Íslandsbanki hf.
Base Prospectus

6 May 2016

Íslandsbanki hf.
Kirkjusandur
155 Reykjavík

Íslandsbanki hf.

(incorporated in Iceland as a limited liability company)

ISK 100,000,000,000
Covered Bond Programme

*On 4 November 2011, Íslandsbanki (the "**Issuer**") established a ISK 100,000,000,000 Covered Bond Programme which is described in this Base Prospectus, under which the Issuer may issue in a continuous and repeated manner bonds (the "**Covered Bonds**") in accordance with the Icelandic Act on Covered Bonds, No. 11/2008 (the "**Act on Covered Bonds**"), any relevant executive orders (Icelandic: stjórnvaldsákvarðanir) 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), (together the "**Covered Bonds Legislation**") denominated in any Specified Currency.*

*The Covered Bonds may be issued in bearer form ("**Bearer Covered Bonds**"), registered form ("**Registered Covered 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 of all outstanding Covered Bonds issued under the Programme will not exceed ISK 100,000,000,000 (or its equivalent in other currencies calculated as described herein). The Covered Bonds may be issued on a continuing basis. However, pursuant to the existing licence issued by the Financial Supervisory Authority, Iceland (the "**FME**") the Programme shall currently not exceed a limit of ISK 70,000,000,000.*

*This Base Prospectus has been approved by 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 Covered Bonds under the Programme during a period of at least twelve months from the date of its publication. This Base Prospectus (which shall include all documents incorporated by reference therein) has been prepared for the purpose of providing disclosure information with regard to the Covered Bonds and covers all outstanding series as well as any new series issued under the Covered Bond Programme. An application will be submitted to NASDAQ OMX Iceland hf. for Covered 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 Covered Bonds being listed (and all related references) shall mean that such Covered 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 Covered Bonds on additional regulated markets.*

Notice of the aggregate nominal amount of Covered Bonds, interest (if any) payable in respect of Covered Bonds, the issue price of Covered Bonds and any other terms and conditions not contained herein which are applicable to each Tranche (as defined under Terms and Conditions of the Covered Bonds) of Covered Bonds will be set out in the Final Terms, which, with respect to Covered 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/.

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 Covered Bonds.

*The Covered 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, Covered Bonds may not be offered, sold or delivered within the United States or to U.S. persons.*

The Issuer may decide that Covered Bonds may be issued in a form not contemplated by the Terms and Conditions of the Covered 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 Covered Bonds.

Íslandsbanki hf.

The date of this Base Prospectus is 6 May 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 Covered 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/ 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 Covered 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 Covered 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 Covered Bonds should purchase any Covered Bonds. Each investor contemplating purchasing any Covered 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 Covered Bonds constitutes an offer or invitation by or on behalf of the Issuer to any person to subscribe for or to purchase any Covered Bonds.

Neither the delivery of this Base Prospectus nor the offering, sale or delivery of any Covered 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 Covered 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 Covered 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 Covered 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 Covered Bonds or distribution of this Base Prospectus in any jurisdiction where action for that purpose is required. Accordingly, no Covered 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 Covered 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 Covered Bonds. In particular, there are restrictions on the distribution of this Base Prospectus and the offer or sale of Covered 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.

CONTENTS

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 *Covered* 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 Bases 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. Civil liability attaches only to those persons 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 and the shares are administered by the Icelandic State Financial Investments. 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	-Selected historical key financial information -No material changes in the prospects of the Issuer -No material changes in the financial or trading position since the date of its last published financial statements	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)
Net interest income	28,010	27,105	28,430
Fee and commission income	20,737	17,984	16,695
Fee and commission expense	(7,567)	(6,501)	(6,262)
Net fee and commission income	13,170	11,483	10,433
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
Other net operating income	3,493	3,855	3,734
Total operating income	44,673	42,443	42,597
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)
Total operating expenses	(27,705)	(26,400)	(28,888)
Profit before loan impairment charges and net valuation c	16,968	16,043	13,709
Loan impairment charges and net valuation changes	8,135	8,810	16,299
Profit before tax	25,103	24,853	30,008
Income tax	(5,851)	(6,239)	(7,866)
Profit for the year from continuing operations	19,252	18,614	22,142
Profit from discontinued operations, net of income tax	1,326	4,136	927
Profit for the year	20,578	22,750	23,069

