate** for an Interest Period means a rate equal to the Floating Rate that would be determined by the Principal Paying Agent or other person specified in the applicable Final Terms under an interest rate swap transaction if the Principal Paying Agent or that other person were acting as Calculation Agent for that swap transaction under the terms of an agreement incorporating the 2000 ISDA Definitions, as published by the International Swaps and Derivatives Association, Inc. and as amended and updated as at the Issue Date of the first Tranche of the Bonds (the **ISDA Definitions**), and under which:

- (i) the Floating Rate Option is as specified in the applicable Final Terms;
- (ii) the Designated Maturity is the period specified in the applicable Final Terms; and
- (iii) unless otherwise stated in the applicable Final Terms, the relevant Reset Date is the first day of that Interest Period.

For the purposes of this subparagraph (i), **Floating Rate, Calculation Agent, Floating Rate Option, Designated Maturity** and **Reset Date** have the meanings given to those terms in the ISDA Definitions.

*Screen Rate Determination for Floating Rate Bonds*

Where Screen Rate Determination is specified in the applicable Final Terms as the manner in which the Rate of Interest is to be determined, the Rate of Interest for each Interest Period will, subject as provided below, be either:

- (i) the offered quotation (if there is only one quotation on the Relevant Screen Page); or
- (ii) the arithmetic mean (rounded if necessary to the fifth decimal place, with 0.000005 being rounded upwards) of the offered quotations, (expressed as a percentage rate per annum) for the Reference Rate which appears or appear, as the case may be, on the Relevant Screen Page as at 11.00 a.m. (Iceland time, in the case of REIBOR, London time, in the case of LIBOR, or Brussels time, in the case of EURIBOR) on the Interest Determination Date in question plus or minus (as indicated in the applicable Final Terms) the Margin (if any), all as determined by the Issuer. If five or more of such offered quotations are available on the Relevant Screen Page, the highest (or, if there is more than one such highest quotation, one only of such quotations) and the lowest (or, if there is more than

one such lowest quotation, one only of such quotations) shall be disregarded by the Issuer for the purpose of determining the arithmetic mean (rounded as provided above) of such offered quotations.

If the Reference Rate from time to time in respect of Floating Rate Bonds is specified in the applicable Final Terms as being other than LIBOR or EURIBOR, the Rate of Interest in respect of such Bonds will be determined as provided in the applicable Final Terms.

c) Minimum Rate of Interest and/or Maximum Rate of Interest

If the applicable Final Terms for a Floating Rate Bond specifies a Minimum Rate of Interest for any Interest Period, then, in the event that the Rate of Interest in respect of such Interest Period determined in accordance with the provisions of paragraph (b) above is less than such Minimum Rate of Interest, the Rate of Interest for such Interest Period shall be such Minimum Rate of Interest.

If the applicable Final Terms for a Floating Rate Bond specifies a Maximum Rate of Interest for any Interest Period, then, in the event that the Rate of Interest in respect of such Interest Period determined in accordance with the provisions of paragraph (b) above is greater than such Maximum Rate of Interest, the Rate of Interest for such Interest Period shall be such Maximum Rate of Interest.

d) Determination of Rate of Interest and calculation of Interest Amounts

The Issuer will at, or as soon as practicable after, each time at which the Rate of Interest is to be determined, determine the Rate of Interest for the relevant Interest Period.

The Issuer will calculate the amount of interest (each an Interest Amount) payable on the Floating Rate Bonds, Inflation Linked Annuity Bond or Inflation Linked Equal Principal Payment Bonds, in respect of each Specified Denomination for the relevant Interest Period. Each Interest Amount shall be calculated by applying the Rate of Interest to each Specified Denomination, multiplying such sum by the applicable Day Count Fraction, and rounding the resultant figure to the nearest sub-unit of the relevant Specified Currency, half of any such sub-unit being rounded upwards or otherwise in accordance with applicable market convention.

e) Certificates to be final

All certificates, communications, opinions, determinations, calculations, quotations and decisions given, expressed, made or obtained for the purposes of the provisions of this Condition 5.4, shall (in the absence of wilful default, bad faith or manifest error as aforesaid) be binding on the Issuer and all Bondholders, Receiptholders and Couponholders.

### *5.5 Accrual of interest*

Each Bond (or in the case of the redemption of part only of a Bond, that part only of such Bond) will cease to bear interest (if any) from the date for its redemption unless payment of principal is improperly withheld or refused. In such event, interest will continue to accrue until whichever is the earlier of:

- a) the date on which all amounts due in respect of such Bond have been paid; and.

- b) five days after the date on which the full amount of the moneys payable in respect of such Bond has been received by the Principal Paying Agent and notice to that effect has been given to the Bondholders in accordance with Condition 11.
- c) In the case of Bonds which are Zero Coupon Bonds, for the purposes of this Condition 5.5 the principal amount outstanding shall be the total amount otherwise payable by the Issuer on the Maturity Date less any payments made by the Issuer in respect of such amount in accordance with these Conditions.

In the event of non-payment of a Zero Coupon Bond, interest will accrue as provided in Condition 7.10.

#### *5.6 Business Day, Business Day Convention, Day Count Fraction and other adjustments*

- a) In these Terms and Conditions, **Business Day** means:
  - (i) a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in London, Reykjavík and any Additional Business Centre specified in the applicable Final Terms; and
  - (ii) either (A) in relation to any sum payable in a Specified Currency other than euro, a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in the principal financial centre of the country of the relevant Specified Currency as specified in Applicable Final Terms (if other than London, Reykjavík and any Additional Business Centre and which if the Specified Currency is Australian dollars or New Zealand dollars shall be Sydney and Auckland, respectively) or (B) in relation to any sum payable in euro, a day on which the Trans-European Automated Real-Time Gross Settlement Express Transfer (TARGET) System (the **TARGET System**) is open.
- b) If a **Business Day Convention** is specified in the applicable Final Terms and (x) if there is no numerically corresponding day in the calendar month in which an Interest Payment Date should occur or (y) if any Interest Payment Date would otherwise fall on a day which is not a Business Day, then, if the Business Day Convention specified is:
  - (i) in any case where Specified Periods are specified in accordance with Condition 5.4 (a), **the Floating Rate Convention**, such Interest Payment Date (1) in the case of (x) above, shall be the last day that is a Business Day in the relevant month and the provisions of (2) below shall apply mutatis mutandis, or (2) in the case of (y) above, shall be postponed to the next day which is a Business Day unless it would thereby fall into the next calendar month, in which event (I) such Interest Payment Date shall be brought forward to the immediately preceding Business Day, and (II) each subsequent Interest Payment Date shall be the last Business Day in the month which falls the Specified Period after the preceding applicable Interest Payment Date occurred; or
  - (ii) **the Following Business Day Convention**, such Interest Payment Date shall be postponed to the next day which is a Business Day; or
  - (iii) **the Modified Following Business Day Convention**, such Interest Payment Date shall be postponed to the next day which is a Business Day unless it would thereby fall into the next calendar month, in which event such Interest Payment Date shall be brought forward to the immediately preceding Business Day; or



(iv) the **Preceding Business Day Convention**, such Interest Payment Date shall be brought forward to the immediately preceding Business Day.

c) **Day Count Fraction** means, in respect of the calculation of an amount of interest for any Interest Period:

if **Actual/Actual (ISMA)** is specified in the applicable Final Terms:

(i) in the case of Bonds where the number of days in the relevant period from (and including) the most recent Interest Payment Date (or, if none, the Interest Commencement Date) to (but excluding) the relevant payment date (the "Accrual Period") is equal to or shorter than the Determination Period (as defined in Condition 5.6. (d)) during which the Accrual Period ends, the number of days in such Accrual Period divided by the product of (I) the number of days in such Determination Period and (II) the number of Determination Dates (as specified in the applicable Final Terms) that would occur in one calendar year assuming that interest was to be payable in respect of the whole of that year; or

(ii) in the case of Bonds where the Accrual Period is longer than the Determination Period during which the Accrual Period ends, the sum of (I) the number of days in such Accrual Period falling in the Determination Period in which the Accrual Period begins divided by the product of (x) the number of days in such Determination Period and (y) the number of Determination Dates that would occur in one calendar year; and (II) the number of days in such Accrual Period falling in the next Determination Period divided by the product of (x) the number of days in such Determination Period and (y) the number of Determination Dates that would occur in one calendar year;

if **Actual/365** is specified in the applicable Final Terms, the actual number of days in the Interest Period divided by 365 (or, if any portion of that Interest Period falls in a leap year, the sum of (i) the actual number of days in that portion of the Interest Period falling in a leap year divided by 366, and (ii) the actual number of days in that portion of the Interest Period falling in a non-leap year divided by 365);

if **Actual/365 (Fixed)** is specified in the applicable Final Terms, the actual number of days in the Interest Period divided by 365;

if **Actual/365 (Sterling)** is specified in the applicable Final Terms, the actual number of days in the Interest Period divided by 365 or, in the case of an Interest Payment Date falling in a leap year, 366;

if **Actual/360** is specified in the applicable Final Terms, the actual number of days in the Interest Period divided by 360;

if **30/360, 360/360** or **Bond Basis** is specified in the applicable Final Terms, the number of days in the Interest Period divided by 360 (the number of days to be calculated on the basis of a year of 360 days with 12 30-day months (unless, in the case of Floating Rate Bonds only, (i) the last day of the Interest Period is the 31st day of a month but the first day of the Interest Period is a day other than the 30th or 31st day of a month, in which case the month that includes that last day shall not be considered to be shortened to a 30-day month, or (ii) the last day of the Interest Period is the last day of the month of February, in which case the month of February shall not be considered to be lengthened to a 30-day month));

if **30E/360** or **Eurobond Basis** is specified in the applicable Final Terms, the number of days in the Interest Period divided by 360 (the number of days to be calculated on the basis of a year of 360 days with 12 30-day months, without regard to the date of the first day or last day of

the Interest Period unless, in the case of the final Interest Period, the Maturity Date is the last day of the month of February, in which case the month of February shall not be considered to be lengthened to a 30-day month); or

such other Day Count Fraction as may be specified in the applicable Final Terms.

- d) **Determination Period** means each period from (and including) a Determination Date to (but excluding) the next Determination Date (including, where either the Interest Commencement Date or the final Interest Payment Date is not a Determination Date, the period commencing on the first Determination Date prior to, and ending on the first Determination Date falling after, such date).
- e) **Interest Period** means the period from (and including) an Interest Payment Date (or the Interest Commencement Date) to (but excluding) the next (or first) Interest Payment Date.
- f) **Principal Amount Outstanding** means, in respect of a Bond except an Inflation Linked Annuity Bond and an Inflation Linked Equal Payment Bond, on any day the principal amount of that Bond on the Issue Date less principal amounts (if any) received by the holder of such Bond in respect thereof on or prior to that day. In respect of an Inflation Linked Annuity Bond and an Inflation Linked Equal Payment Bond, the meaning given in the applicable Final Terms.
- g) **Sub-unit** means, with respect to any currency other than euro, the lowest amount of such currency that is available as legal tender in the country of such currency and, with respect to euro, euro 0.01.

## 6 PAYMENTS

### 6.1 Payments in respect of Inflation Linked Bonds

#### a) Payments in respect of Inflation Linked Annuity Bonds

In case of an Inflation Linked Annuity Bond, the Issuer shall, on each relevant Interest Payment Date, make a combined payment of principal, and interest due (together, the **Annuity Amount**) as calculated by the Calculation Agent in accordance with the formula specified in the applicable Final Terms.

#### b) Payments in respect of Inflation Linked Equal Principal Payment Bonds

In case of an Inflation Linked Equal Payment Bond, the Issuer shall, on each relevant Interest Payment Date, make a combined payment of principal, and interest due (together, the **Equal Payment Amount**) as calculated by the Calculation Agent in accordance with the formula specified in the applicable Final Terms.

### 6.2 Method of payment

Subject as provided below payments in a Specified Currency will be made:

- a) by credit or transfer to an account in the relevant Specified Currency maintained by the payee with a bank in the principal financial centre of the country of such Specified Currency, or
- b) by credit or transfer to an account in any other Specified Currency maintained by the payee with a bank in the principal financial centre of the country of such Specified Currency which shall be converted into such Specified Currency at the date of payment using the spot rate of exchange for the purchase of such currency against payment of ISK being quoted by the Fiscal Agent.

Payments will be subject in all cases to any fiscal or other laws and regulations applicable thereto in the place of payment but without prejudice to the provisions of Condition 8.

### *6.3 Presentation of Bonds and Coupons*

- a) Bonds: Payments of principal in respect of definitive Bearer Bonds will (subject as provided below) be made in the manner provided in Condition 6.2 (Method of Payment) above only against presentation and surrender (or in the case of part payment of any sum due only, endorsement) of definitive Bearer Bonds, and payment of interest in respect of definitive Bearer Bonds will (subject as provided below) be made as aforesaid only against presentation and surrender (or in the case of part payment of any sum due only, endorsement) of Coupons, in each case at the Specified Office of any Paying Agent outside the United States (which expression, as used herein, means the United States of America including the States and the District of Columbia, its territories, its possessions and other areas subject to its jurisdiction)).
- b) Coupons for Fixed Rate Bonds: Fixed Rate Bonds in definitive bearer form (other than, Inflation-Linked Bonds) should be presented for payment together with all unmatured Coupons appertaining thereto (which expression shall for this purpose include Coupons falling to be issued on exchange of matured Talons), failing which the amount of any missing unmatured Coupon (or, in the case of payment not being made in full, the same proportion of the amount of such missing unmatured Coupon as the sum so paid bears to the sum due) will be deducted from the sum due for payment. Each amount of principal so deducted will be paid in the manner mentioned above against surrender of the relative missing Coupon at any time before the expiry of ten years after the Relevant Date (as defined in Condition 8 (Taxation)) in respect of such principal (whether or not such Coupon would otherwise have become void under Condition 9 (Prescription)).

Up on any Fixed Rate Bond in definitive bearer form becoming due and repayable prior to its Maturity Date, all unmatured Talons (if any) appertaining thereto will become void and no further Coupons will be issued in respect thereof.

- (i) Coupons for Floating Rate, Inflation-Linked Bonds: Upon the date on which any Floating Rate Bond or Inflation-Linked Bond in definitive bearer form becomes due and repayable, unmatured Coupons and Talons (if any) relating thereto (whether or not attached) shall become void and no payment or, as the case may be, exchange for further Coupons shall be made in respect thereof.
- (ii) Payments other than in respect of Matured Coupons: If the due date for redemption of any definitive Bearer Bond is not an Interest Payment Date, interest (if any) accrued in respect of such definitive Bearer Bond from (and including) the preceding Interest Payment Date of Interest Commencement Date, as the case may be, shall be payable only against surrender of the relevant definitive Bearer Bond.
- (iii) VS System Bonds: Payments of principal and interest in respect of VS System Bonds will be made to the Bondholders shown in the relevant records of the ISD, VP LUX or Clearstream/Euroclear (as the case may be) in accordance with and subject to the rules and regulations from time to time governing the ISD, VP LUX or Euroclear/Clearstream (as the case may be).

### *6.4 Payment Day*

If the date for payment of any amount in respect of any Bond, Receipt or Coupon is not a Payment Day, the holder thereof shall not be entitled to payment of the relevant amount due until the next following Payment

Day and shall not be entitled to any interest or other sum in respect of any such delay. For these purposes, Payment Day means any day which (subject to Condition 9) is:

- a) a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in:
  - the relevant place of presentation;
  - Reykjavík; and
  - any Additional Financial Centre specified in the applicable Final Terms.
- (i) either (i) in relation to any sum payable in a Specified Currency other than euro, a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in the principal financial centre of the country of the relevant Specified Currency (if other than the place of presentation, Reykjavík and any Additional Financial Centre) or (ii) in relation to any sum payable in euro, a day on which the TARGET System is open.
- (ii) Interpretation of principal  
Any reference in these Terms and Conditions to principal in respect of the Bonds shall be deemed to include, as applicable:
  - the Final Redemption Amount of the Bonds;
  - the Early Redemption Amount of the Bonds;
  - the Optional Redemption Amount(s) (if any) of the Bonds;

in relation to Bonds (other than Inflation Linked Annuity Bonds or Inflation Linked Equal Principal Payment Bonds) redeemable in instalments, the Instalment Amounts;

in relation to Zero Coupon Bonds, the Amortised Face Amount (as defined in Condition 7.6); and

any premium and any other amounts (other than interest) which may be payable under or in respect of the Bonds.

## **7 REDEMPTION AND PURCHASE**

### *7.1 Redemption of Inflation Linked Annuity Bonds and Inflation Linked Equal Payment Bonds*

Unless previously redeemed or purchased and cancelled, each Inflation Linked Annuity Bond and each Inflation Linked Equal Payment Bond will, subject to Condition 6.1(a) or (b) (as applicable), be redeemed in one or more amounts, calculated in accordance with the formula specified in the applicable Final Terms, in the relevant Specified Currency on the relevant Interest Payment Dates.

