

APPLICABLE FINAL TERMS

10 October 2016

ÍSLANDBANKI HF.
Issue of 400,000,000 Zero Coupon Bond
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.

- | | |
|---|---|
| 1. Issuer: | Íslandsbanki hf. |
| 2. | |
| i. Series Number: | 41 |
| ii. Tranche Number: | 2 |
| iii. Ticker: | ISLA 17 0119 |
| 3. Specified Currency or Currencies: | ISK |
| 4. Aggregate Nominal Amount: | |
| I. Series: | 800,000,000 |
| II. Tranche: | 400,000,000 |
| 5. Issue Price: | 98.4487 per cent. of the Aggregate Nominal Amount |
| 6. Specified Denominations: | 20,000,000 |
| 7. | |
| i. Issue Date: | 12 October 2016 |
| ii. Interest Commencement Date: | 12 October 2016 |

- 8.**
- i. Maturity Date: 19 January 2017
- 9.**
- i. Interest Basis to Maturity Date: Zero Coupon
- 10. Redemption/Payment Basis:** Redemption at par
- 11. Change of Interest Basis or Redemption/Payment Basis:** Not Applicable
- 12. Call Option:** Not Applicable
- 13. Status of the Bonds:** Senior.
- 14. Approval for issuance of the Bonds:**
- Date of Board approval for issuance of Bonds obtained: 20 August 2012
- 15. Method of distribution:** Non-syndicated

PROVISIONS RELATING TO INFLATION LINKED ANNUITY BONDS

- 16. Inflation Linked Annuity Bonds:** Not Applicable

PROVISIONS RELATING TO INFLATION LINKED EQUAL

PRINCIPAL PAYMENT BONDS

17. Inflation Linked Equal Principal Payment

Bonds:

Not Applicable

PROVISIONS RELATING TO INTEREST (IF ANY) PAYABLE

18. Fixed Rate Bond Provisions:

Not Applicable

19. Floating Rate Bond Provisions:

Not Applicable

20. Zero Coupon Bond Provisions:

Applicable

- i. Accrual Yield: 5.73 per cent. per annum
- ii. Reference Price: 98.4487
- iii. Any other formula/basis of determining amount payable: Not Applicable
- iv. Day Count Fraction in relation to Early Redemption Amounts and late payment: Conditions 7.6.b) and 7.10 apply

PROVISIONS RELATING TO REDEMPTION

21. Issuer Call:

Not Applicable

22. Final Redemption Amount of each Bond:

Not Applicable

GENERAL PROVISIONS APPLICABLE TO THE BONDS

- 23. New Global Bond:** No
- 24. Form of Bonds:** VS System Bonds
- 25. Additional Financial Centre(s) or other special provisions relating to Payment Days:** Not Applicable
- 26. Talons for future Coupons or Receipts to be attached to definitive Bonds (and dates on which such Talons mature):** No
- 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
- 28. Details relating to Instalment Bonds:**
- i. Instalment Amount(s): Not Applicable
 - ii. Instalment Date(s): Not Applicable
- 29. Redenomination applicable:** Redenomination not applicable
- 30. Other final terms:** Not Applicable

DISTRIBUTION

31.

i. If syndicated, names of Managers : Not Applicable

ii. Stabilising Manager (if any): Not applicable

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

33. Additional selling restrictions: Not Applicable

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.

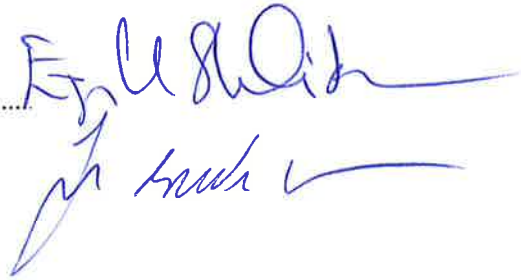
RESPONSIBILITY

The Issuer accepts responsibility for the information contained in these Final Terms.

Signed on behalf of the Issuer:

By:

Duly authorised

A handwritten signature in blue ink, consisting of a large, stylized initial 'E' followed by a surname, and a second, smaller signature below it.

PART B – OTHER INFORMATION

1. LISTING

- | | | |
|-----|-----------------------|---|
| i. | Listing: | NASDAQ Iceland |
| II. | Admission to trading: | Application has been made for the Bonds to be admitted to trading on Nasdaq Iceland with effect from 12 October 2016. |

2. RATING

Not Applicable

3. NOTIFICATION

Not Applicable.

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

Save for any fees payable to the Dealer, so far as the Issuer is aware, no person involved in the issue of the Bonds has an interest material to the issue.

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

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|------|---------------------------|--|
| I. | Use of proceeds: | For general funding purposes of the Issuer |
| II. | Estimated net proceeds: | 393,444,800 |
| III. | Estimated total expenses: | 350,000 |

6. YIELD (*Fixed Rate Bonds only*)

Indication of yield: Not Applicable

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

Not Applicable.

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*)

Not Applicable.

9. OPERATIONAL INFORMATION

- | | | |
|-----|--------------|--------------|
| i. | ISIN Code: | IS0000027407 |
| II. | Common Code: | 000002740 |

- III.** Any clearing system(s) other than Euroclear Bank S.A./N.V. or Clearstream Banking, société anonyme and the relevant identification number(s): Nasdaq CSD Iceland hf.
- IV.** Delivery: Delivery against payment
- V.** Names and addresses of additional Paying Agent(s) (if any): Not Applicable
- VI.** Intended to be held in a manner which would allow Eurosystem eligibility: No