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
Assets			
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
Total Assets	1,045,769	911,328	866,009
Liabilities			
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
Total Liabilities	843,542	725,841	698,691
Equity			
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
Total equity attributable to the equity holders of Ísla	198,290	183,823	166,019
Non-controlling interests	3,937	1,664	1,299
Total Equity	202,227	185,487	167,318
Total Liabilities and Equity	1,045,769	911,328	866,009

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 activites	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 and the shares are administered by the Icelandic State Financial Investments. 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 Covered Bonds may be rated or unrated. In the case of rated Covered 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 Covered Bonds has declined or is in question. If any rating assigned to the Covered Bonds is lowered or withdrawn, the market value of the Covered Bonds may be reduced The Issuer has been assigned a credit rating by two rating agencies; S&P and Fitch. S&P rate the issuer as BBB-/A-3 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	Covered Bonds will be issued in Series. Each Series may comprise one or more Tranches issued on different issue dates. The Covered 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. 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 Covered Bonds and this Base Prospectus and must be read in conjunction with this Base Prospectus. Covered Bonds may provide for interest based on a fixed rate ("**Fixed Rate Covered Bonds**"). Covered Bonds may provide for interest based on a floating rate ("**Floating Rate Covered Bonds**"). Covered Bonds may provide for payments of interest to be linked to an index ("**Inflation-**

		Linked Interest Covered Bonds"). Covered Bonds may provide that no interest is payable ("**Zero Coupon Covered Bonds**"). Zero Coupon Covered Bonds will be offered and sold at a discount to their nominal amount and will not bear interest
C.2	Currency of the securities	Covered 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 "**Specified Currency**"). Payments in respect of Covered Bonds may, subject to such compliance, be made in and/or linked to, any currency or currencies other than the currency in which such Covered 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 Covered Bonds
C.4, C.8 and C.9	Description of the rights attached to the securities	Each Covered Bond constitutes unsubordinated obligations issued in accordance with the Act on Covered Bonds and ranks *pari passu* among themselves and with related derivative contracts contained in the relevant Cover Pool (as specified in the applicable Final Terms). Senior debt (if any) ranks immediately thereafter. To the extent that claims in relation to the Covered Bonds, related derivative contracts and Senior Debt (if any) are not met out of the assets of the relevant Cover Pool or the proceeds arising from it, the residual claims 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. In the event of the establishment of an administration estate of the Issuer, the costs and debt (if any) of such administration will rank ahead of claims for payments of the Covered Bonds, of related derivative contracts and of the relevant Senior Debt (if any). Interest will be payable on Fixed Rate Covered Bonds on such date or dates as may be agreed by the Issuer (as specified in the applicable Final Terms) and on redemption. Floating Rate Covered Bonds will bear interest at a rate determined: • 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 • on the basis of a reference rate appearing on the agreed screen page of a commercial quotation service; or • on such other basis as may be agreed by the Issuer, as specified in the applicable Final Terms. The margin (if any) relating to such floating rate will be agreed by the Issuer for each Series of Floating Rate Covered Bonds. Payments of principal in respect of Inflation-Linked Interest Covered 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). Interest on Floating Rate Covered Bonds and Inflation-Linked Interest Covered 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 The applicable Final Terms will indicate the scheduled maturity date of such Covered Bonds (the "**Maturity Date**") and will also indicate whether such Covered Bonds can be redeemed prior to their stated maturity for taxation reasons or whether such Covered Bonds will be redeemable at the option of the Issuer ("**Call Option**") 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 Covered Bondholders 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 There will be no representative of debt security holders
C.21	Indication of the market where the securities will be traded and for which prospectus has been published	This Base Prospectus has been approved by FME as a base prospectus. Application will be made to the NASDAQ OMX Iceland for the Covered Bonds issued under the Programme to be admitted to trading on the NASDAQ OMX Iceland regulated market. Covered 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. Covered Bonds that are neither listed nor admitted to trading on any market may also be issued. The applicable Final Terms will state whether or not the relevant Covered Bonds are to be listed and/or admitted to trading and, if so, on which stock exchanges and/or markets