### *7.2 Final Redemption*

Unless previously redeemed or purchased and cancelled, each Bond will be redeemed by the Issuer at its Final Redemption Amount specified in, or determined in the manner specified in, the applicable Final Terms in the relevant Specified Currency on the Final Maturity Date.

### *7.3 Redemption at the option of the Issuer (Issuer Call)*

If an Issuer Call is specified in the applicable Final Terms, the Issuer may, having given not less than 15 nor more than 30 days' notice to the Bondholders in accordance with Condition 11 (which notices shall be irrevocable and shall specify the date fixed for redemption), redeem all or some only of the Bonds then outstanding on any

Optional Redemption Date and at the Optional Redemption Amount(s) specified in, or determined in the manner specified in, the applicable Final Terms together, if appropriate, with interest accrued to (but excluding) the relevant Optional Redemption Date. Any such redemption must be of a nominal amount not less than the Minimum Redemption Amount and not more than the Maximum Redemption Amount, in each case as may be specified in the applicable Final Terms. In the case of a partial redemption of Bonds, the Bonds to be redeemed (**Redeemed Bonds**) will be selected individually without involving any part only of a Bearer Bond, in the case of Redeemed Bonds represented by definitive Bonds, and in accordance with the rules of Euroclear and/or Clearstream, (to be reflected in the records of Euroclear and Clearstream as either a pool factor or a reduction in nominal amount, at their discretion) and in accordance with the rules of the ISD or any other relevant clearing system (as the case may be) in the case of VS System Bonds in each case not more than 30 days prior to the date fixed for redemption (such date of selection being hereinafter called the **Selection Date**). In the Case of Redeemed Bonds represented by definite Bonds, a list of the serial numbers of such Redeemed Bonds will be published in accordance with Condition 11 not less than 15 days prior to the date fixed for redemption. The aggregate nominal amount of Redeemed Bonds represented by definitive Bonds shall bear the same portion to the aggregate nominal amount of all Redeemed Bonds as the aggregate nominal amount of definite Bond outstanding bears to the aggregate nominal amount of the Bonds outstanding, in each case on the Selection Date. No exchange of the relevant Bond will be permitted during the period from (and including) the Selection Date to (and including) the date fixed for redemption pursuant to this Condition 7.3 and notice to that effect shall be given by the Issuer to the Bondholders in accordance with Condition 11 at least five days prior to the Selection Date.

#### *7.4 Redemption due to illegality or invalidity*

If the Bonds become illegal and/or invalid, the Bonds of all Series may be redeemed at the option of the Issuer in whole, but not in part, at any time, on giving not less than 30 or more than 60 days' notice to all Bondholders (which notice shall be irrevocable).

Bonds redeemed pursuant to this Condition 7.4 will be redeemed at their Early Redemption Amount referred to in Condition 7.6 together (if appropriate) with interest accrued (and, if this is an Inflation Linked Annuity Bond or an Inflation Linked Equal Principal Payment Bond, adjusted for indexation in accordance with the provisions set out in the applicable Final Terms) to (but excluding) the date of redemption.

#### *7.5 Certification*

The publication of any notice of redemption pursuant to Condition 7.3 or 7.4 shall include a certificate signed by two Directors of the Issuer stating that the Issuer is entitled or required to effect such redemption and setting forth a statement of facts showing that the conditions precedent to the right of the Issuer so to redeem have occurred and the certificate shall be sufficient evidence of the satisfaction of the conditions precedent set out above, in which event it shall be conclusive and binding on all Bondholders, Receiptholders and Couponholders.

#### *7.6 Early Redemption Amounts*

For the purpose of Condition 7.4, each Bond will be redeemed at its Early Redemption Amount calculated as follows:

- a) in the case of a Bond (other than a Zero Coupon Bond but including an Instalment Bond), at the amount specified in, or determined in the manner specified in, the applicable Final Terms or, if no such amount or manner is so specified in the applicable Final Terms, at its Principal Amount Outstanding (and, in the case of an Inflation Linked Annuity Bond or an Inflation Linked Equal Principal Payment Bond, adjusted for indexation in accordance with the provisions set out in the applicable Final Terms); or

- b) in the case of a Zero Coupon Bond, at an amount (the **Amortised Face Amount**) calculated in accordance with the following formula:

$$\text{Early Redemption Amount} = \text{RP} \times (1 + \text{AY})^y$$

where:

**RP** means the Reference Price;

**AY** means the Accrual Yield expressed as a decimal; and

**y** is a fraction the numerator of which is equal to the number of days (calculated on the basis of a 360-day year consisting of 12 months of 30 days each) from (and including) the Issue Date of the first Tranche of the Bonds to (but excluding) the date fixed for redemption or (as the case may be) the date upon which such Bond becomes due and repayable and the denominator of which is 360, or on such other calculation basis as may be specified in the applicable Final Terms.

### *7.7 Instalments*

Instalment Bonds will be redeemed in the Instalment Amounts and on the Instalment Dates. In the case of early redemption, the Early Redemption Amount will be determined pursuant to Condition 7.6.

### *7.8 Purchases*

The Issuer or any of its Subsidiaries may at any time purchase Bonds at any price in the open market or otherwise. If purchases are made by tender, tenders must be available to all Bondholders alike. Subject to the provision below, such Bonds may be held, reissued, resold or, at the option of the Issuer, surrendered to the Issuer for cancellation.

### *7.9 Cancellation*

All Bonds which are redeemed will forthwith be cancelled (together with all unmatured Receipts and Coupons attached thereto or surrendered therewith at the time of redemption). All Bonds so cancelled and any Bonds purchased and surrendered for cancellation pursuant to Condition 7.8 and cancelled (together with all unmatured Receipts and Coupons cancelled therewith) shall be forwarded to the the Issuer and in the case of VS System Bonds shall be deleted from the records of the ISD, VP LUX or any other relevant clearing system (as the case may be) and and cannot be reissued or resold.

### *7.10 Late Payment on Zero Coupon Bonds*

If the amount payable in respect of any Zero Coupon Bond upon redemption of such Zero Coupon Bond pursuant to Conditions 7.2, 7.3 or 7.4 above, the amount due and repayable in respect of such Zero Coupon Bond shall be the amount calculated as provided in Condition 7.6 (b) above as though the references therein to the date fixed for the redemption or the date upon which such Zero Coupon Bond becomes due and payable were replaced by references to the date which is the earlier of:

- a) the date on which all amounts due in respect of such Zero Coupon Bond have been paid; and
- b) five days after the date on which the full amount of the moneys payable in respect of such Zero Coupon Bonds has been received by the Issuer and notice to that effect has been given to the Bondholders in accordance with Condition 11.

### 7.11 Redemption for Tax Reasons

The Bonds may be redeemed at the option of the Issuer in whole, but not in part, at any time or on any Interest Payment Date, on giving not less than 30 nor more than 60 days' notice to the ISD and, in accordance with Condition 11 (Notices), the Bondholders (which notice shall be irrevocable), if:

- a) on the occasion of the next payment due under the Bonds, the Issuer has or will become obliged to pay additional amounts as provided or referred to in Condition 8 (Taxation) as a result of any change in, or amendment to, the laws or regulations in Iceland or any political subdivision or any authority thereof or any authority or agency therein having power to tax, or any change in the application or official interpretation of such laws or regulation, which change or amendment becomes effective on or after the Issue Date of the first Tranche of the Bonds; and
- b) such obligation cannot be avoided by the Issuer taking reasonable measures available to it.

Bonds redeemed pursuant to this Condition 7.11 will be redeemed at their Early Redemption Amount together (if appropriate) with interest accrued to (but excluding) the date of redemption.

## 8 TAXATION

All payments of principal and interest in respect of the Bonds and Coupons by the Issuer will be made without, or deduction for or on account of, any present or future taxes, duties assessments or governmental charges of whatever nature imposed or levied by or on behalf of Iceland or any political subdivision or any authority or agency thereof or therein having power to tax unless such withholding or deduction is required by law. In such event, the Issuer will pay such additional amount as shall be necessary in order that the net amounts received by the holders of the Bonds and Coupons after such withholding or deduction shall equal the respective amounts of principal and interest which would otherwise have been receivable in respect of the Bonds or Coupons, as the case may be, in the absence of such withholding or deduction, except that no such additional amounts shall be payable with respect to any Bond or Coupon:

- a) in respect of any demand made for payment in Iceland; or
- b) in respect of any demand made for payment by or on behalf of a holder who is liable for such taxes, duties, assessments or governmental charges in respect of such Bond or Coupon by reason of it having some connection with Iceland other than the mere holding of such Bond or Coupon; or
- c) in respect of any demand made for payment more than thirty days after the Relevant Date (as defined below) except to the extent that the holder thereof would have been entitled to an additional amount on making such demand for payment on or before the expiry of such period of thirty days; or
- d) where such withholding or deduction is imposed on a payment to an individual and is required to be made pursuant to European Council Directive 2003/48/EC or any law implementing or complying with, or introduced in order to conform to, such Directive; or
- e) in respect of any demand made for payment by or on behalf of a holder who would be able to avoid such withholding or deduction by making a demand in respect of the Bond or Coupon to another Paying Agent in a Member State of the European Union.

As used herein the "Relevant Date" means the date on which such payment first becomes due.

## 9 PRESCRIPTION

The Bonds, Receipts and Coupons will become void in accordance with Act on the Expiration of Debt and other Obligations No. 150/2007 (*Icelandic: Lög um fyrningu kröfuréttinda nr. 150/2007*) unless presented for

payment within 10 years (in the case of principal) and four years (in the case of interest or any other amount) after the Relevant Date (as defined below).

There shall not be included in any Coupon sheet issued on exchange of a Talon, any Coupon the claim for payment in respect of which would be void pursuant to this Condition or Condition 6.3 or any Talon which would be void pursuant to Condition 6.3.

For the purposes of these Terms and Conditions, **Relevant Date** means the date on which such payment first becomes due, except that, if the full amount of the moneys payable has not been duly received by the Principal Paying Agent on or prior to such due date, it means the date on which, the full amount of such moneys having been so received, notice to that effect is duly given to the Bondholders in accordance with Condition 11.

## 10 EVENTS OF DEFAULT

If any one or more of the following events (each an **Event of Default**) shall occur with respect to any Bond:

- a) if default is made in the payment of any principal or interest due in respect of the Bonds or any of them and the default continues for a period of three days in the case of principal and seven days in the case of interest; or
- b) if the Issuer fails to perform or observe any of its other obligations under these Conditions and (except in any case where the failure is incapable of remedy when no such continuation or notice as is hereinafter mentioned will be required) the failure continues for the period of 30 days next following the service by a Bondholder on the Issuer of notice requiring the same to be remedied; or
- c) if (i) any Financial Indebtedness (as defined below) of the Issuer becomes due and repayable prematurely by reason of an event of default (however described); (ii) the Issuer fails to make any payment in respect of any Financial Indebtedness on the due date for payment; (iii) any security given by the Issuer for any Financial Indebtedness becomes enforceable; or (iv) default is made by the Issuer in making any payment due under any guarantee and/or indemnity given by it in relation to any Financial Indebtedness of any other person, provided that no such event shall constitute an Event of Default unless the Financial Indebtedness or other relative liability either alone or when aggregated with other Financial Indebtedness and/or liabilities relative to all (if any) other events specified in (i) to (iv) above which shall have occurred and be outstanding shall amount to at least U.S.\$5,000,000 (or its equivalent in any other currency); or
- d) if any order is made by any competent court or resolution passed for the winding up or dissolution of the Issuer; or
- e) if the Issuer ceases or threatens to cease to carry on the whole or a substantial part of its business, or the Issuer stops or threatens to stop payment of, or is unable to, or admits inability to, pay, its debts (or any class of its debts) as they fall due, or is deemed unable to pay its debts pursuant to or for the purposes of any applicable law, or is adjudicated or found bankrupt or insolvent; or
- f) if (i) proceedings are initiated against the Issuer under any applicable liquidation, insolvency, composition, reorganisation or other similar laws, or an application is made (or documents filed with a court) for the appointment of an administrative or other receiver, manager, administrator or other similar official, or an administrative or other receiver, manager, administrator or other similar official is appointed, in relation to the Issuer or, as the case may be, in relation to the whole or a substantial part of the undertaking or assets of any of them, or an encumbrancer takes possession of the whole or a substantial part of the undertaking or assets of any of them, or a distress, execution, attachment, sequestration or other process is levied, enforced upon, sued out or put in force against the whole or a substantial part of the undertaking or assets of any of them and (ii) in any case (other than the appointment of an administrator) the same is not discharged or stayed within 14 days; or
- g) if the Issuer initiates or consents to judicial proceedings relating to itself under any applicable liquidation, insolvency, composition, reorganisation or other similar laws or makes a conveyance or assignment for the benefit of, or enters into any composition or other arrangement with, its



- creditors generally (or any class of its creditors) or any meeting is convened to consider a proposal for an arrangement or composition with its creditors generally (or any class of its creditors); or
- h) if any event occurs which, under the laws of any relevant jurisdiction, has or may have an analogous effect to any of the events referred to in paragraphs (d) to (g) above,

then any holder of a Bond may, by written notice to the Issuer, effective upon the date of receipt thereof by the Issuer, declare any Bond held by it to be forthwith due and payable whereupon the same shall become forthwith due and payable at its Early Redemption Amount (as defined in Condition 7.6), together with accrued interest (if any) to the date of repayment, without presentment, demand, protest or other notice of any kind.

For the purposes of these Conditions:

**Financial Indebtedness** means any indebtedness for or in respect of:

- (i) moneys borrowed;
- (ii) any amount raised by acceptance under any acceptance credit facility or any dematerialised equivalent;
- (iii) any amount raised pursuant to any note purchase facility or the issue of any debenture, bond, note or loan stock or other similar instrument (with the exception of any loan stock issued by the Issuer which is cash collateralised);
- (iv) the amount of any liability in respect of any lease or hire purchase contract which would, in accordance with IFRS, be treated as a finance or capital lease;
- (v) receivables sold or discounted (otherwise than on a non-recourse basis);
- (vi) any amount raised under any other transaction (including any forward sale or purchase agreement) having the commercial or economic effect of a borrowing and which, for the avoidance of doubt, includes any transaction that is required to be classified and accounted for as borrowings, for financial reporting purposes in accordance with IFRS;
- (vii) any derivative transaction entered into in connection with protection against or benefit from fluctuation in any rate or price (and, when calculating the value of any derivative transaction, only the marked to market value shall be taken into account);
- (viii) any counter-indemnity obligation in respect of a guarantee, indemnity, bond, standby or documentary letter of credit or any other instrument issued by a bank or financial institution; or
- (ix) the amount of any liability in respect of any guarantee or indemnity for any of the items referred to in paragraphs (i) to (viii) above;

## 11 NOTICES

All notices regarding the Bonds will be valid if published in a manner which complies with the rules and regulations of the relevant act which apply to publicly listed securities, and/or any stock exchange and/or any other relevant authority on which the Bonds are for the time being listed or by which they have been admitted to trading. Any such notice will be deemed to have been given on the date of the first publication. The Issuer can additionally at its own discretion obtain information from the ISD on the Bondholders in order to send notices to each Bondholder directly.

Notices to be given by any Bondholder shall be in writing and given by lodging the same, together with the relevant Bond or Bonds.

## 12 FURTHER ISSUES

The Issuer shall be at liberty from time to time without the consent of the Bondholders, the Receiptholders or the Couponholders to create and issue further Bonds having terms and conditions the same as the Bonds or

the same in all respects save for the amount and date of the first payment of interest thereon and so that the same shall be consolidated and form a single Series with the outstanding Bonds.

### **13 GOVERNING LAW AND JURISDICTION**

The Bonds (except for the ISD System Bonds), the Receipts, the Coupons are governed by, and shall be construed in accordance with, English law except for Condition 3 (Status of Bonds), which will be governed by, and construed in accordance with Icelandic Law.

The Issuer irrevocably agrees that any dispute arising out of the Programme, the Bonds, the Coupons, the Receipts (except for the ISD System Bonds) shall be subject to the exclusive jurisdiction of the Courts of England.

The ISD System Bonds will be governed by, and construed in accordance with Icelandic law.

The Issuer irrevocably agrees that any dispute arising out of the ISD System Bonds shall be subject to the exclusive jurisdiction of the District Court of Reykjavík (Héraðsdómur Reykjavíkur).

Legal action taken under this Condition 13 may be proceeded with in accordance with the Act on Civil Procedure No. 91/1991 (Lög um meðferð einkamála), Chapter 17.

## INFORMATION ABOUT THE ISSUER

### NAME, INCORPORATION AND REGISTRATION

The Issuer's legal and commercial name is Íslandsbanki hf. The Issuer is a public limited company incorporated in Iceland on 14 October 2008. It is registered with the Register of Enterprises (*Fyrirtækjaskrá Ríkisskattstjóra*) in Iceland and bears the registration number 491008-0160. The registered office of the Issuer is at Kirkjusandur 2, 155 Reykjavik, Iceland, and the telephone number is +354 440 4000. The Issuer's homepage is: [www.islandsbanki.is](http://www.islandsbanki.is). Information on the website is not part of this Base Prospectus.

The Issuer's operations are subject to the provisions of the Act on Public Limited Companies No. 2/1995 and the Act on Financial Undertakings No. 161/2002. The Issuer is authorised to provide all financial services stipulated in the latter Act. Its activities are under the supervision of the Financial Supervisory Authority Iceland (FME).

### HISTORY & DEVELOPMENT OF THE ISSUER

The Issuer traces its roots back to 1904 when the original Íslandsbanki hf. was founded as the first privately-owned bank in Iceland. Útvegsbanki Íslands took over Íslandsbanki's operations in 1930 and in the year 1990 Útvegsbanki Íslands, Alþýðubanki Íslands, Iðnaðarbanki Íslands and Verslunarbanki Íslands merged into Íslandsbanki. In 2000, Íslandsbanki hf. merged with The Icelandic Investment Bank (FBA), which, itself was created through the merger of three state-owned credit funds, forming Íslandsbanki-FBA hf. As a result, the bank further solidified its connections with the corporate sector, particularly in the seafood industry. In the years 2000-2007, the bank expanded its business away from Iceland by first lending to seafood enterprises in northern Europe and North America and later through strategic acquisitions in the Nordic countries. In March 2006, the bank was rebranded as Glitnir banki hf. (All the aforementioned banks collectively referred to as "Glitnir").

Following a collapse of the Icelandic banking system in October 2008, by decree of the newly passed Act on the Authority for Treasury Disbursements due to Unusual Financial Market Circumstances etc. No. 125/2008 (usually referred to as the Emergency Act), the Issuer assumed the domestic assets and liabilities of Glitnir while the remainder of Glitnir's assets, which were mostly foreign assets, were left within Glitnir under the supervision of a Resolution Committee ("**Resolution Committee**") which was appointed to maximise the recovery value of those assets for the benefit of its creditors. The Issuer, initially named New Glitnir Banki hf., reverted back to its previous brand name of Íslandsbanki hf., on 20 February 2009.

On 13 September 2009, Glitnir, on behalf of its creditors, and the Icelandic Government reached an agreement on the settlement of assets and liabilities between the Issuer and Glitnir. Under the agreement the Resolution Committee acquired a 95% stake in the Issuer. Glitnir therefore assumed majority control of the Issuer and a new Board of Directors was appointed on 25 January 2010. The 95 per cent. stake was owned by ISB Holding ehf., a holding company wholly owned by GLB Holding ehf., a subsidiary of Glitnir. In January 2016, Glitnir signed an agreement to deliver the 95 per cent. stake to the Icelandic Government as a part of the estate's stability contribution. The change was approved by the Competition Authority on March 11, 2016.

In June 2011 the Issuer announced that it had successfully won a public bid for the entire share capital of Byr hf., a local bank in Iceland. Byr hf. focused mainly on retail banking and was built on the foundation of an older savings bank which became insolvent in April 2010. The shares were acquired from the Byr savings bank winding up committee and the Icelandic government. The acquisition price was ISK 6.6bn. The acquisition agreement was executed on 29 November 2011 and the acquisition was completed in the first quarter of 2012.

In March 2011, the Issuer acquired all shares in the credit card company, Kreditkort hf. and on 27 March 2012 Kreditkort was merged into the Issuer.

### CREDIT RATING

The Issuer has been assigned a credit rating by two rating agencies; S&P and Fitch. S&P rate the issuer as BBB-/A3 with positive outlook. Fitch rate the issuer as BBB-/F3 with stable outlook.

## BUSINESS OVERVIEW

The Issuer is an Icelandic bank headquartered in Iceland. Its primary market is Iceland.

The Issuer is licensed as a commercial bank in Iceland, in accordance with Point 1 of Art. 4(1) of the Act on Financial Undertakings and offers comprehensive services to the retail and corporate sectors. The Issuer is one of Iceland's three main banks and maintains a strong market share across the spectrum of banking services in the country. According to Capacent Gallup market surveys in 2015, the Issuer had approximately 31 per cent. of the market share in consumer banking, 33 per cent. of the market share in small to medium-sized enterprise banking and 33 per cent. of the market share of banking services to Iceland's 300 largest companies. The Issuer seeks to provide the highest quality services to consumers and corporations, with a focus on building value whilst retaining a strong sense of social responsibility.

The Issuer operates 17 branches, the majority of which are based around the Reykjavík metropolitan area but maintains a presence in larger municipalities across the country.

When the Issuer assumed the domestic operations of Glitnir a decision was made to continue to build on Glitnir's industry focus in the fields of seafood and geothermal energy. Glitnir and its predecessors had based its overseas strategy on lending and advising services to these fields.

### The Issuer's business lines are as follows:



Figure 1: Issuer's business lines

## CORPORATE BANKING

The primary activities of the Corporate Banking division (**CB**) include credit services and other related services to medium- to large-sized companies and institutional investors. This entails providing services to current customers, as well as developing business with potential new customers.

Business managers in the business management unit are responsible for maintaining customer relationships. Credit management supported by credit experts support the business managers in servicing the customers as well as monitoring and managing the credit exposure. The Issuer has an asset-based financing unit known as ERGO. This unit provides customers with financing to purchase or lease cars, equipment and heavy machinery. Organisationally the unit was placed with Retail Banking until January 2016, when it was moved under Corporate Banking.

Portfolio management is responsible for all portfolio analysis and monitoring and reporting requirements of CB, including risk assessment, financial reporting and analysis and the provision process.

## WEALTH MANAGEMENT

Wealth Management division (**VÍB**) offers comprehensive solutions in asset management and private banking for private investors and institutional clients. In addition, VÍB provides advisory, investment and pension services for retail investors as well as portfolio management services for affluent private investors.

Mutual funds and discretionary portfolios for institutional clients are managed through an independent subsidiary, Íslandssjódir hf., which manages some of the largest fixed income funds in Iceland.

## RETAIL BANKING

The Retail Banking division serves private customers and small and medium-sized enterprises. Retail Banking operates through 18 branches and offers a full range of retail banking services, including online and telephone

banking, credit cards, commercial banking, mortgages, credit lines, construction loans and guarantees. The Issuer is one of the three leading retail banks in Iceland and has an approximate 31 per cent. market share of the retail banking market according to a Capacent Gallup market survey conducted in December 2013.

Retail Banking is the Issuer's largest generator of profit and revenue stream.

## **MARKETS**

The Markets division is divided into seven units: Corporate Finance, FX Sales, Securities Sales, Interbank Trading, Securities Trading, Research, and Finance & Operations.

Corporate Finance works with medium-sized and large companies, providing advisory services on mergers and acquisitions, listings, and public offerings. The unit is also a licensed certified advisor for the Nasdaq First North market.

FX Sales offers businesses and foreign investors access to currency markets, as well advising on currency and interest rate risk management.

Securities Sales offers professional investors, large pension funds, and mutual funds access to the domestic equity and bond markets.

Interbank Trading is a market maker in FX, money market, and longer interest rate swaps in Icelandic krónur. It also manages the Bank's liquidity in both ISK and foreign currencies. The unit communicates and trades with domestic and foreign banks and quotes prices to the FX and Securities Sales desks.

Securities Trading is a market maker in domestic securities.

Research functions as an independent department carrying out macroeconomic research for the Bank and its clients. It also conducts in-depth market analysis on economic indicators, including inflation and policy rate forecasts, and publishes earnings forecasts and stock valuations on companies listed on the domestic market.

## **SUPPORT DIVISIONS**

### **FINANCE AND TREASURY**

The Finance division includes finance and accounting operations as well as treasury and financial institutions and investor relations. This division also manages and oversees shareholding in the Issuer's subsidiaries.

### **RISK MANAGEMENT AND CREDIT CONTROL**

The Risk Management & Credit Control division is a core division of the Issuer. The role of Risk Management is to oversee, monitor and manage risk in the Issuer's operations. Risk Management reports on risk to internal and external stakeholders and ensures that risk limits are adhered to and in line with the Issuer's risk policy as defined by the Board of Directors. Credit Control is accountable for the execution of the credit process in accordance with credit policies.

### **OPERATIONS & INFORMATION TECHNOLOGY**

The operations and Information Technology division (IT) is responsible for operational services, branch services, back office functions, legal collection, the Issuer's IT platform and systems and software development.

### **LEGAL**

The legal division provides general legal advice, assists in negotiating contracts with customers and manages legal disputes on the Issuer's behalf.

### **HUMAN RESOURCES**

The human resources department is responsible for recruiting, training, and dismissing the Issuer's employees. The division further works closely with management on corporate development and implementation of organisational changes.

### **RELATIONSHIP BANKING**

The Relationship Banking division was established in the spring of 2014 to ensure business focus and co-operation across all business units. The division is responsible for implementation of the Bank's relationship banking strategy that was introduced in 2014. The division consists of the following five departments:

- Sales and Customer Analysis, responsible for Sales management and sales strategy and client data analysing
- Online Banking and Communications, responsible for PR and online and mobile banking
- Marketing and Services, responsible for marketing and events
- Business Relations, responsible for key account management
- Business Development, responsible for strategy and strategy implementation and business development

#### **COMPLIANCE**

The Compliance division has an independent position within the Issuer's organisational structure. The compliance division's function is to assist in managing compliance risk on a consolidated basis. Compliance risk can be defined as the risk of legal or regulatory sanctions, financial loss, or damage to the Issuer's reputation in the event of failure to comply with applicable laws, regulations, and codes of conduct and standards of good practice. The Compliance division, in co-operation with Group Internal Audit, performs a special fit and proper test by gathering information via questionnaires and examinations to management and key employees.

#### **GROUP INTERNAL AUDIT**

Group Internal Audit is responsible for the Issuer's internal auditing in accordance with the Act on Financial Undertakings. The role of Group Internal Audit is to provide the Issuer with independent and objective assurance and consulting services designed to add value and improve the Issuer's operations. Group Internal Audit assists the Issuer in evaluating and improving the effectiveness of its risk management, controls and governance processes. The Chief Audit Executive is appointed by the Board of Directors and reports directly to the Board of Directors.

#### **ORGANISATIONAL STRUCTURE**

Íslandsbanki hf. is wholly owned by the Icelandic government and the shares are administered by the Icelandic State Financial Investments.

The following chart illustrates the Issuer's organisational structure.

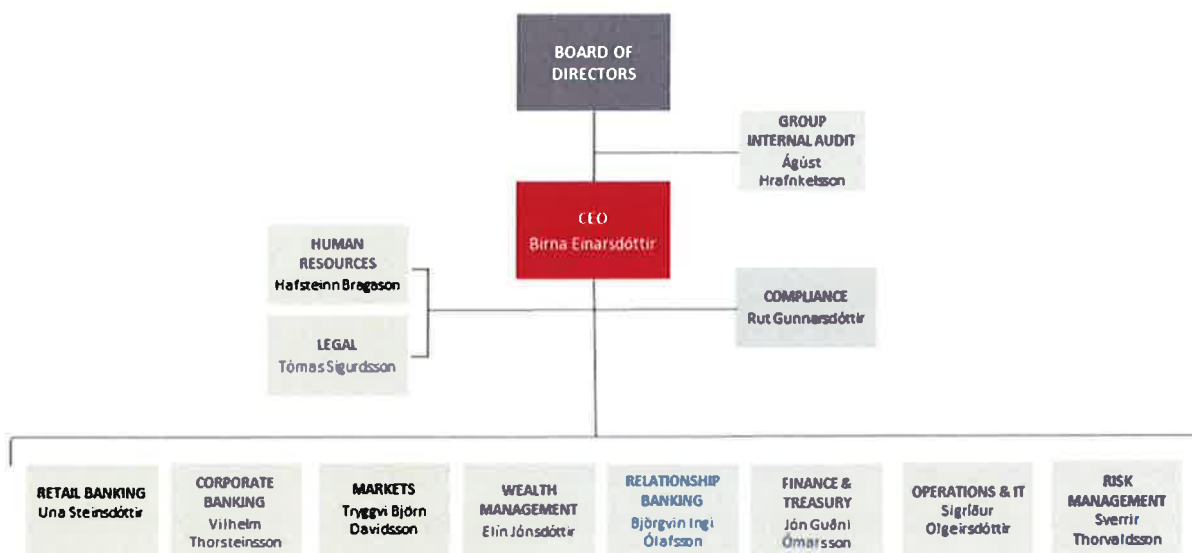


Figure 2: Organisational Structure

The Issuer's investment in significant subsidiaries can be seen in the table below, along with a specification of the nature of business of those subsidiaries (as of 31 December 2015):

Subsidiary	Ownership	Company Description
Borgun hf.	63.5%	Payment processing company
Íslandssjódir hf.	100%	Fund management company
Hringur Eignarhaldsfélag ehf.	100%	Holding company
Allianz Ísland hf.	100%	Sales agent for insurance
D1 ehf	100%	Real estate company
22 other subsidiaries (SME)		

#### Trend Information

No material adverse changes have occurred in the prospects of the Issuer since the date of its last published audited financial statements.

#### Recent Developments

No significant changes have been in the financial position of the Issuer since the last published Financial Statements for the financial year ended 31 December 2015.

#### Legal and arbitration proceedings

Information regarding legal and arbitration proceedings can be found in the chapter on Risk Factors on pages 17-19.





## ADMINISTRATIVE, MANAGEMENT AND SUPERVISORY BODIES

### BOARD OF DIRECTORS

The Issuer's Board of Directors consists of seven members. Two alternate members are also appointed. The Board of Directors appoints the Chief Executive Officer and the Chief Audit Executive. The Chief Executive Officer appoints the Managing Directors of the Issuer.

The business address of each director is Íslandsbanki hf., Kirkjusandur 2, 155 Reykjavík, Iceland. Set forth below are the members of the Issuer's Board of Directors:

Name	Title
Mr. Fridrik Sophusson	Chairman
Mrs. Marianne Økland	Vice Chairman
Mr. Árni Tómasson	Member of the Board
Mr. Neil Graeme Brown	Member of the Board
Ms. Eva Cederbalk	Member of the Board
Ms. Helga Valfells	Member of the Board
Mr. Gunnar Fjalar Helgason	Member of the Board

#### **Mr. Fridrik Sophusson (Chairman)**

Fridrik Sophusson has nearly forty years' wide-ranging experience in fiscal policy making, management and public service in Iceland.

Mr. Sophusson holds a Cand. Jur. degree in Law from the University of Iceland.

#### **Ms. Marianne Økland (Vice Chairman):**

Marianne Økland, a Norwegian national, has spent most of her career in the banking industry dealing with debt financing and has held various positions at JP Morgan and Union Bank of Switzerland (UBS).

Ms. Økland holds a Master of Science degree in Finance, economics and mathematics from the Norwegian School of Economics and Business Administration.

#### **Mr. Árni Tómasson (Member of the Board of Directors):**

Árni Tómasson has extensive experience in accounting and teaching. Mr. Tómasson was appointed chairman of Glitnir's Resolution Committee in October 2008 and led the committee's work until October 2011 when he resigned from the committee.

Mr. Tómasson has a Cand. Oecon. degree in Business Administration from the University of Iceland and is a State Authorised Public Accountant.

#### **Mr. Neil Graeme Brown (Member of the Board of Directors):**

Neil Graeme Brown, a British national, has spent the majority of his professional life dealing with finance and restructuring of international businesses.

Mr. Brown holds a Master of Arts degree in business from Emmanuel College Cambridge and is an associate of the Institute of Chartered Accountants (ACA).

#### **Ms. Eva Cederbalk (Member of the Board of Directors)**

Eva Cederbalk, a Swedish national works as an independent consultant to various company and has extensive experience in the field of banking. Ms. Cederbalk holds a M.Sc. degree in international Economics and Marketing from Stockholm School of Economics.

#### **Ms. Helga Valfells (Member of the Board of Directors):**

Helga Valfells is the Managing Director of the NSA Ventures.

MS. Valfells holds a BA degree in Economics and English literature from Harvard University and an MBA from London Business School.

**Mr. Gunnar Fjalar Helgason**

Gunnar Fjalar Helgason has extensive experience and expertise in the field of international investment banking, particularly in the field of mergers and acquisitions. Mr. Helgason holds a B.Sc. in Economics from the University of Iceland.

The alternate members of the Issuer's Board of Directors are as follows:

<b>Name</b>	<b>Title</b>
Mr. Jón Eiríksson	Alternate Member of the Board of Directors
Ms. Margrét Kristmannsdóttir	Alternate Member of the Board of Directors

**Mr. Jón Eiríksson (Alternate Member of the Board of Directors)**

Jón Eiríksson has extensive experience in accounting. Mr. Eiríksson has been a state authorised public accountant since 1978.

**Ms. Margrét Kristmannsdóttir (Alternate Member of the Board of Directors)**

Ms. Kristmannsdóttir is the managing director of Pfaff hf. and has extensive experience as member of the board of various companies and associations in Iceland. She holds an MBA degree from Stetson University and a Cand Oecon degree from the University of Iceland.