D Risks

Element	Disclosure requirement	Information
D.2	Key information on the key risks that are specific to the Issuer	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: Credit risk: • Third parties that owe the Issuer money, securities or other assets may be unable to meet their obligations towards the Issuer. • The Issuer's loan portfolio is 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. 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 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. Operational risk: • 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 • 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. Liquidity risk: • 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. Legal risk: • 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. 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.
D.3	Key information on the key risks that are specific to the	The Issuer identifies the following main risks associated with the Covered Bonds that may affect its ability to fulfil its obligations under the Programme.

	securities	• Mortgaged real estate properties may be concentrated in certain locations in Iceland and any deterioration in prices in the residential real estate markets and any deterioration in the economic conditions in such areas may adversely affect the ability of the borrowers to make payments on the loans. • 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.; • There is a risk that borrowers of certain loans contained in the Cover Pool retain a residual right, *inter alia*, to set-off claims against the Issuer against the amount outstanding under their relevant loans. In order to mitigate this risk the Issuer currently intends that it shall, include additional assets in the relevant Cover Pool up to a value that is equal to the set-off risk as calculated on a quarterly basis. • No Covered Bondholders or counterparties to derivative contracts can claim early repayment of payment obligations on the basis of a bankruptcy order against the Issuer or the Issuer´s failure to satisfy the requirement for additional collateral. Moreover, the relevant borrower(s) of the underlying loan(s) will retain the right to repay their loan(s) in full or in part without variation. Furthermore, it is not possible for individual Covered Bondholders or counterparties to the derivative contracts to initiate claims against the Issuer during the Issuer's bankruptcy. • The Covered Bonds may be rated or unrated. In the case of rated Covered 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 Covered Bonds has declined or is in question. If any rating assigned to the Covered Bonds is lowered or withdrawn, the market value of the Covered Bonds may be reduced. ; and • while the Covered 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 Covered Bonds will develop in the future.

E OFFER

Element	**Disclosure requirement**	**Information**
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 Covered 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 Covered 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 Covered 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 Covered 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 Covered Bonds and General Risk Factors.

The following is a general discussion of risks typically associated with the Issuer and the acquisition and ownership of Covered 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 Covered 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 COVERED 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 evolvement 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 31 December 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 Íslandsbanki.

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 COVERED BONDS

THE COVERED BONDS MAY NOT BE A SUITABLE INVESTMENT FOR ALL INVESTORS

Each potential investor of Covered 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 Covered Bonds, the merits and risks of investing in the relevant Covered 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 Covered 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 Covered Bonds, including Covered 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 Covered 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 Covered 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 Covered 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 Covered Bonds will perform under changing conditions, the resulting effects on the value of such Covered Bonds and the impact this investment will have on the potential investor's overall investment portfolio.

LOCATION OF THE MORTGAGED PROPERTIES

Mortgaged real estate in respect of residential properties securing the Covered Bonds issued under this Base Prospectus will be located in Iceland. Such real estate properties may be concentrated in certain locations and any deterioration in prices in the residential real estate markets and any deterioration in the economic conditions in such areas may adversely affect the ability of the borrowers to make payments on the loans. The concentration of loans secured by residential properties, therefore, result in a greater risk of non-payment than if such concentration had not been present.
Moreover, such factors may have an impact on the value of the properties. If the residential real estate markets in Iceland experience an overall decline in property values, the value of the Cover Pool could be significantly reduced and, may ultimately, result in losses allocable to the Covered Bonds should it be necessary to enforce the security granted in respect of such properties.

ECONOMIC CONDITIONS

As the assets which make up the Cover Pool will include loans secured by mortgages over residential properties, then the values of the assets and the ability of the Issuer to continue to make timely payments on the Covered Bonds could be adversely affected by, among other things, adverse developments in the Icelandic economy and/or residential and/or, the real estate markets.

COMPETITION

The Issuer faces competition in the residential mortgage market in Iceland, primarily from the Icelandic Housing Financing Fund and other financial institutions providing residential mortgages. Some of the Issuer's competitors may be larger and better capitalised. The Issuer may face pricing pressure in the future as competitors seek to obtain market shares by reducing prices or offering new services at low prices. While the Issuer believes it is positioned to compete effectively with these competitors, there can be no assurance that existing or increased competition will not adversely affect the Issuer. The demand for the Issuer's products is also dependant on levels of customer confidence, prevailing market rates and other factors that have an influence on the customers' economic situation.