**SENIOR MANAGEMENT**

The Executive Board consists of the following nine members:

**Ms. Birna Einarsdóttir, Chief Executive Officer.**

Birna Einarsdóttir worked at lðnaðarbankinn hf., a predecessor of Glitnir, from 1987. After six years with Royal Bank of Scotland, from 1998, Ms. Einarsdóttir rejoined Glitnir in the fall of 2004 as the Managing Director of Sales and Marketing. She was appointed Executive Vice President of Retail Banking of Glitnir in August 2007. Ms. Einarsdóttir assumed the role of CEO of the Issuer in October of 2008. Ms. Einarsdóttir has worked as head of marketing for the Icelandic Broadcasting Company Ltd. (Channel 2) and Managing Director for the Icelandic Football Pools (Íslensk getspá).

Ms. Einarsdóttir holds a B.Sc. in Business Administration from the University of Iceland and an MBA from the University of Edinburgh.

**Mr. Jón Guðni Ómarsson, Chief Financial Officer**

Jón Guðni Ómarsson worked in Capital Markets division at Glitnir from 2000-2002. He rejoined Glitnir in 2005 and has held various positions in the Leverage Finance and Treasury divisions, working on different types of investment and funding transaction. In October 2008 he was appointed Executive Director of Treasury and in October 2011 he was appointed Chief Financial Officer of the Issuer.

Mr. Ómarsson holds a B.Sc. degree in Industrial and Mechanical Engineering from the University of Iceland and an M.Sc. degree in Quantitative and Computational Finance (QCF) from the Georgia Institute of Technology. He is a Chartered Financial Analyst (CFA) and a securities broker licensed by the Icelandic Ministry of Finance and Economic Affairs.

**Mr. Sverrir Örn Thorvaldsson, Chief Risk Officer**

Sverrir Örn Thorvaldsson joined Glitnir in 2006 as Executive Director of Risk Management. Prior to joining the Issuer he worked in research and software development for deCODE Genetics Ltd. where he served as Executive Director of Data Management and Data Processing.

Mr Thorvaldsson holds a B.Sc. degree in Mathematics from the University of Iceland and an M.Sc. degree in Financial Mathematics from Stanford University. He is a securities broker licensed by the Icelandic Ministry of Finance and Economic Affairs and a Financial Risk Manager (FRM) certified by the Global Association of Risk Professionals (GARP). He is currently a member of GARP's FRM committee.

**Ms. Elín Jónsdóttir, Managing Director VÍB (Wealth Management)**

Elín Jónsdóttir was appointed Managing Director of VÍB in July 2014. Prior to joining the issuer she served as the Chairman of the Board of Tryggingamiðstöðin, insurance company, Director General of the Icelandic State Financial Investments, Managing Director of Arev securities and a lawyer at the Icelandic Financial Supervisory Authority.

Ms. Jónsdóttir holds a Cand.Jur. degree from the University of Iceland and an LL.M. degree from Duke University and is a securities broker licensed by the Icelandic Ministry of Finance and Economic Affairs.

**Ms. Sigríður Olgeirsdóttir, Chief Operating Officer**

Sigríður Olgeirsdóttir was appointed Chief Operating Officer of the Issuer in September 2010. Ms Olgeirsdóttir has worked in the information and technology industry since 1984 and prior to joining the Issuer she was Executive Director of the Information and Technology division of Tæknival hf., Managing Director of Ax Business Intelligence A/S in Denmark and Managing Director of Ax Business Intelligence in Iceland.

Ms. Olgeirsdóttir is a systems analyst educated at EDB Skolen in Odense, Denmark, holds a degree in Business Operations from the Institute of Continuing Education at the University of Iceland and an MBA in International Business Management from Reykjavík University.

**Ms. Una Steinsdóttir, Managing Director Retail Banking.**

Una Steinsdóttir joined Glitnir in 1991 as a specialist in International Banking. Ms. Steinsdóttir has over 20 years of experience in working for the Issuer and its predecessors and has amongst other things worked in credit control and service management. Ms. Steinsdóttir was a branch manager in Keflavik for eight years, from 1999-2007 until she was appointed director of Retail Banking in 2007. She was then appointed Managing Director of Retail Banking for the Issuer in October 2008.

Ms. Steinsdóttir holds a Cand. Oecon degree in business administration from the University of Iceland and has completed an AMP management programme from IESE, Barcelona.

**Mr. Vilhelm Már Thorsteinsson, Managing Director Corporate Banking.**

Vilhelm Már Thorsteinsson joined Glitnir in 1999. He has held various positions in Capital Markets and Leverage Finance divisions and within the CEO's office working on different types of transactions and strategic projects in Iceland and internationally. In May 2008 he was appointed Executive Vice President of Treasury and Corporate Centre and in October 2008 he was appointed Managing Director of Corporate Banking of the Issuer.

Mr. Thorsteinsson holds a B.Sc. degree in Business Administration from Reykjavík University, an MBA from Pace University New York and is a securities broker licensed by the Icelandic Ministry of Finance and Economic Affairs.

**Mr. Tryggvi Björn Davíðsson, Managing Director Markets.**

Tryggvi Björn Davíðsson was appointed Managing Director of Markets in September 2011. Mr. Davíðsson has a broad experience of international financial markets. For seven years prior to joining the Issuer Mr. Davíðsson had been a Director of Distressed Debt at Barclays Capital in London where he built up some of Barclay's core credit trading relationships and covered key participants in the European distressed market. Before his time at Barclays, Mr. Davíðsson was an analyst in asset trading at Íslandsbanki-FBA. Additionally he was a commercial

Attaché for the Icelandic Ministry of Foreign Affairs in Paris as well as a Research Associate with the Central Bank of Iceland.

Ms. Davíðsson holds a B.Sc. degree in Economics from the University of Iceland, an MBA degree from INSEAD in France and Singapore, and an M.Sc. Degree in Finance and Econometrics from Université de Toulouse.

**Mr. Björgvin Ingi Ólafsson, Managing Director Relationship Banking.**

Björgvin Ingi Ólafsson was appointed Managing Director of Relationship banking in September 2014. For two years prior to joining the issuer, Mr. Ólafsson worked for McKinsey & Company. Prior to that he held various positions in the financial sector in Iceland, including Íslandsbanki from the year 2000 to 2005.

Mr. Ólafsson holds a B.Sc. degree in Economics from University of Iceland, an MBA degree from Kellogg School of Management and is a securities broker licensed by the Icelandic Ministry of Finance and Economic Affairs.

**POTENTIAL CONFLICT OF INTEREST**

There are no potential conflicts of interest with any of the members of the management or supervisory bodies of the Issuer.

**MAJOR SHAREHOLDERS**

Íslandsbanki is wholly owned by the Icelandic government and the shares are administered by the Icelandic State Financial Investments.

**VOTING RIGHTS**

Each Share carries one vote. Accordingly, all shareholders have voting rights in proportion to their percentage of share ownership.

**CHANGE IN CONTROL OF THE ISSUER**

In January 2016, Glitnir signed an agreement to deliver their 95 per cent. stake to the Icelandic Government as a part of the estate's stability contribution. The Competition Authority confirmed their approval on March 11. The Icelandic Government has stated that they do not intend to be a long-term owner of the Issuer's shares.

**DIRECT OR INDIRECT OWNERSHIP OR CONTROL BY INDIVIDUAL SHAREHOLDERS**

The Issuer is not directly or indirectly owned or controlled by parties other than the shareholders listed above.

## FINANCIAL INFORMATION

### IFRS

The Financial Statements of the Issuer for the years 2013 - 2015 were prepared on a going concern basis in accordance with the International Financial Reporting Standards (IFRS) as adopted by the European Union.

### AUDITORS

Consolidated Financial Statements for 2013 and 2014 were audited by Deloitte hf., Smáratorgi 3, 201 Kópavogi.

Pálína Árnadóttir and Gunnar Þorvarðarson were the Issuer's auditors on behalf of Deloitte. Both are members in The Institute of State Authorized Public Accountants in Iceland (FLE).

Consolidated Financial Statements for 2015 were audited by Ernst & Young ehf. Margrét Pétursdóttir was the Issuer's auditor on behalf of Ernst & Young. She is a member in the Institute of State Authorized Public Accountants in Iceland (FLE).

### AGE OF LATEST FINANCIAL STATEMENT

The latest audited Consolidated Financial Statements were published on 22 February 2016 and are for the year ended 31 December 2015.

To the Issuer's best knowledge, no significant changes have occurred in the financial position of the Issuer since the end of the last financial period.

### EXPLANATORY NOTES

Detailed information regarding the Consolidated Statement of Comprehensive Income, Consolidated Statement of Changes in Equity, and Consolidated Statement of Cash Flow are accessible in the explanatory notes in the relevant financial statements incorporated into this Base Prospectus, by reference<sup>3</sup>.

### SELECTED FINANCIAL INFORMATION

Following is a summary of the Issuer's Consolidated Financial Statements. This information should be read together with each Consolidated Financial Statement due to changes in methodology between years. The Consolidated Financial Statements 2013 - 2015 can be found on the Issuer's website: <http://www.islandsbanki.is/english/investor-relations/financials/>.

Profit from the Issuer's operations for the year 2015 amounted to ISK 20,578 million, which corresponds to a 10.8 per cent. return on equity. Issuer equity, according to the Consolidated Financial Position, amounted to ISK 202,227 million at 31 December 2015. The Issuer's total official capital ratio, calculated according to the Act on Financial Undertakings, was 30.1 per cent. and the Tier 1 ratio was 28.3 per cent. Current capital ratios are well in excess of both internal and regulatory requirements. Based on the 2015 SREP process, the minimum requirement of the FME is 19.9% while the minimum capital target ratio approved by the Board of Directors is 23% for the near and medium term. The Issuer's total assets amounted to ISK 1,045,769 million at the end of the year 2015.

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<sup>3</sup> Notes 5 to 83 in the Consolidated Financial Statements 2015, notes 5 to 84 in the Consolidated Financial Statements 2014, notes 5 to 83 in the Consolidated Financial Statement 2013.

## Consolidated Income Statement for the years 2013-2015

ISK million	2015	2014	2013
Interest income .....	53,414	50,816	54,333
Interest expense .....	( 25,404)	( 23,711)	( 25,903)
<b>Net interest income</b>	<b>28,010</b>	<b>27,105</b>	<b>28,430</b>
Fee and commission income .....	20,737	17,984	16,695
Fee and commission expense .....	( 7,567)	( 6,501)	( 6,262)
<b>Net fee and commission income</b>	<b>13,170</b>	<b>11,483</b>	<b>10,433</b>
Net financial income .....	3,881	1,568	4,612
Net foreign exchange gain (loss) .....	( 1,490)	165	( 2,423)
Other net operating income .....	1,102	2,122	1,545
<b>Other net operating income</b>	<b>3,493</b>	<b>3,855</b>	<b>3,734</b>
<b>Total operating income</b>	<b>44,673</b>	<b>42,443</b>	<b>42,597</b>
Administrative expenses .....	( 23,760)	( 22,901)	( 25,551)
Impairment of goodwill .....	-	-	-
Contribution to the Depositors' and Investors' Guarantee Fund ....	( 1,067)	( 1,055)	( 1,016)
Bank tax .....	( 2,878)	( 2,444)	( 2,321)
<b>Total operating expenses</b>	<b>( 27,705)</b>	<b>( 26,400)</b>	<b>( 28,888)</b>
<b>Profit before loan impairment charges and net valuation changes</b>	<b>16,968</b>	<b>16,043</b>	<b>13,709</b>
Loan impairment charges and net valuation changes .....	8,135	8,810	16,299
<b>Profit before tax</b>	<b>25,103</b>	<b>24,853</b>	<b>30,008</b>
Income tax .....	( 5,851)	( 6,239)	( 7,866)
<b>Profit for the year from continuing operations</b>	<b>19,252</b>	<b>18,614</b>	<b>22,142</b>
Profit from discontinued operations, net of income tax .....	1,326	4,136	927
<b>Profit for the year</b>	<b>20,578</b>	<b>22,750</b>	<b>23,069</b>

The group has changed its presentation in the consolidated income statement as follows:

- Interest income has been changed from ISK 51,006 million to ISK 50,816 million and interest expense has been changed from ISK (23,901) million to ISK (23,711) million 2014. Reclassification of the interest owned by HFF (Íbúðalánasjóður).
- The line item Share of profit or loss of associates has been included in the line item other operating income.
- The line item Administrative expenses has been split up into two lines: Salaries and related expenses and other operating expenses.

## Consolidated Statement of Financial Position

ISK million	31.12.2015	31.12.2014	31.12.2013
<b>Assets</b>			
Cash and balances with Central Bank .....	216,760	103,389	111,779
Bonds and debt instruments .....	78,606	87,347	75,186
Shares and equity instruments .....	18,320	10,531	9,208
Derivatives .....	1,981	1,810	843
Loans to credit institutions .....	35,534	35,072	44,078
Loans to customers .....	665,711	634,799	554,741
Investments in associates .....	716	570	1,563
Property and equipment .....	7,344	7,402	8,772
Intangible assets .....	1,331	619	299
Other assets .....	6,674	8,140	12,434
Non-current assets and disposal groups held for sale .....	12,792	21,649	47,106
<b>Total Assets</b>	<b>1,045,769</b>	<b>911,328</b>	<b>866,009</b>
<b>Liabilities</b>			
Deposits from Central Bank and credit institutions .....	25,631	25,796	29,689
Deposits from customers .....	593,245	529,447	489,331
Derivative instruments and short positions .....	6,981	3,963	11,176
Debt issued and other borrowed funds .....	150,308	96,889	89,193
Subordinated loans .....	19,517	21,306	21,890
Tax liabilities .....	8,358	8,388	10,826
Other liabilities .....	36,677	37,262	37,130
Non-current liabilities and disposal groups held for sale .....	2,825	2,790	9,456
<b>Total Liabilities</b>	<b>843,542</b>	<b>725,841</b>	<b>698,691</b>
<b>Equity</b>			
Share capital .....	10,000	10,000	10,000
Share premium .....	55,000	55,000	55,000
Other reserves .....	6,002	2,535	2,471
Retained earnings .....	127,288	116,288	98,548
<b>Total equity attributable to the equity holders of Ísla</b>	<b>198,290</b>	<b>183,823</b>	<b>166,019</b>
Non-controlling interests .....	3,937	1,664	1,299
<b>Total Equity</b>	<b>202,227</b>	<b>185,487</b>	<b>167,318</b>
<b>Total Liabilities and Equity</b>	<b>1,045,769</b>	<b>911,328</b>	<b>866,009</b>

The Group has changed its presentation in the consolidated statement of financial position as follows:

- The line item Deferred tax assets has been included in the line item Other assets
- The line items Deposits from Central Bank and Deposits from credit institutions have been combined into one line: Deposits from Central Bank and credit institutions
- The line items Current tax liabilities and Deferred tax liabilities have been combined into one line: Tax liabilities





## **RISK MANAGEMENT**

The Issuer is exposed to various risk factors. Managing these risk factors is an integral part of the Issuer's operations. All amounts are presented in ISK million, unless otherwise stated, and some disclosures are only provided on an annual basis. More detailed information about the Issuer's risk management and risk assessment processes is available in the Risk Report 2013 which can be found on the Issuer's website.

### **Risk Governance**

The Issuer's management body has a dual structure. The Board of Directors has a supervising role in monitoring the execution of set policies, the sound control of accounting and financial management and ensures that group internal audit, compliance and risk management are effective at all times. The Chief Executive Officer, the Chief Risk Officer, other members of the senior management and the senior management committees are responsible for implementing risk management practises and internal monitoring in accordance with Board authorisation.

The Chief Executive Officer (**CEO**) is responsible for the day-to-day operations of the Issuer, pursuant to set policies and resolutions of the Board. Moreover, it is the task of the CEO to ensure that the Issuer's operations are consistent at all times with applicable legislation and the Issuer's Articles of Association which includes maintaining adequate and effective risk management and internal control functions. The CEO appoints the Chief Risk Officer (**CRO**), the Compliance Officer as well as other members of the Executive Board, the Risk Committee, the Asset and Liability Committee (**ALCO**) and the Investment Committee.

The Chief Audit Executive is appointed by the Board and directs Group Internal Audit by Board authorisation. The Chief Audit Executive is responsible for internal audit matters within the Issuer including outsourced projects.

As a financial undertaking licensed to conduct securities trading and an issuer of listed financial instruments, the Issuer operates a compliance department. The Issuer's Compliance Officer is appointed by the CEO, subject to Board confirmation. The Compliance Officer is responsible for regular monitoring and assessment of the suitability and efficacy of the Issuer's measures concerning securities transactions and anti-money laundering in accordance to Icelandic law.

The Chief Risk Officer (**CRO**) heads the Risk Management department and is responsible for defining the daily tasks of the department and to assess the adequacy of its professional skills. In addition, the CRO is responsible for organising risk management within the Issuer in order to ensure that the Issuer has the right resources and an appropriate organisation to manage its risks efficiently. The CRO is a member of the Executive Board. The CRO reports directly to the Board and cannot be removed without its prior approval. Regular reporting from the CRO to the Board includes an overview of compliance to risk limits and risk appetite, review of risk aspects inherent in the Issuer's remuneration system and adequacy of risk based pricing of assets and liabilities.

Risk Management is independent from business lines but provides strategic support aligned with the Issuer's business objectives. The existence of an independent risk management department does not absolve management from its responsibility as a first line of defence to identify and manage all risks arising in their business and function.

The Risk Management division is responsible for maintaining and developing internal directives and processes regarding risk management and internal control. The department organises training for the Issuer's employees on the Issuer's policies, internal directives and processes related to risk management and internal control. In addition, Risk Management provides the managers of business units with information and guidance regarding risk management and internal control issues. The Risk Management division advises on risk and risk assessment. It develops, maintains and tests risk models and provides other forms of support within its expertise.

## **MANAGEMENT COMMITTEES**

The implementation of the risk management policies and internal controls, under authorisation by the Board of Directors, is delegated to the management committees: the Executive Board, the Risk Committee, the ALCO and the Investment Committee. Under this authorisation, these management committees issue guidelines for risk assessment and individual risk thresholds in accordance with the Issuer's defined risk appetite. The members of the management committees are appointed by the CEO, and their mandate and rules of procedure are documented in a charter. The Executive Board is responsible for the Issuer's operational risk framework and governs the Issuer's Operational Risk Policy. In addition, the Executive Board approves concepts for new products and its approval is a prerequisite for product development according to the Issuer's formal product approval process.

The Risk Committee is responsible for supervising and monitoring the Issuer's credit and credit concentration risks. The Risk Committee governs the Issuer's credit risk policy and other credit rules and procedures. The Risk Committee can delegate authorisation power to subcommittees and decides on credit authorisation limits to individuals and employees. The Risk Committee and each of its subcommittees have the authority to decide on credit proposals, credit risk and counterparty credit risk within defined limits. Decisions on exposures that exceed committee limits must be referred to a more senior committee. If credit decisions exceed the limits of the Risk Committee then the Board of Directors can grant increased authorisation limits for that particular case. As described above all credit proposals that are decided upon by the Risk Committee or its subcommittees are initiated, and the respective risk owned, by a business unit.

The Risk Committee is also responsible for final approval of products and services according to a formal product approval process.

ALCO supervises other financial risks, including market risk, liquidity risk and interest rate risk in the Issuer's banking book (non-trading portfolio). The ALCO decides on and sets limits for these risks and governs the Issuer's market risk policy and liquidity risk policy. The ALCO also oversees the Issuer's capital allocation framework, the funding strategy and transfer pricing mechanism. The ALCO also supervises the capital management framework, including the Internal Adequacy Assessment Process (ICAAP) and the Pillar 2 Framework and makes proposals to the Board of Directors regarding issues related to capital management and funding.

The Investment Committee makes decisions pertaining to the purchase or sale of equity stakes in other companies as well as other types of investments, such as investments in investment funds and real estate, other than those originated in the trading book.

## **CREDIT RISK**

Credit risk is defined as current or prospective risk to the Issuer's earnings and capital arising from an obligor's potential failure to meet the terms of any contract with the Issuer or to otherwise fail to perform as agreed.

Credit risk arises principally from the Issuer's loans and advances to customers and other banks but also from balances with the Central Bank of Iceland and off-balance sheet items such as guarantees, loan commitments and derivatives. This risk comprises of default risk, recovery risk, country risk, settlement risk and credit concentration risk. Credit concentration risk is the significantly increased risk that is driven by common underlying factors, e.g. sector, economy, geographical location, type of financial instrument or due to connections or relations among counterparties. This includes large individual exposures to parties under common control and significant exposures to groups of counterparties whose likelihood of default is driven by common underlying factors.

## CREDIT RISK MANAGEMENT

The Issuer has policies and procedures dedicated to accepting, measuring, and managing credit risk. The objective of the Issuer's credit risk management is to achieve an appropriate balance between risk and return and to minimise potential adverse effects of credit risk on the Issuer's financial performance.

A thorough analysis of a borrower's financial standing, past and estimated future cash flows and a borrower's general ability to repay its obligations is the basis for all credit decisions. The Issuer structures the level of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, groups of borrowers, countries and industry segments. The Issuer measures and consolidates its credit risk for each counterparty or group of connected borrowers in accordance with the Issuer's internal and external criteria. The Issuer employs a range of policies and practices to mitigate credit risk. The most traditional of these is the taking of security in a borrower's assets. The principal collateral types for loans are real properties, vehicles, equipment, vessels and securities. When applicable, other credit risk mitigants are employed.

## MAXIMUM CREDIT EXPOSURE

The Issuer's credit risk exposure is comprised of both on-balance sheet and off-balance sheet items. Maximum exposure to credit risk for on-balance sheet assets is the net carrying amount as reported in the statement of financial position before the collective impairment allowance is subtracted. The maximum exposure for off-balance sheet items is the amount that the Issuer might have to pay against financial guarantees and loan commitments less provisions the Issuer has made because of these items. The maximum credit exposure for a derivative contract is calculated by adding future credit exposure to the market value of the contract, as described in Chapter 6 of the Regulation (EU) No. 575/2013 of the European Parliament.

The table below shows the Issuer's credit exposure by industry classification. The breakdown follows an internal industry classification based on the Icelandic ISAT2008 that derives from the European NACE Rev. 2 classification standard.

**Maximum credit exposure**

Maximum exposure 31.12.2015

	Individuals	Central governments	Commerce and services	Construction	Energy	Financial services	Industrials and transportation	Investment companies	Public sector and non-profit organisations	Real estate	Seafood	Total
Cash and balances with CB	-	216,760	-	-	-	-	-	-	-	-	-	216,760
Derivatives	5	-	23	-	1,208	3,073	22	15	-	13	53	4,412
Bonds and debt instruments	-	72,876	1,530	-	-	3,067	306	506	16	304	-	78,605
Loans to credit institutions	-	-	-	-	-	35,534	-	-	-	-	-	35,534
Loans to customers:	272,610	-	89,781	23,013	3,737	105	60,726	19,362	13,878	99,094	85,872	668,178
Overdrafts	11,931	-	9,632	3,924	15	37	6,223	1,047	790	3,408	1,647	38,654
Credit cards	15,847	-	1,448	201	4	27	391	33	127	51	37	18,166
Mortgages	197,307	-	-	-	-	-	-	-	-	-	-	197,307
Leases	10,842	-	20,913	2,037	9	1	6,527	197	121	1,224	247	42,118
Other loans	36,683	-	57,788	16,851	3,709	40	47,585	18,085	12,840	94,411	83,941	371,933
Off-balance sheet items:												
Financial guarantees	1,406	-	3,445	2,592	-	1,868	1,831	52	29	219	363	11,605
Undrawn loan commitments	-	-	1,385	9,339	10,222	-	11,207	757	-	4,226	5,549	42,885
Unused overdrafts	9,636	-	9,007	1,834	209	3,198	3,103	404	2,482	1,595	1,663	33,131
Credit card commitments	25,360	-	3,677	520	36	169	998	162	802	227	162	32,115
Other financial assets	233	12	137	3	1	4,234	14	80	1	738	82	5,535
<b>Total maximum credit exposure</b>	<b>309,250</b>	<b>289,650</b>	<b>108,985</b>	<b>37,301</b>	<b>15,413</b>	<b>51,048</b>	<b>78,207</b>	<b>21,338</b>	<b>17,208</b>	<b>106,416</b>	<b>93,744</b>	<b>1,128,560</b>

Maximum credit exposure at 31 December 2014

	Individuals	Central governments	Commerce and services	Construction	Energy	Financial services	Industrial and transportation	Investment companies	Public sector and non-profit organisations	Real estate	Seafood	Total
Cash and balances with CB	-	103,389	-	-	-	-	-	-	-	-	-	103,389
Bonds and debt instruments	-	79,834	-	-	291	5,785	-	890	251	296	-	87,347
Derivatives	28	-	423	17	805	2,644	28	16	121	49	-	4,131
Loans to credit institutions	-	-	-	-	-	35,072	-	-	-	-	-	35,072
Loans to customers:	262,848	-	79,658	18,751	7,315	121	61,878	13,911	12,216	99,540	81,412	637,650
Overdrafts	12,751	-	10,075	3,432	34	60	4,762	549	1,343	2,164	2,058	37,228
Credit cards	15,583	-	1,334	156	4	23	355	29	132	43	31	17,690
Mortgages	186,583	-	-	-	-	-	-	-	-	-	-	186,583
Capital leases	10,241	-	15,559	2,581	-	1	5,960	213	196	1,249	231	36,231
Other loans	37,690	-	52,690	12,582	7,277	37	50,801	13,120	10,545	96,084	79,092	359,918
Other financial assets	183	-	809	205	1	4,163	12	224	4	866	100	6,567
Off-balance sheet items:												
Financial guarantees	1,444	-	2,318	2,281	-	1,170	1,134	39	39	166	533	9,124
Undrawn loan commitments	-	-	996	8,248	5,816	-	2,639	1,400	7,247	4,234	443	31,023
Undrawn overdrafts	9,216	-	7,459	1,618	23	3,673	2,561	187	1,974	975	1,381	28,947
Credit card commitments	23,183	-	3,455	477	31	167	906	166	818	197	144	29,544
<b>Total maximum credit exposure</b>	<b>296,902</b>	<b>183,223</b>	<b>95,110</b>	<b>31,597</b>	<b>14,282</b>	<b>52,795</b>	<b>69,158</b>	<b>16,833</b>	<b>22,570</b>	<b>106,323</b>	<b>83,993</b>	<b>972,794</b>

\* Note that the table has been changed since the audited consolidated financial statements for 31 December 2014 where the separate lines for "Other financial assets" has been added.

### CREDIT EXPOSURE COVERED BY COLLATERAL

Collateral and other credit mitigants vary between types of obligors and credit facilities. Loans to credit institutions are usually unsecured. For loans to individuals the principal collateral is residential property against mortgages. In the case of corporate entities the Issuer takes a charge over assets such as real estate, fishing vessels, cash and securities as well as other types of collateral including accounts receivables, inventory, vehicles and equipment. Loans to government entities and to municipalities are usually unsecured. Derivative exposures are generally made under ISDA master agreements with a Credit Support Annex or pledged collateral in the form of cash and government bonds.

In some cases the Issuer uses guarantees as a credit enhancement but since guarantees effectively transfer credit risk from one counterparty to another they do not reduce maximum credit exposure. Covenants in loan agreements are also an important credit enhancement but do not reduce maximum credit exposure.

Valuation of collateral is based on market price, official valuation for tax purposes or expert opinion of the Issuer's employees, depending on availability. In the case of fishing vessels the fishing quota is included in the valuation. Collateral is allocated according to claim value of loans, not carrying amount, and is measured without including the effect of overcollateralization. This means that if some loans have collateral values in excess of their claim value, the excess is removed in order to reflect the Issuer's actual maximum exposure to credit risk. The total value of pledged assets can thus be higher than the cover indicates. An estimate of the collateral held by the Issuer against credit exposure is shown below:

<b>At 31.12.2015</b>	Real estate	Vessels	Cash & Securities	Vehicles & equipment	Other collateral	Total collateral
Derivatives .....	-	-	3,181	-	-	3,181
Loans and commitments to customers - total .....	425,053	78,274	6,416	38,604	42,650	590,997
Individuals.....	223,131	33	688	10,329	45	234,226
Commerce and services.....	46,418	422	344	19,902	8,719	75,805
Construction.....	20,856	154	208	1,953	2,360	25,531
Energy.....	2,895	-	414	9	88	3,406
Financial services.....	40	-	24	1	-	65
Industrials and transportation.....	23,776	6,208	411	5,797	10,765	46,957
Investment companies.....	5,056	10	3,460	91	7,524	16,141
Public sector and non-profit organisations.....	1,034	-	9	105	-	1,148
Real estate.....	96,805	-	572	207	562	98,146
Seafood.....	5,042	71,447	286	210	12,587	89,572
<b>Total</b>	<b>425,053</b>	<b>78,274</b>	<b>9,597</b>	<b>38,604</b>	<b>42,650</b>	<b>594,178</b>

<b>At 31.12.2014</b>	Real estate	Vessels	Cash & Securities	Vehicles & equipment	Other collateral	Total collateral
Derivatives .....	-	-	2,500	-	-	2,500
Loans and commitments to customers - total .....	391,139	74,032	5,991	33,473	24,174	528,809
Individuals.....	213,550	41	469	9,901	12	223,973
Commerce and services.....	40,484	290	472	14,525	8,838	64,609
Construction.....	13,217	269	59	2,473	1,592	17,610
Energy.....	1,260	-	411	1	152	1,824
Financial services.....	39	-	32	1	-	72
Industrials and transportation.....	16,487	-	148	5,760	7,914	30,309
Investment companies.....	4,973	-	3,434	248	2,642	11,297
Public sector and non-profit organisations.....	1,510	-	11	179	-	1,700
Real estate.....	94,859	-	650	143	564	96,216
Seafood.....	4,760	73,432	305	242	2,460	81,199
<b>Total</b>	<b>391,139</b>	<b>74,032</b>	<b>8,491</b>	<b>33,473</b>	<b>24,174</b>	<b>531,309</b>

#### CREDIT QUALITY OF ASSETS

Loans are classified as impaired loans if there is objective evidence that an impairment loss has incurred. Their carrying amount is then reduced through the use of an allowance account to the present value of expected future cash flow, discounted at the effective interest rate of the corresponding loans.

The full carrying amount of all loans which give rise to individual impairment is included in impaired loans, even if parts are covered by collateral. The collective impairment has not been subtracted from the carrying amount in the tables below.

	Neither past due nor impaired	Past due but not impaired	Classified as impaired	Total carrying amount
<b>At 31.12.2015</b>				
Cash and balances with Central Bank .....	216,760			216,760
Derivatives .....	4,412			4,412
Bonds and debt instruments .....	78,606			78,606
Loans to credit institutions .....	35,534			35,534
Loans to customers - total .....	636,685	23,572	7,921	668,178
Individuals .....	253,798	15,443	3,369	272,610
Commerce and services .....	87,102	1,517	1,162	89,781
Construction .....	21,655	583	775	23,013
Energy .....	3,737	-	-	3,737
Financial services .....	65	40	-	105
Industrials and transportation .....	59,267	885	574	60,726
Investment companies .....	18,476	580	306	19,362
Public sector and non-profit organisations .....	13,839	39	-	13,878
Real estate .....	96,243	1,562	1,289	99,094
Seafood .....	82,503	2,923	446	85,872
Other financial assets	4,748	787		5,535
<b>Total</b>	<b>976,745</b>	<b>24,359</b>	<b>7,921</b>	<b>1,009,025</b>

	Neither past due nor impaired	Past due but not impaired	Classified as impaired	Total carrying amount
<b>At 31.12.2014</b>				
Cash and balances with Central Bank .....	103,389			103,389
Derivatives .....	4,131			4,131
Bonds and debt instruments .....	87,347			87,347
Loans to credit institutions .....	35,072			35,072
Loans to customers - total .....	595,903	27,619	14,128	637,650
Individuals .....	237,253	18,752	6,843	262,848
Commerce and services .....	75,572	2,253	1,833	79,658
Construction .....	17,319	914	518	18,751
Energy .....	7,315	-	-	7,315
Financial services .....	84	37	-	121
Industrials and transportation .....	60,295	881	702	61,878
Investment companies .....	12,500	766	645	13,911
Public sector and non-profit organisations .....	12,165	51	-	12,216
Real estate .....	96,905	1,969	666	99,540
Seafood .....	76,495	1,996	2,921	81,412
Other financial assets	6,424	143		6,567
<b>Total</b>	<b>832,266</b>	<b>27,762</b>	<b>14,128</b>	<b>874,156</b>

\*Note that the table has been changed since the audited consolidated financial statements for 31 December 2014 where the separate lines for "Other financial assets" has been added.

## LOANS

### NEITHER PAST DUE NOR IMPAIRED LOANS

The Issuer uses internal rating models to assess the default probability of corporate and retail customers. The models assign one of ten risk classes to each customer. One risk class is for customers in default (risk class 10), and the other nine risk classes are for performing customers (risk classes 1-9). Risk classes are assigned based on customer level and not facility level

The rating of corporate customers is based on a company's most recent financial statement, together with a qualitative assessment of its management, market position and industry sector. For retail customers, the Issuer uses two different statistical rating models. One model is for individuals and another is for small companies with a total exposure to the Issuer of less than ISK 150 million. These models are behavioural scoring models and are based on a customer's payment history, the amount of debt and deposits, and demographic variables to assess the probability that a customer will default on any of his obligations within 12 months of the rating assessment.