BUSINESS RISK FACTORS

There are many circumstances that affect the level of credit loss, early repayments, withdrawals and final payments of interest and principal amounts, such as changes in the economic climate, both nationally and internationally, and changes regarding taxation, interest rate developments, level of unemployment, inflation and/or the political environment. Borrowers may default as a result of interest rate increases or as a result of adverse developments in their own personal circumstances (for example, in respect of residential mortgages following redundancy or divorce, insolvency of the borrower and/or insolvency of the tenant of the relevant property and/or failure (for any reason) by such tenant to make rental payments in respect of such property).

Default in respect of the Issuer's assets comprised in the Cover Pool could jeopardise the Issuer's ability to make payments in full or on a timely basis on the Covered Bonds.

Risks attaching to the Covered Bonds as a result of default in respect of the assets in the Cover Pool are reduced by a number of features of the Covered Bonds, including the ability of the Issuer to substitute assets to and from the relevant Cover Pool. However, if a material amount of assets in the Cover Pool were to default, there is no guarantee that the required level of assets within the relevant Cover Pool could be maintained or that the Issuer would be in a position to substitute non-defaulting assets for the defaulting assets.

NO DUE DILIGENCE

Covered Bondholders will not have the ability to investigate the Cover Pool, but will instead rely on the obligations of the Issuer under the Act on Covered Bonds and the investigations of the Independent Investigator.

THE ISSUER IS LIABLE TO MAKE PAYMENTS WHEN DUE ON THE COVERED BONDS

The Issuer is liable to make payments when due on the Covered Bonds. The obligations of the Issuer under the Covered Bonds are direct, secured, 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 issued pursuant to the Act on Covered Bonds (save for any obligations required to be preferred by law)..

LIMITED DESCRIPTION OF THE COVER POOL

Covered Bond holders will not receive detailed statistics or information in relation to the bonds or other assets contained or to be contained in the Cover Pool, as it is expected that the constitution of the Cover Pool may change from time to time. However, an Independent Inspector appointed under the Independent Inspector Agreement and in accordance with the Act on Covered Bonds, and appurtenant regulations, shall monitor the Issuer's compliance with the requirements of the Act on Covered Bonds. A regular report on the Cover Pool will be published quarterly, no later than 30 days from the end of each quarter, on the Issuer's homepage: http://www.islandsbanki.is/english/investor-relations/

There is no assurance that the characteristics of further mortgages will be the same as those mortgages in the Cover Pool as at Issue Date. However, each mortgage will be required to meet the requirements set out in the Act on Covered Bonds and appurtenant regulations.

COVERED BONDS ISSUED UNDER THE PROGRAMME

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

COVERED BONDS SUBJECT TO OPTIONAL REDEMPTION BY THE ISSUER

An optional redemption feature is likely to limit the market value of Covered Bonds. During any period when the Issuer may elect to redeem Covered Bonds, the market value of such Covered 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 Covered Bonds when its cost of borrowing is lower than the interest rate on the Covered 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 Covered 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 Covered Bonds

The Covered Bonds will constitute obligations of the Issuer which have the benefit of a statutory preference under the Act on Covered Bonds in respect of the relevant pool of assets maintained by the Issuer being the Cover Pool. An investment in the Covered Bonds involves a reliance on the assets of the Cover Pool and the creditworthiness of the Issuer. The Covered Bonds are not guaranteed by any third party. In addition, an investment in the Covered Bonds involves the risk that subsequent changes in the actual or perceived creditworthiness of the Issuer may adversely affect the market value of the Covered Bonds.

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

Enforcement Risk

When a mortgage loan is enforced, a court order may be needed to establish the borrower's obligation to pay and to enable a sale by executive measures. The Issuer's ability to make use of the collateral after enforcement can be limited and the collateral could decline in value when trying to sell the collateral in the market.

Set-off risks in relation to some types of Loans may adversely affect the value of the Portfolio or any part thereof

There is a risk that borrowers of certain loans contained in the Cover Pool retain a residual right under Icelandic law to set-off claims against the Issuer against the amount outstanding under their relevant loans. Under Icelandic law set-off can be exercised when claims are (i) mutual, (ii) due, and (iii) obligations are of the same nature.

In such circumstances the borrowers of certain loans contained in the Cover Pool would most likely be depositors with the Issuer. In a bankruptcy event of the Issuer, these depositors are guaranteed under the Icelandic Act No. 98/1999, on the Depositors and Investors Guarantee Fund, certain to a maximum amount. The Guarantee Fund would in a bankruptcy event compensate the depositor and assume the deposit claims, which would become priority claims of the estate of the Issuer under the Icelandic Act No. 21/1991 on Bankruptcy etc., cf. the Act on Financial Undertakings, and therefore reducing any risk of set-off as the Guarantee Fund would not assume any right to set-off against the Issuer. The Issuer however intends to mitigate this risk with Overcollateralisation.

Overcollateralisation

The Issuer will maintain the Value of the relevant Cover Pool at a level that exceeds the value of the Covered Bonds by at least 20 per cent. ("Overcollateralisation") which, in the opinion of the Issuer, will be sufficient to manage the market risk of the Cover Pool and to enable the Covered Bonds to obtain and maintain the Programme and any Cover Pool rating. The rating of the Covered Bonds, if any, is based on an assumption of Overcollateralisation; if the level of Overcollateralisation is not maintained, the rating of the Covered Bonds may change from time to time.

According to the Issuer´s license to issue the Covered Bonds the aggregated total amount of the Cover Pool shall not exceed a level of 30 per cent. above the issued Covered Bonds at any time unless increased demand has developed due to other provisions of the Act on Covered Bonds, such as due to stress test present value calculations. If the

Overcollateralisation exceeds the limit the Issuer shall notify the FME and the Independent Inspector immediately. The Issuer will have 14 days to remedy the level.

EXTENDABLE OBLIGATIONS UNDER THE COVERED BONDS

The applicable Final Terms will provide that an Extended Maturity Date applies to each Series of Covered Bonds unless to do so would result in the Issuer being unable to obtain if applicable the relevant credit rating from the relevant rating agencies appointed by the Issuer at the relevant time in respect of a Series of Covered Bonds, as applicable.

The extension of the maturity of the principal amount outstanding of the Covered Bonds from the Maturity Date to the Extended Maturity Date will not result in any right of the Covered Bondholders to accelerate payments or take action against the Issuer, and no payment will be payable to the Covered Bondholders in that event other than as set out in the Terms and Conditions of the Covered Bonds as amended by the applicable Final Terms. Furthermore the Issuer may at its discretion decide to either pay amounts due on any Interest Payment Date or add the same to the principal amount outstanding.

LIQUIDITY RISK RELATING TO THE COVER POOL UPON INSOLVENCY OF THE ISSUER

According to the Act on Covered Bonds, upon an insolvency event of the Issuer, the court appointed administrator shall fulfil the commitments of the Issuer under the Programme. However there are no assurances that the Cover Pool can sustain the Covered Bonds payments post insolvency which could force the administrator to liquidate the Cover Pool. In such an event there could potentially be no market, or a limited market, for the Cover Pool assets.

GENERAL RISK FACTORS

NO EVENTS OF DEFAULT

The terms and conditions of the Covered Bonds do not include any events of default relating to the Issuer, the occurrence of which would entitle Covered Bondholders to accelerate the Covered Bonds, and it is envisaged that Covered Bondholders will only be paid the scheduled interest payments under the Covered Bonds as and when they fall due under the Terms and Conditions of the Covered Bonds.

CONFLICTING INTERESTS OF OTHER CREDITORS

The rights of the Covered Bondholders and counterparties to derivative contracts included in the Cover Pool rank in priority to those of other creditors in so far as the Cover Pool is concerned (save for costs incurred in connection with the operation, management, collection and realisation of the Cover Pool in the event of bankruptcy which shall be covered before the claims of the Covered Bondholders). To the extent that claims in relation to the Covered Bonds and related derivative contracts are not met out of the assets of the Cover Pool or the proceeds arising from it, the residual claims will rank *pari passu* with claims of all other unsecured and unsubordinated creditors of the Issuer (other than those preferred by law).

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 Covered Bond as a result of the imposition of such withholding tax.

Changes of law

The terms and conditions of the Covered Bonds, in case of ISD System Covered 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.
The Icelandic Covered Bonds Legislation is a relatively new legislation in Iceland and for this reason there is no available case law on it. It is uncertain how the Act on Covered Bonds will be interpreted or whether changes or amendments will be made to it which will affect Covered Bonds issued under the Programme, including retroactive effect.

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 Covered Bonds.