The table below shows loans that are neither past due nor impaired aggregated in five customer groups based on probability of default. Groups 1 to 4 represent low risk, groups 5 to 6 represent moderate risk, groups 7 to 8 represent increased risk, group 9 represents high risk, and risk group 10 represents customers in default. "Unrated" are loans originating from subsidiaries of the Issuer that do not have rating models, in addition to loans that are yet to be rated or with an expired rating. A customer can have loans that are more than 90 days past due or impaired and at the same time have other loans that are neither past due nor impaired. Such customers are in risk class 10 and their loans that are neither past due nor impaired are included in the table below.

At 31 December 2015	Risk class	Risk class	Risk class	Risk class	Risk class	Unrated	Total
	1-4	5-6	7-8	9	10		
Individuals .....	11,793	99,967	91,329	44,290	2,418	4,001	253,798
Commerce and services .....	13,264	53,916	15,418	3,357	294	853	87,102
Construction .....	657	10,676	7,659	2,130	506	27	21,655
Energy .....	353	3,243	141	-	-	-	3,737
Financial services .....	36	9	20	-	-	-	65
Industrials and transportation .....	14,329	30,049	12,207	2,507	87	88	59,267
Investment companies .....	4,735	7,029	5,235	1,328	149	-	18,476
Public sector and non-profit organisations .....	5,605	8,048	175	3	7	1	13,839
Real estate .....	29,490	42,952	21,177	2,403	50	171	96,243
Seafood .....	36,848	33,065	11,372	327	892	-	82,504
<b>Total</b>	<b>117,110</b>	<b>288,954</b>	<b>164,733</b>	<b>56,345</b>	<b>4,403</b>	<b>5,141</b>	<b>636,686</b>



	Risk class 1-4	Risk class 5-6	Risk class 7-8	Risk class 9	Risk class 10	Unrated	Total
<b>At 31 December 2014</b>							
Loans to customers:							
Individuals .....	10,432	91,744	84,838	43,101	3,659	3,479	237,253
Commerce and services .....	15,240	35,903	18,182	3,891	1,873	483	75,572
Construction .....	381	6,698	7,032	846	2,321	41	17,319
Energy .....	3,877	3,396	42	-	-	-	7,315
Financial services .....	50	13	19	1	-	1	84
Industrial and transportation .....	21,850	30,334	6,822	1,128	161	-	60,295
Investment companies .....	1,143	7,013	2,604	1,450	25	265	12,500
Public sector and non-profit organisations .....	7,094	4,815	248	6	-	2	12,165
Real estate .....	31,145	46,626	14,369	2,686	2,012	67	96,905
Seafood .....	39,777	28,171	6,176	746	1,625	-	76,495
<b>Total</b>	<b>130,989</b>	<b>254,713</b>	<b>140,332</b>	<b>53,855</b>	<b>11,676</b>	<b>4,338</b>	<b>595,903</b>

#### PAST DUE BUT NOT IMPAIRED LOANS

Past due but not impaired loans are loans where contractual interest or principal payments have passed due date by more than 3 days without the obligor making full payment, but where specific impairment is not appropriate. The reason is usually that contractual payments are expected to be eventually fulfilled or these loans are expected to be restructured without any loss to the Issuer. The loss is then usually avoided because there is sufficient collateral. Payments three days or less in arrears are not considered to have informational value regarding credit quality. The majority of these loans are loans to individuals where the authorised overdraft limit has expired and will be renewed again. On 31.12.2015 loans with payments three days in arrears or less amounted to ISK 39 million but on 31.12.2014 the corresponding figure was ISK 160 million. Amounts reported as loans past due refer to the total loan exposure and not only the payment or sum of payments that are past due. Past due but not impaired loans are as follows:

	Loans past due 4-30 days	Loans past due 31-60 days	Loans past due 61-90 days	Loans past due more than 90 days	Total past due loans
<b>At 31.12.2015</b>					
Loans to customers - total .....	10,351	4,975	1,292	6,954	23,572
Individuals .....	7,322	3,156	432	4,533	15,443
Commerce and services .....	544	460	300	213	1,517
Construction .....	413	114	8	48	583
Energy .....	-	-	-	-	0
Financial services .....	-	-	-	40	40
Industrials and transportation .....	499	106	13	267	885
Investment companies .....	289	72	72	147	580
Public sector and non-profit organisations .....	27	10	-	2	39
Real estate .....	614	577	42	329	1,562
Seafood .....	643	480	425	1,375	2,923
Other financial assets .....	765			22	787
<b>Total</b>	<b>11,116</b>	<b>4,975</b>	<b>1,292</b>	<b>6,976</b>	<b>24,359</b>

	Loans past due 4-30 days	Loans past due 31-60 days	Loans past due 61-90 days	Loans past due more than 90 days	Total past due loans
<b>At 31.12.2014</b>					
Loans to customers - total .....	12,631	5,379	1,386	8,223	27,619
Individuals .....	8,331	3,458	680	6,283	18,752
Commerce and services .....	1,144	516	256	337	2,253
Construction .....	429	116	76	293	914
Energy .....	-	-	-	-	0
Financial services .....	37	-	-	-	37
Industrials and transportation .....	390	156	104	231	881
Investment companies .....	145	363	47	211	766
Public sector and non-profit organisations .....	38	6	7	-	51
Real estate .....	914	602	179	274	1,969
Seafood .....	1,203	162	37	594	1,996
Other financial assets .....	111	4	5	23	143
<b>Total</b>	<b>12,742</b>	<b>5,383</b>	<b>1,391</b>	<b>8,246</b>	<b>27,762</b>

\*Note that the table has been changed since the audited consolidated financial statements for 31 December 2014 where the separate lines for "Other financial assets" has been added.

#### RESTRUCTURING AND FORBEARANCE

When restructuring measures are believed to be more appropriate than collection procedures then the Issuer can offer several debt relief measures and restructuring frameworks for its customers in financial difficulties. These forbearance measures include temporary payment holidays, extension of loan terms, capitalisation of

arrears and waiving of covenants. In many cases these measures are precursors to the more formal restructuring process

#### **LARGE EXPOSURE DISCLOSURE**

When the Issuer's total exposure to a group of connected clients is 10 per cent. or higher of the Issuer's capital base it is considered a large exposure.

Both on-balance sheet and off-balance sheet items from all types of financial instruments are included in the exposure as defined by FME rules 625/2013. The Issuer has internal criteria that define connections between clients. These criteria reflect the Issuer's interpretation of Article (1)(a) of law 161/2002 on Financial Undertakings, where groups of connected clients are defined. In line with the law, the capital base from year-end 2015 is used.

The exposure is evaluated both before and after credit risk mitigating effects eligible according to the Financial Supervisory Authority rules. After mitigating effects, the Group has currently one large exposure which is 12% of its capital base. No large exposure is above the maximum 25% single large exposure limit set by the law. The following tables show the Issuer's large exposures as a percentage of the Issuer's capital base, before and after eligible credit risk mitigating effects. Note that group references might change between reporting periods, i.e. Group 1 might not be the same group in the two tables.

	31/12/2015	
Client groups	Gross	Net
Group 1 .....	117%	0%
Group 2 .....	12%	12%

	31/12/2014	
Client groups	Gross	Net
Group 1 .....	69%	0%
Group 2 .....	12%	12%

#### **LIQUIDITY RISK**

The Issuer defines liquidity risk as the risk of not being able to fund its financial obligations or planned growth, or only being able to do so substantially above the prevailing market cost of funds.

#### **LIQUIDITY RISK MANAGEMENT**

The Issuer's main source of funding is customer deposits. The Issuer's Treasury is responsible for managing the Issuer's funding and liquidity management within the limits approved by the Board of Directors and the ALCO. The Issuer's Interbank desk manages the Issuer's intraday liquidity.

The Risk Management Division is responsible for measuring, monitoring and reporting on the Issuer's liquidity position. The Issuer's liquidity risk policy assumes that the Issuer has at all times sufficient liquidity to meet all maturing liabilities and other obligations, at least over the next twelve months.

Key measures for the assessment of liquidity risk are the Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) introduced by the Basel Committee on Banking Supervision in 2010 and incorporated into European law through the CRD IV.

In preparation for the lifting of capital controls in Iceland, the implementation of the LCR and the NSFR has been ahead of that in Europe and special focus has been on setting limits regarding LCR and NSFR in foreign currencies. The Central Bank of Iceland, which is the main supervisory authority regarding liquidity risk, has incorporated the LCR and the NSFR based on the CRD IV standards into the Rules on liquidity ratio and the Rules on funding ratio in foreign currencies.

At year-end 2015, the minimum LCR requirements were 80% for the overall ratio and 100% for foreign currency denominated assets and liabilities. At the same time the minimum NSFR requirement for foreign currency denominated assets and liabilities was 80%. The table below shows the LCR and NSFR for the group at year-end 2014 and 2015. The regulatory requirements for the NSFR were not introduced until 1 December 2014.

<b>Liquidity coverage ratio</b>	31.12.2015	31.12.2014
Total .....	143%	130%
Foreign currencies .....	467%	617%

<b>Net stable funding ratio</b>	31.12.2015	31.12.2014
Total .....	120%	112%
Foreign currencies .....	141%	126%

2014 numbers are unaudited

The tables below show the contractual payments of principal and interest for the Issuer's financial liabilities as of 31 December 2015. Thus, the total figures for each liability class in the table below are higher than the respective balance sheet amount. Cash flows for payments of an unknown nature, such as for floating rate, CPI linked (as defined below) or foreign currency denominated payments, are based on internal yield curves and forecasts.

For dated financial liabilities the amounts are grouped into maturity buckets according to contractual maturities of principal and estimated contractual payments of interest. For demand deposits or other non-dated liabilities, the figures are grouped according to the first possible required payment date.

The tables showing the cash flow of assets include principal payments whereas the tables showing cash flow of financial liabilities include both principal and interest payments.

<b>Maturity analysis 31 December 2015</b>								
<b>Financial liabilities</b>	Carrying amount	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Short positions .....	4,073	4,073	-	-	-	-	-	4,073
Deposits from Central Bank and credit institutions .....	25,631	18,905	6,862	-	-	-	-	25,767
Deposits from customers .....	593,245	358,266	128,895	37,110	63,649	20,978	-	608,898
Debt issued and other borrowed funds .....	150,308	2	5,098	32,107	105,982	29,524	-	172,713
Subordinated loans .....	19,517	-	-	736	23,542	-	-	24,278
Other financial liabilities .....	45,034	31,571	4,910	7,620	933	-	-	45,034
<b>Total financial liabilities</b>	<b>837,808</b>	<b>412,817</b>	<b>145,765</b>	<b>77,573</b>	<b>194,106</b>	<b>50,502</b>	<b>-</b>	<b>880,763</b>

\* Note that the table has been changed since the audited consolidated financial statements for 31 December 2014 where the separate lines for "Deposits from Central Bank" and "Deposits from credit institutions" have been put together in the line "Deposits from CB and credit institutions".

Off-balance sheet liabilities show the amount of contractual obligations that the Issuer has with customers, either by committing to lend money in the future or as third party guarantees. The amounts shown reflect the maximum amount of the obligation and do not take into account the Issuer's ability to reduce overdraft or credit card limits before the current undrawn amount is fully utilised by the customer. These obligations all fall into the first time bucket since contractually, on a case by case basis, the Issuer could be required to fulfil these obligations instantaneously.

The table below shows the Issuer's off-balance sheet liabilities as of 31 December 2015:

<b>Off-balance sheet liabilities</b>	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Financial guarantees .....	11,605	-	-	-	-	-	11,605
Undrawn loan commitments .....	42,685	-	-	-	-	-	42,685
Undrawn overdrafts .....	33,131	-	-	-	-	-	33,131
Credit card commitments .....	32,115	-	-	-	-	-	32,115
<b>Total</b>	<b>119,536</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>119,536</b>

The table below shows the contractual cash flow of the Issuer's derivative liabilities, i.e. derivatives that have a negative carrying amount at the date of reporting. Derivatives with a positive carrying amount are detailed separately. For derivatives settled on a gross basis, both gross and net cash flow are shown, since netting cannot be applied upon settlement.

The table below shows the Issuer's derivative financial liabilities as of 31 December 2015:

<b>Derivative financial liabilities</b>	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
<b>Gross settled derivatives</b>							
Inflow .....	-	19,749	18,135	55,090	3,284	-	96,258
Outflow .....	-	(19,994)	(18,675)	(55,481)	(3,815)	-	(97,965)
<b>Total</b>	<b>-</b>	<b>(245)</b>	<b>(540)</b>	<b>(391)</b>	<b>(531)</b>	<b>-</b>	<b>(1,707)</b>
<b>Net settled derivatives</b>							
<b>Total</b>	<b>-</b>	<b>(601)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(601)</b>
<b>Total</b>	<b>-</b>	<b>(846)</b>	<b>(540)</b>	<b>(391)</b>	<b>(531)</b>	<b>-</b>	<b>(2,308)</b>

Maturity classification of assets is based on contractual maturity. For loans that were acquired at a deep discount and have not yet been restructured, the contractual amount is scaled to reflect the carrying amount of the claim. For bonds and debt instruments in the banking book, the maturity classification is based on contractual maturity dates, while for bonds and debt instruments held for trading the maturity classification is based on the estimated liquidation time of the asset.

The table below shows the Issuer's financial assets and derivative financial assets as of 31 December 2015. The total amount of loans to customers is shown before collective impairment allowance and is therefore higher than the total amount shown in the Interim Financial Statements incorporated herein:

	Carrying amount	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
<b>Financial assets</b>								
Cash and balances with Central Bank	216,760	33,221	183,539	-	-	-	-	216,760
Bonds and debt instruments	78,606	1,551	24,160	15,708	33,361	3,826	-	78,606
Shares and equity instruments	18,320	-	-	-	-	-	18,320	18,320
Loans to credit institutions	35,534	31,064	4,470	-	-	-	-	35,534
Loans to customers	665,711	4,723	73,386	52,827	194,904	342,338	-	668,178
Other financial assets	6,675	2,046	926	807	54	6	2,835	6,675
<b>Total financial assets</b>	<b>1,021,606</b>	<b>72,605</b>	<b>286,481</b>	<b>69,342</b>	<b>228,319</b>	<b>346,170</b>	<b>21,155</b>	<b>1,024,072</b>
<b>Derivative financial assets</b>								
<b>Gross settled derivatives</b>								
Inflow	-	-	10,589	9,902	25,286	77	-	45,854
Outflow	-	-	(10,488)	(9,289)	(24,257)	(57)	-	(44,091)
Total	-	-	101	613	1,029	20	-	1,763
Net settled derivatives	-	-	207	-	-	-	-	207
<b>Total</b>	-	-	<b>308</b>	<b>613</b>	<b>1,029</b>	<b>20</b>	-	<b>1,970</b>

The tables below show the comparative amounts for financial assets and liabilities as of 31 December 2014.

#### Maturity analysis 31 December 2014

	Carrying amount	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
<b>Financial liabilities</b>								
Short positions	686	686	-	-	-	-	-	686
Deposits from Central Bank and credit institutions	25,796	22,331	3,054	434	-	-	-	25,819
Deposits from customers	529,447	341,454	80,037	72,685	20,602	28,342	-	543,120
Debt issued and other borrowed funds	96,889	2	4,255	18,940	71,141	14,365	-	108,703
Subordinated loans	21,306	-	-	837	27,292	-	-	28,129
Other financial liabilities	45,395	32,715	5,108	7,868	(296)	-	-	45,395
<b>Total financial liabilities</b>	<b>719,519</b>	<b>397,188</b>	<b>92,454</b>	<b>100,764</b>	<b>118,739</b>	<b>42,707</b>	-	<b>751,852</b>

	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
<b>Off-balance sheet liabilities</b>							
Financial guarantees	9,124	-	-	-	-	-	9,124
Undrawn loan commitments	31,023	-	-	-	-	-	31,023
Undrawn overdrafts	28,947	-	-	-	-	-	28,947
Credit card commitments	29,544	-	-	-	-	-	29,544
<b>Total</b>	<b>98,638</b>	-	-	-	-	-	<b>98,638</b>

Total non-derivative financial liabilities and off-balance sheet liabilities ..... 495,826 92,454 100,764 118,739 42,707 0 850,490

	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
<b>Derivative financial liabilities</b>							
<b>Gross settled derivatives</b>							
Inflow	-	2,371	7,758	56,798	-	-	66,927
Outflow	-	(2,292)	(8,165)	(60,437)	-	-	(70,894)
Total	-	79	(407)	(3,639)	-	-	(3,967)
Net settled derivatives	-	(133)	-	-	-	-	(133)
<b>Total</b>	-	<b>(54)</b>	<b>(407)</b>	<b>(3,639)</b>	-	-	<b>(4,100)</b>

\* Note that the table has been changed since the audited consolidated financial statements for 31 December 2014 where the separate lines for “Deposits from Central Bank” and “Deposits from credit institutions” have been put together in the line “Deposits from CB and credit institutions”.

	Carrying amount	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
<b>Financial assets</b>								
Cash and balances with Central Bank .....	103,389	22,546	80,843	-	-	-	-	103,389
Bonds and debt instruments .....	87,347	1,076	20,645	25,298	35,209	5,119	-	87,347
Shares and equity instruments .....	10,531	-	-	-	-	-	10,531	10,531
Loans to credit institutions .....	35,072	23,185	11,837	50	-	-	-	35,072
Loans to customers .....	634,799	5,481	73,629	55,235	176,402	326,903	-	637,650
Other financial assets .....	7,619	1,703	825	1,865	54	27	3,144	7,619
<b>Total financial assets</b>	<b>878,757</b>	<b>53,991</b>	<b>187,779</b>	<b>82,448</b>	<b>211,665</b>	<b>332,049</b>	<b>13,675</b>	<b>881,607</b>
<b>Derivative financial assets</b>								
<b>Gross settled derivatives</b>								
Inflow .....	-	-	6,387	11,738	35,515	1,710	-	55,350
Outflow .....	-	-	(5,885)	(11,063)	(34,724)	(1,975)	-	(53,647)
Total .....	-	-	502	675	791	(265)	-	1,703
Net settled derivatives .....	-	-	242	-	-	-	-	242
<b>Total</b>	-	-	<b>744</b>	<b>675</b>	<b>791</b>	<b>(265)</b>	-	<b>1,945</b>

As a part of managing liquidity risk, the Issuer holds a portfolio of liquid assets to meet unexpected outflows of funds or temporary shortages in access to new funding. These assets are subject to strict criteria with respect to credit quality, liquidation time and price volatility. The table below shows the composition and amount of the Issuer's back-up liquidity at 31 December 2015 and 31 December 2014.

<b>Composition and amount of liquidity back-up</b>	<b>31.12.2015</b>	<b>31.12.2014</b>
Cash and balances with Central Bank .....	216,760	103,455
Domestic bonds eligible as collateral against borrowing at the Central Bank .....	21,218	29,478
Foreign government bonds .....	41,330	46,593
Short-term placements with credit institutions .....	35,143	34,006
<b>Composition and amount of liquidity back-up</b>	<b>314,451</b>	<b>213,532</b>

The Group's deposits are categorised according to the Liquidity Coverage Ratio (LCR) introduced in the Basel III standards. The groups are listed in order of estimated stability and the respective LCR outflow weight. Deposits are also classified as stable if the customer has an established business relationship with the Issuer and is covered by an effective insurance scheme.

31 December 2015

Deposits maturing within 30 days

	Less stable	Weight (%)	Stable	Weight (%)	Term deposits	Total deposits
Retail	93,385	10%	56,443	5%	56,122	205,950
SME	47,394	10%	13,340	5%	5,897	66,631
Operational relationship	2,050	25%	-	5%	-	2,050
Corporations	66,306	40%	235	20%	25,509	92,050
Sovereigns, Central Bank and public sector entities	5,723	40%	257	20%	970	6,950
Financial institutions in composition	58,428	100%	-	-	39,783	98,211
Pension funds	23,775	100%	-	-	26,765	50,541
Domestic financial entities	32,601	100%	-	-	20,919	53,520
Foreign financial entities	19,033	100%	-	-	1,636	20,669
Other foreign entities	17,936	100%	1,956	25%	2,413	22,305
<b>Total</b>	<b>366,631</b>		<b>72,231</b>		<b>180,014</b>	<b>618,876</b>

The table below shows the comparative amounts for financial assets and liabilities at the end of 2014.

31 December 2014

Deposits maturing within 30 days

	Less stable	Weight (%)	Stable	Weight (%)	Term deposits	Total deposits
Retail	86,173	10%	52,389	5%	54,650	193,212
SME	44,030	10%	12,654	5%	6,369	63,053
Operational relationship	-	25%	-	5%	-	-
Corporations	77,907	40%	280	20%	23,636	101,823
Sovereigns, Central Bank and public sector entities	6,211	40%	273	20%	1,918	8,402
Financial institutions in composition	13,394	100%	-	-	45,721	59,116
Pension funds	22,521	100%	-	-	22,906	45,427
Domestic financial entities	22,085	100%	-	-	6,083	28,168
Foreign financial entities	18,696	100%	-	-	2,401	21,097
Other foreign entities	26,728	100%	1,829	25%	6,389	34,946
<b>Total</b>	<b>317,745</b>		<b>67,425</b>		<b>170,073</b>	<b>555,243</b>

\*2014 numbers are unaudited

## MARKET RISK

Market risk is the current or prospective risk to the Issuer's earnings and capital arising from adverse movements in the level or volatility of prices of market instruments, such as those that arise from changes in interest rates, equity prices, commodity prices and foreign exchange rates.

## MARKET RISK MANAGEMENT

The Issuer's market risk appetite is determined by the Board of Directors. The ALCO decides on limits for portfolios and products in accordance with the market risk policy approved by the Board of Directors. The Risk Management division is responsible for monitoring and reporting on the Issuer's overall market risk positions and compliance with internal limits. The objective of market risk management is to manage and control market risk exposures within acceptable parameters.

The Issuer separates exposures to market risk for its trading book and banking book (non-trading portfolios). The Issuer's primary sources of market risk in the trading portfolio are shares, debt instruments and foreign currency positions. All financial assets and liabilities in the trading portfolio are recognised at fair value and all resulting changes are immediately reflected in the income statement. Market risk in the banking book is mainly due to mismatches in interest rate terms and denomination currency of assets and liabilities. These mismatches are reported to management and are subject to regulatory and internal limits.

## INTEREST RATE RISK

Interest rate risk is defined as the current or prospective risk to earnings or capital arising from adverse movements in interest rates. The Issuer uses sensitivity measures like Basis Point Value (BPV) to measure and manage risk arising from its fixed income exposures. The BPV measures the effect of a 0.01 per cent. upward parallel shift in the yield curve on the fair value of these exposures.



## INTEREST RATE RISK IN THE TRADING PORTFOLIO

The fixed income trading unit invests mainly in government bonds, bonds issued by the Housing Financing Fund (HFF), which are guaranteed by the Icelandic government, but also domestic municipality bonds and covered bonds issued by the Icelandic banks. These positions can include short positions. Icelandic government bonds are either indexed to the Icelandic Consumer Price Index (CPI) or non-indexed, with a term of up to ten years. HFF bonds are CPI linked and have a term of up to 13 years. All bond trading positions, both intraday and end-of-day, are subject to BPV limits. In addition to BPV limits short and long positions in each instrument are subject to separate limits. The Risk Management division monitors these limits and reports all breaches to the ALCO.

In the table below, the total market value of long and short positions may not be exactly the same as what is reported in Note 7 to the Issuer's audited consolidated financial statements for the year ended 31 December 2014. The reason for this difference is that note 7 sums up the net positions in each security while the table below ignores netting of long and short positions in specific securities between different portfolios.

Trading bonds and debt instruments, long positions	31.12.2015			31.12.2014		
	MV	Duration	BPV	MV	Duration	BPV
Indexed	1,818	8.08	(1.47)	1,772	8.03	(1.42)
Non-indexed	43,703	0.32	(1.42)	48,260	0.41	(1.96)
<b>Total</b>	<b>45,521</b>	<b>0.83</b>	<b>(2.89)</b>	<b>50,032</b>	<b>0.68</b>	<b>(3.38)</b>

Trading bonds and debt instruments, short positions	31.12.2015			31.12.2014		
	MV	Duration	BPV	MV	Duration	BPV
Indexed	1,754	7.04	1.24	-	-	-
Non-indexed	3,057	1.10	0.34	73	7.39	0.05
<b>Total</b>	<b>4,811</b>	<b>3.27</b>	<b>1.58</b>	<b>73</b>	<b>7.39</b>	<b>0.05</b>

<b>Net position of trading bonds and debt instruments</b>	<b>40,710</b>	<b>0.32</b>	<b>(1.31)</b>	<b>49,959</b>	<b>0.67</b>	<b>(3.33)</b>
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\*Note that the total duration for 31.12.2014 in the table has been corrected since the audited consolidated financial statements for the year ended 31 December 2014.

The Issuer's liquidity management assumes that part of the liquidity portfolio in foreign currencies can be invested in highly liquid bills issued by foreign governments with a long-term issuer rating of AA- from S&P or Fitch or Aa3 from Moody's. At year-end 2015 the Group held a significant amount of foreign AAA and AA+ credit-rated government bills for liquidity management purposes. These bills have a duration ranging up to six months and the sensitivity measured in BPV was ISK -0.85 million at year-end 2015 compared to ISK -1.35 million at year-end 2014.

Country	31/12/2015		31/12/2014	
	Market value	BPV	Market value	BPV
Canada	-	-	1,094	(0.02)
Denmark	-	-	1,036	(0.02)
France	6,366	(0.14)	6,944	(0.30)
Germany	13,439	(0.30)	15,434	(0.41)
Netherlands	12,025	(0.25)	6,944	(0.18)
Norway	1,471	(0.07)	1,708	(0.04)
Sweden	-	-	4,109	(0.14)
USA	8,030	(0.09)	9,323	(0.24)
<b>Total</b>	<b>41,331</b>	<b>(0.85)</b>	<b>46,592</b>	<b>(1.35)</b>

\*Note that the totals for the market value and BPV for 31.12.2014 in the table have been corrected since the audited consolidated financial statements for the year ended 31 December 2014.

#### SENSITIVITY ANALYSIS FOR INTEREST RATE RISK IN TRADING PORTFOLIOS

For sensitivity analysis in the trading portfolio the Issuer uses a 99th percentile shift based on historical data of either five years (domestic rates) or ten years (foreign rates) and a holding period of 20 days. The following table demonstrates the sensitivity of the Issuer's equity and income statement to these changes in interest rates, all other risk factors held constant. The shifts have been updated from the ones reported in the consolidated financial statements for the year ended 31 December 2014 and the figures for year-end 2014 have been updated accordingly.

Currency (ISK million)	Parallel shift in yield curve (basis points)	31.12.2015		31.12.2014	
		Profit or (loss)			
		Downward shift	Upward shift	Downward shift	Upward shift
ISK, indexed	100	147	(147)	142	(142)
ISK, non-indexed	100	42	(42)	59	(59)
EUR	25	17	(17)	22	(22)
GBP	35	-	-	1	(1)
USD	80	12	(12)	15	(15)
Other total	80	4	(4)	-	-
<b>Total</b>		<b>222</b>	<b>(222)</b>	<b>239</b>	<b>(239)</b>

\*Note that the shifts have been updated since the audited consolidated financial statements for the year ended 31 December 2014. The figures for 31.12.2014 have been updated accordingly.

#### INTEREST RATE RISK IN THE NON-TRADING PORTFOLIO

Interest rate risk in the banking book arises from the Issuer's core banking activities. The main source of this type of interest rate risk is the risk of loss from fluctuations in future cash flows or fair value of financial instruments as interest rates change over time, reflecting the fact that the Group's assets and liabilities are of different maturities and are priced relative to different interest rates.

The Issuer holds a government bond designated at fair value amounting to ISK 30.6 billion at 31 December 2015 (31 December 2014: ISK 30.6 billion). The bond pays a floating rate coupon and carries relatively low interest rate risk.

The Group uses traditional measures for assessing the sensitivity of the Group's financial assets, financial liabilities and earnings to changes in the underlying interest rates.

In the table below the total amount for loans to customers is shown before the collective impairment allowance is subtracted and is therefore not the same as the total amount shown in the Issuer's financial statements. Loans with specific impairment have been placed in the category 0-3 months since such loans bear no interest rate risk until possibly after debt restructuring. Note that collective impairment has been added to the total amount for loans to customers at 31 December 2014 as well.

**Banking book interest rate adjustment periods on 31 December 2015**

<b>Assets</b>	0-3 months	3-12 months	1-2 years	2-5 years	5-10 years	Over 10 years	Total
Balances with the Central Bank .....	216,760	-	-	-	-	-	216,760
Bonds and debt instruments .....	32,034	458	952	108	426	185	34,163
Loans to credit institutions .....	35,531	3	-	-	-	-	35,534
Loans to customers .....	463,177	22,748	38,187	130,927	2,431	8,241	665,710
<b>Total assets</b>	<b>747,502</b>	<b>23,209</b>	<b>39,139</b>	<b>131,035</b>	<b>2,857</b>	<b>8,426</b>	<b>952,167</b>
Off-balance sheet items .....	73,020	9,571	1,456	35,196	-	-	119,243
<b>Liabilities</b>							
Deposits from CB and credit institutions .....	25,631	-	-	-	-	-	25,631
Deposits from customers .....	581,171	1,659	1,778	7,772	865	-	593,245
Debt issued and other borrowed funds .....	35,360	24,180	19,801	48,505	16,053	6,409	150,308
Subordinated loans .....	19,517	-	-	-	-	-	19,517
<b>Total liabilities</b>	<b>661,679</b>	<b>25,839</b>	<b>21,579</b>	<b>56,277</b>	<b>16,918</b>	<b>6,409</b>	<b>788,701</b>
Off-balance sheet items .....	87,095	6,446	5,968	28,872	2,976	-	131,357
<b>Net interest gap on 31 December 2015</b>	<b>71,748</b>	<b>495</b>	<b>13,048</b>	<b>81,082</b>	<b>( 17,037)</b>	<b>2,017</b>	<b>151,352</b>

Non-trading portfolio interest rate adjustments as of 31 December 2014:

<b>Assets</b>	0-3 months	3-12 months	1-2 years	2-5 years	5-10 years	Over 10 years	Total
Balances with Central Bank .....	103,389	-	-	-	-	-	103,389
Bonds and debt instruments .....	31,119	-	67	1,230	291	367	33,074
Loans to credit institutions .....	35,072	-	-	-	-	-	35,072
Loans to customers .....	451,191	47,768	29,963	97,052	1,868	9,809	637,650
<b>Total assets</b>	<b>620,771</b>	<b>47,768</b>	<b>30,030</b>	<b>98,282</b>	<b>2,159</b>	<b>10,176</b>	<b>809,185</b>
Off-balance sheet items .....	68,186	7,508	21,649	112	-	-	97,455
<b>Liabilities</b>							
Deposits from CB and credit institutions .....	25,375	421	-	-	-	-	25,796
Deposits from customers .....	514,898	3,643	1,030	2,383	7,493	-	529,447
Debt issued and other borrowed funds .....	17,723	9,403	22,760	34,421	12,582	-	96,889
Subordinated loans .....	21,306	-	-	-	-	-	21,306
<b>Total liabilities</b>	<b>579,302</b>	<b>13,467</b>	<b>23,790</b>	<b>36,804</b>	<b>20,075</b>	<b>-</b>	<b>673,438</b>
Off-balance sheet items .....	77,732	3,272	7,701	17,850	-	-	106,555
<b>Net interest gap on 31 December 2014</b>	<b>31,923</b>	<b>38,537</b>	<b>20,188</b>	<b>43,740</b>	<b>( 17,916)</b>	<b>10,176</b>	<b>126,647</b>

\*Note that some of the figures in the table have been updated since the audited consolidated financial statements for the year ended 31 December 2014. Furthermore the separate lines for "Deposits from Central Bank" and "Deposits from credit institutions" have been put together in the line "Deposits from CB and credit institutions".

#### **SENSITIVITY ANALYSIS FOR INTEREST RATE RISK IN THE BANKING BOOK**

For the sensitivity analysis in the banking book the Group uses as a reference the 99th percentile shift based on historical data of either 5 years (domestic rates) or 10 years (foreign rates) and a holding period of six months. The following table demonstrates the sensitivity of the Group's equity and income statement to these changes in interest rates, all other risk factors held constant. The table shows how applied shifts would affect the fair value of the Group's banking book. The shifts have been updated from the ones reported in the consolidated financial statements for the year ended 31 December 2014 and the figures for year-end 2014 have been updated accordingly. Sensitivity analysis for non-trading bonds and debt instruments:

**Bonds and debt instruments in the banking book**

31/12/2015

31/12/2014

Currency (ISK million)	Parallel shift in yield curve (basis points)	Profit or loss			
		Downward shift	Upward shift	Downward shift	Upward shift
ISK, indexed .....	220	5,735	( 5,735)	4,902	( 4,902)
ISK, non-indexed .....	250	( 267)	267	( 206)	206
CHF .....	50	( 2)	2	( 6)	6
EUR .....	60	( 70)	70	( 22)	22
GBP .....	90	2	( 2)	3	( 3)
JPY .....	45	2	( 2)	1	( 1)
USD .....	150	11	( 11)	20	( 20)
Other .....	150	( 39)	39	17	( 17)
<b>Total</b>		<b>5,372</b>	<b>( 5,372)</b>	<b>4,709</b>	<b>( 4,709)</b>

\*2014 numbers are unaudited

**CURRENCY RISK**

Currency risk is the risk that earnings or capital may be negatively affected by the fluctuations of foreign exchange rates, due to transactions in foreign currencies, or a mismatch in the currency composition of assets or liabilities.