Exchange rate risks

The Issuer will pay principal and interest on the Covered 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 Covered Bonds;,;
ii. the Investor's Currency-equivalent value of the principal payable on the Covered Bonds; and
iii. the Investor's Currency-equivalent market value of the Covered Bonds.

Interest rate risks

Investment in Fixed Rate Covered Bonds involves the risk that subsequent changes in market interest rates may adversely affect the value of the Fixed Rate Covered Bonds. Also the pledged assets may or may not carry fixed interest rates and thus interest rate movements may adversely affect their value.

There can also be a mismatch between the interest rate profile of the pledged assets and the Covered Bonds. This risk is monitored closely according to the Act on Covered Bonds in Iceland and the coverage of the pledged assets is such that their market value does not go below the market value of the Covered Bonds following a 100 basis points sudden and permanent shock to the relevant interest rates. The risk remains that a more severe shock will occur and the Issuer is unable to pledge more assets as collateral.

Inflation risk

The payments and the principal of Covered Bonds issued under the programme may or may not be indexed to the Consumer Price Index ("CPI"). This creates the risk of a cash flow mismatch as well as a market value mismatch between the assets in the Cover Pool and the Covered Bonds issued since those assets also may or may not be indexed to the CPI. This risk is monitored closely and the coverage of the Cover Pool is such that their market value does not go below the market value of the Covered Bonds following a sudden and unexpected inflation/deflation shock of 2.5%. The risk remains that a more severe shock will occur and the Issuer is unable to pledge more assets as collateral.
Investment in indexed linked Covered Bonds involves the risk that subsequent changes in the CPI may adversely affect the value of the index linked Covered Bonds.

Index for mortgage payment adjustment

A large part of the assets in the Cover Pool is now indexed to the index for mortgage payment adjustment, according to the Icelandic Act on Smoothing of Mortgage Loans to Individuals No. 63/1985, as amended. This index is created by a specific combination of Iceland's employment level and the official salary index. This creates the risk of a cash flow mismatch during prolonged periods of high unemployment and during periods where salaries do not keep up with inflation. The Issuer meets this risk by increasing the collateral coverage but the risk remains that the Issuer depletes its sources for eligible collateral. This risk is monitored closely and the coverage of the Cover Pool is such that its market value does not go below the market value of the Covered Bonds even under a stress scenario for the index for mortgage payment adjustment. The stress test is designed to be of a similar severity as the other stress tests described above for interest rates and inflation. The risk remains that the reality will be more severe and the cash flow of the pledged assets will be insufficient to meet the cash flow of the Covered Bonds.

Liquidity risk

The Issuer faces liquidity risk. This includes the risk of not having liquidity to meet coupon payments of the Covered Bonds as well as the risk of not being able to refinance the principal of the Covered Bonds at maturity. These risks are mitigated, respectively, by the fact that according to Act on Covered Bonds the cash-flow from the Cover Pool is sufficient to service the coupon cash-flow of the Covered Bonds and the fact that the market value of the Cover Pool exceeds the market value of Covered Bonds.

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) Covered Bonds are legal investments for it, (ii) Covered Bonds can be used as collateral for various types of borrowing and (iii) other restrictions apply to its purchase or pledge of any Covered Bonds. Financial institutions should consult their legal advisors or the appropriate regulators to determine the appropriate treatment of Covered 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 Covered Bonds admission to trading on a regulated market cf. Article 52 of the Act on Securities Transactions.

Reykjavík, Iceland,

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 and 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 92 - 123 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 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 92-123 from the annual reports for the financial years 2013 and 2014. Our responsibility is based on our work to express conclusion 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 92-123 are, in all material respects, in accordance with the published annual reports from which they have been extracted.

Conclusion

Our conclusion is that the consolidated financial information presented on pages 92-123 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 92-123

Kópavogur, Iceland
On behalf of Deloitte hf.

Pálína Árnadóttir State Authorised Public Accountant
Gunnar Þorvarðarson State Authorised Public Accountant

Gunnar Þorvarðarson Pálína Árnad

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 92-123 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 92-123 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 92-123 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 92-123 to financial information in the consolidated financial statements for 2015.

Conclusion

Our conclusion is that the consolidated financial information presented on pages 92-123 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 92-123

Reykjavík, Iceland,
On behalf of Ernst & Young ehf

Margrét Pétursdóttir

Margrét Pétursdóttir

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. The 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 Covered Bonds issued under the Programme.