The analysis of the Issuer's foreign currency exposure presented in the tables below is based on the contractual currency of the underlying balance sheet items. Additionally, there are off-balance sheet items that carry currency risk and are included in the total currency imbalance. The off-balance sheet amounts below represent the notional amounts of derivatives and unsettled spot agreements. The tables below summarise the Issuer's exposure to currency risk at 31 December 2015, based on contractual currencies, off-balance sheet items along with the currency adjustment, but excluding assets categorised as held-for-sale.

Currency analysis as of 31 December 2015

**Currency analysis 31 December 2015**

<b>Assets</b>	EUR	USD	GBP	CHF	JPY	SEK	NOK	DKK	Other	Total
Cash and balances with Central Bank ..	387	250	131	37	11	66	74	90	33	1,079
Bonds and debt instruments .....	31,829	9,867	-	-	-	-	1,471	-	-	43,167
Shares and equity instruments .....	5,515	276	-	-	-	-	1	-	-	5,792
Loans to credit institutions .....	18,584	11,474	988	1,027	523	1,420	297	209	511	35,033
Loans to customers .....	62,438	28,980	5,409	6,907	6,905	272	7,340	1,113	103	119,467
Other assets .....	432	1,859	246	-	23	35	12	27	47	2,681
<b>Total assets</b>	<b>119,185</b>	<b>52,706</b>	<b>6,774</b>	<b>7,971</b>	<b>7,462</b>	<b>1,793</b>	<b>9,195</b>	<b>1,439</b>	<b>694</b>	<b>207,219</b>

**Liabilities**

Deposits from credit institutions .....	1,389	816	1	440	584	-	-	-	-	3,230
Deposits from customers .....	66,267	22,351	5,047	1,488	1,031	1,103	2,931	946	1,356	102,520
Debt issued and other borrowed funds	39,467	-	-	-	-	21,639	7,366	-	-	68,472
Subordinated loans .....	19,517	-	-	-	-	-	-	-	-	19,517
Other liabilities .....	4,084	5,066	834	1	118	98	64	163	94	10,522
<b>Total liabilities</b>	<b>130,724</b>	<b>28,233</b>	<b>5,882</b>	<b>1,929</b>	<b>1,733</b>	<b>22,840</b>	<b>10,361</b>	<b>1,109</b>	<b>1,450</b>	<b>204,261</b>

On-balance sheet imbalance	( 11,539)	24,473	892	6,042	5,729	( 21,047)	( 1,166)	330	( 756)	2,958
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**Off-balance sheet items**

Off-balance sheet assets .....	71,768	12,667	2,037	833	19	20,833	2,042	424	1,544	112,167
Off-balance sheet liabilities .....	54,802	36,353	2,694	6,894	5,722	-	2,956	777	603	110,801
<b>Net off-balance sheet items</b>	<b>16,966</b>	<b>( 23,686)</b>	<b>( 657)</b>	<b>( 6,061)</b>	<b>( 5,703)</b>	<b>20,833</b>	<b>( 914)</b>	<b>( 353)</b>	<b>941</b>	<b>1,366</b>

**Net currency imbalance on 31 December 2015**

	5,427	787	235	( 19)	26	( 214)	( 2,080)	( 23)	185	4,324
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#### SENSITIVITY ANALYSIS FOR CURRENCY RISK

The table below shows how the currency imbalance is affected by either depreciation or appreciation of each currency assuming other risk factors being held constant. The shift number is the 99th percentile of a 10-day return distribution for each currency for the previous 365 days. The adverse movement of each currency is applied for the impact of the shift and demonstrates how equity and the Issuer's income statement would be affected by the shifts. The shifts have been updated from the ones reported in the consolidated financial statements for the year ended 31 December 2015 and the figures for year-end 2014 have been updated accordingly.

Sensitivity to currency risk 31 December 2015		Sensitivity to currency risk 31 December 2014	
Currency (shift)	Shift effect	Currency (shift)	Shift effect
EUR (2%) ..	( 109)	EUR (3%) ..	( 221)
USD (6%) ..	( 55)	USD (4%) ..	( 208)
GBP (6%) ..	( 14)	GBP (4%) ..	( 116)
CHF (5%) ..	( 1)	CHF (3%) ..	( 14)
JPY (5%) ...	( 2)	JPY (6%) ..	( 15)
SEK (5%) ..	( 11)	SEK (5%) ..	( 55)
NOK (7%) ..	( 146)	NOK (7%) .	( 156)
DKK (2%) ..	( 0)	DKK (3%) ..	( 69)
Other (8%)	( 19)	Other (6%)	( 19)
Total	( 357)	Total	( 873)

\*The 2014 numbers are unaudited

#### SHARES AND EQUITY INSTRUMENTS

The Issuer's equity exposure in the trading book arises from flow trading, mainly in shares denominated in ISK. Limits on both aggregated market value and maximum exposure in single securities are aimed at reducing the equity risk and concentration risk in the Issuer's portfolio. Shares and equity instruments in the banking book are designated at fair value through profit or loss or are classified as held-for-sale.

#### SENSITIVITY ANALYSIS FOR SHARES AND EQUITY INSTRUMENTS

For the sensitivity analysis the Group uses as a reference the 99th percentile shift in the domestic stock index based on historical data of five years and a holding period of 20 days for the trading book and six months for the banking book. The following table demonstrates how these shifts would affect the Group's equity and net financial income. The shifts have been updated from the ones reported in the consolidated financial statements for the year ended 31 December 2014 and the figures for year-end 2014 have been updated accordingly.

Sensitivity analysis for equities	31/12/2015		31/12/2014		
	Profit or loss				
	Change in equity prices	Downward shift	Upward shift	Downward shift	Upward shift
<b>Portfolio (ISK million)</b>					
Trading .....	11%	( 368)	368	( 194)	194
Banking book .....	28%	( 2,891)	2,891	( 1,602)	1,602
<b>Total</b>		( 3,259)	3,259	( 1,796)	1,796

\*Note that the shifts have been updated since the audited consolidated financial statements for the year ended 31 December 2014. The figures for 31.12.2014 have been updated accordingly.

#### DERIVATIVES

The Issuer uses derivatives to hedge currency exposure, interest rate risk in the banking book and inflation risk. The Issuer carries relatively low indirect exposure due to margin trading with clients and it holds collateral for possible losses. Other derivatives held by the Issuer for trading or for other purposes are insignificant.

#### INFLATION RISK

The Issuer is exposed to inflation risk since the value of CPI-indexed assets exceeds the value of CPI-indexed liabilities. The value of these assets and liabilities changes according to changes in the CPI at any given time and all changes in the CPI index affect profit or loss. On 31 December 2015, the CPI gap amounted to ISK 42.6 billion (31 December 2014: ISK 61.7 billion). Thus, a 1 per cent. increase in the index would lead to an ISK 426 million increase in the statement of financial position and a 1 per cent. decrease would lead to a corresponding decrease, other risk factors are held constant.

Assets, CPI indexed linked	31/12/2015	31/12/2014
Bonds and debt instruments .....	2,329	6,206
Loans to customers .....	223,719	215,320
Off-balance sheet position .....	31,019	31,046
<b>Total assets</b>	<b>257,067</b>	<b>252,572</b>
<b>Liabilities, CPI indexed linked</b>		
Deposits from customers .....	96,424	97,923
Debt issued and other borrowed funds .....	56,909	50,100
Off-balance sheet position .....	61,112	42,805
<b>Total liabilities</b>	<b>214,445</b>	<b>190,828</b>
<b>CPI Balance</b>	<b>42,622</b>	<b>61,744</b>

\*2014 numbers are unaudited

#### CAPITAL MANAGEMENT

##### RISK EXPOSURE AND CAPITAL BASE

The table below shows the capital base, risk weighted assets ("RWA") and the resulting capital ratios of the Group at 31 December 2015 and 31 December 2014. The Issuer's total official capital ratio, as of 31 December



2015, calculated according to the Act on Financial Undertakings, was 30.1 per cent. and the Tier 1 ratio was 28.3 per cent.

The eligibility of the Tier 2 subordinated loan issued by the Group as Tier 2 capital will decrease linearly by 20% until maturity in 2019 because the remaining term is now less than 5 years. As a result the Tier 2 subordinated loan only attributes 80% into the total capital base.

The Group has revised its minimum capital targets. The previous minimum total capital target ratio of 18% has been increased to 23% for the near and medium term. The increase is based on more conservative requirements set forth by the Icelandic regulator and on the Group's view that it is prudent to retain a sizable strategic capital buffer through the near-term steps being taken towards the lifting of capital controls in Iceland. The Group expects to be able to give more clarity on the medium- to long-term capital targets in the next 12–18 months, as further clarity is expected regarding the regulatory capital requirements and the Group's operating environment.

The Issuer's regulatory capital calculations for credit risk and market risk are based on the standardised approach and the capital calculations for operational risk are based on the basic indicator approach.

The table below shows the capital base, risk weighted assets and capital ratios of the Issuer at 31 December 2015 and 31 December 2014.

	31/12/2015	31/12/2014
<b>Tier 1 capital</b>		
Ordinary share capital .....	10,000	10,000
Share premium .....	55,000	55,000
Other reserves .....	6,002	2,535
Retained earnings .....	127,288	116,288
Non-controlling interests .	3,937	1,664
Tax assets .....	-	( 521)
Intangible assets .....	( 1,331)	( 619)
Other regulatory adjustments .....	( 2,779)	-
<b>Total Tier 1 capital .....</b>	<b>198,117</b>	<b>184,347</b>
<b>Tier 2 capital</b>		
Subordinated loans .....	19,517	21,306
Adjustment to eligible capital instruments .....	( 3,903)	-
Other regulatory adjustments .....	(2,779)	-
<b>Total capital base .....</b>	<b>210,952</b>	<b>205,653</b>
<b>Risk-weighted assets</b>		
-due to credit risk .....	606,591	583,375
-due to market risk .....	16,607	33,326
Market risk, trading book .....	9,931	6,594
Currency risk .....	6,676	26,732
-due to operational risk .....	76,495	78,401
<b>Total Risk weighted assets .....</b>	<b>699,693</b>	<b>695,102</b>
<b>Capital ratios</b>		
Tier 1 ratio .....	28.3%	26.5%
Total capital ratio .....	30.1%	29.6%

Article 86 of the act on Financial Undertakings (161/2002) details the measures taken in the case of insufficient funds of a financial undertaking. If the Board or managing directors of a financial undertaking have reason to expect that its own funds will be less than the minimum required by law, they must immediately notify the FME thereof. The FME may grant the financial undertaking concerned a time limit of up to six months to increase its own funds to the minimum provided. If the remedies are not satisfactory in the opinion of the FME or if the time limit provided expires, the operating licence of the financial undertaking shall be revoked.

#### **OPERATIONAL RISK**

The Issuer has adopted the definition of operational risk from the CRD of the European Parliament and of the Council, where operational risk is defined “as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events“. The Issuer's definition of operational risk includes compliance risk, and reputational risk.

The Board of Directors has approved an Operational Risk Management Policy, applicable to the Issuer and its subsidiaries, in accordance with article 78 of the Financial institution Act No. 161/2002. The policy outlines a framework for operational risk management within the Issuer. The operational risk management framework is described in further detail in several subdocuments, such as the Quality Management Policy, Business Continuity Management Framework, Security Policy, and the Crisis Communication Policy, all of which have been approved by the Executive Board.

According to the Operational Risk Management Policy, the Executive Board is responsible for the operational risk management framework, and the Risk Monitoring Unit within the Risk Management division is responsible for the implementation of the operational risk framework throughout the Issuer.

The Issuer uses the Basic Indicator Approach of the CRD to calculate the capital requirements for Pillar 1 operational risks, in accordance with Rules on the Capital Requirement and Risk Weighted Assets of Financial Undertakings no. 215/2007.

## **TAXATION**

### **ICELANDIC TAXATION**

*The comments below are of a general nature based on the understanding of the Issuer of current law and practice in Iceland and should not be construed as providing legitimate expectations as to the system of taxation being described herein or precluding changes in the applicable rules on taxation in the future. They relate only to the position of persons who are the absolute beneficial owners of Bonds to be issued under the Programme. They may not apply to certain classes of persons such as dealers. Prospective holders of Bonds to be issued under the Programme who are in any doubt as to their personal tax position or who may be subject to tax in any other jurisdiction, should consult their professional advisers.*

### **NON-ICELANDIC TAX RESIDENTS**

Non-Icelandic residents are not subject to tax on any interest income derived by them from the Bonds provided the Bonds are registered with a securities depository within the Organisation for Economic Co-operation and Development, the European Economic Area or a member of the European Free Trade Association or the Faroe Islands, and the Issuer will register any Bonds issued under the Programme with the Directorate of Internal Revenue in Iceland to exempt the Bonds from such taxation, all in accordance with point 8 of the first Paragraph of Article 3 of Act no 90/2003 on Income Tax. The Issuer will provide a certificate of such tax exemption for each issue of Bonds.

In the event that the Issuer is required to withhold tax then the provisions of Condition 8 will apply and the Issuer will be required to pay additional amounts to cover the amounts so withheld.

Capital gains on the sale of the Bonds are classified as interest and thus are not subject to tax in Iceland.

There are no estate or inheritance taxes, succession duties or gift taxes imposed by Iceland or any authority of, or in, Iceland in respect of the Bonds if, at the time of the death of the holder or the transfer of the Bonds, such holder or transferor is not a tax resident of Iceland.

### **ICELANDIC TAX RESIDENTS**

Beneficial owners of the Bonds that are resident in Iceland for tax purposes are subject to income tax in Iceland on their interest income in accordance with Icelandic tax law. The rate depends on their tax status.

Subject to certain exemptions, applicable to e.g. most banks and pension funds, the Issuer is required to withhold a 20 per cent. tax on the interest paid to the holders of Bonds which is considered a preliminary tax payment but does not necessarily constitute the final tax liability of the holder.

### **EU SAVINGS DIRECTIVE**

Under EU Council Directive 2003/48/EC on the taxation of savings income, Member States are required, from 1 July, 2005, to provide to the tax authorities of another Member State details of payments of interest (or similar income) paid by a person within its jurisdiction to an individual resident in that other Member State. However, for a transitional period, Belgium, Luxembourg and Austria are instead required (unless during that period they elect otherwise) to operate a withholding system in relation to such payments (the ending of such transitional period being dependent upon the conclusion of certain other agreements relating to information exchange with certain other countries). A number of non-EU countries and territories including Switzerland have agreed to adopt similar measures (a withholding system in the case of Switzerland) with effect from the same date. Iceland is neither a Member State nor has it agreed to adopt similar measures.

## **DOCUMENTS ON DISPLAY**

For the life of this Base Prospectus, the following documents are available for viewing at the Issuer's premises at Kirkjusandur 2, 155 Reykjavík, Iceland and at the Issuer's website <http://www.islandsbanki.is/english/investor-relations/funding/>

- i. The Base Prospectus, dated 12 April 2016.
- ii. All issued Final Terms.
- iii. The Issuer's Articles of Association.
- iv. The Consolidated Financial Statements of the Issuer for the years 2013, 2014 and 2015
- v. Independent Auditors' Reports for the years 2013-2015

Following the publication of this Base Prospectus one or more supplements may be prepared by the Issuer and approved by the FME in accordance with Article 16 of the Prospectus Directive and Article 46 of the Act on Securities Transactions. Statements contained in any such supplements (or contained in any document incorporated by reference therein) shall, to the extent applicable (whether expressly, by implication or otherwise), be deemed to modify or supersede statements contained in this Base Prospectus. Any statement so modified or superseded shall not, except as so modified or superseded, constitute a part of this Base Prospectus.

In the event of any significant factor arising or any material mistake or accuracy relating to the information included in this Base Prospectus which is capable of affecting the assessment of any Bonds or any change in the condition of the Issuer which is material in the context of the Programme or the issue of Bonds, the Issuer will prepare and publish a supplement to this Base Prospectus or publish a new prospectus for use in connection with any subsequent issue of Bonds. Furthermore, the Issuer will, in connection with the listing of the Bonds on NASDAQ OMX Iceland, so long as any Bond remains outstanding and listed on such exchange, in the event of any material adverse change in the financial condition of the Issuer which is not reflected in this Base Prospectus, prepare and publish a further supplement to this Base Prospectus or publish a new prospectus for use in connection with any subsequent issue of the Bonds to be listed on NASDAQ OMX Iceland.

**DOCUMENTS INCORPORATED BY REFERENCE**

The Consolidated Financial Statements of the Issuer for years 2013-2015 and the Independent Auditors' Reports for the years 2013-2015 are hereby incorporated into this Base Prospectus, by reference. The Financial Statements and the Independent Auditors' Reports are available for viewing at the Issuer premises at Kirkjusandur 2, 155 Reykjavík, Iceland and at the Issuer's website <http://www.islandsbanki.is/english/investor-relations/financials/>.

**ISSUER**

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**ARRANGER**

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