[*Date*]

ÍSLANDSBANKI HF.

Issue of [Aggregate Nominal Amount of Tranche] [Title of Covered Bonds] under the ISK 100,000,000,000

Covered 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 Covered Bonds (the **Terms and Conditions**) set forth in the Base Prospectus dated 6 May 2016. This document constitutes the Final Terms of the Covered 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 Covered 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/covered-bonds/ 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.*.]

1.	**Issuer:**	Íslandsbanki hf.
2.		
	i. Series Number:	[ ]
	ii. Tranche Number:	[ ] *(If fungible with an existing Series, details of that Series, including the date on which the Covered Bonds become fungible)*
	iii. Ticker:	[ ]
3.	**Specified Currency or Currencies:**	[ ]
4.	**Aggregate Nominal Amount:**	
	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*]]
	ii. Extended Maturity Date:	[Applicable/Not Applicable] (*If not applicable, delete the remaining sections of this subparagraph*) The Extended Maturity Date is [specify date or Interest Payment Date falling in or nearest to the relevant month and year; in each case falling up to 36 months after the Maturity Date] [*If applicable, complete relevant sections regarding interest, etc.*]
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*)
	ii. Interest Basis from Maturity Date to Extended Maturity Date:	[Inflation Linked Interest] [[ ] per cent. Fixed Rate] [[LIBOR/EURIBOR/REIBOR] +/- [ ] per cent. Floating Rate] [Zero Coupon] [*specify other*]
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 Covered Bonds into another Interest Basis or Redemption/Payment Basis*]
12. Call Option:	[Issuer Call/ Not Applicable] [(*further particulars specified below*)]
13. Status of the Covered Bonds:	Senior.
14. Approval for issuance of the Covered Bonds:	
[Date of [Board] approval for issuance of Covered Bonds obtained]:	[Date/ Not Applicable] (*N.B. Only relevant where Board (or similar) authorisation is required for the particular Tranche of Covered Bonds*)
15. Method of distribution:	[Syndicated/Non-syndicated]

PROVISIONS RELATING TO INFLATION LINKED ANNUITY COVERED BONDS

16.	**Inflation Linked Annuity Covered 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.	Rate(s) of Interest from Maturity Date to Extended Maturity Date:	[ ] per cent. per annum [payable [annually/semi-annually/quarterly/monthly] in arrear]
iii.	Number of Interest Payment Dates:	[ ]
iv.	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 [].
v.	Day Count Fraction:	[30/360] [*specify other*]
vi.	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.)

vii. 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, which is calculated according to the following formula:

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

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.)

viii. Payment(s):

On each Interest Payment Date the sum of the relevant Principal Repayment and the Interest Payment.

ix. Calculation Agent:: [Issuer] [specify other]

x. 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:

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

where:

CP_{M-1} = CPI value published by Statistic Iceland in the month preceding month M

CP_{M-2} = CPI value published by Statistic Iceland 2 months prior to month M

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 COVERED BONDS INCLUDING COVERED BONDS WITH ONE PAYMENT OF PRINCIPAL ON MATURITY DATE

17.	**Inflation Linked Equal Principal Payment Covered 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.	Rate(s) of Interest from Maturity Date to Extended Maturity Date:	[ ] per cent. per annum [payable [annually/semi-annually/quarterly/monthly] in arrear]
iii.	Number of Interest Payment Dates:	[number of dates]
iv.	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 [].
v.	Number of Principal Payment Dates:	[Number of Interest Payment Dates/1]
vi.	Principal Payment Date(s):	[On each Interest Payment Date/Maturity Date]
vii.	Day Count Fraction:	[Act/Act] [*specify other*]
viii.	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.
ix.	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.

x. Payments(s): On each Interest Payment Date the sum of the relevant Principal Repayment and the Interest Payment.

xi. Calculation Agent: [Issuer] [*specify other*]

xii. 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_t means the Principal Amount Outstanding on the relevant Interest Payment Date.

PAO_{t-1} means the Principal Amount Outstanding on the preceding Interest Payment Date.

PR_{t-1} means the Principal Repayment on the preceding Interest Payment Date.

IR_t means the Index Ratio on the relevant Interest Payment Date.

IR_{t-1} means the Index Ratio on the preceding Interest Payment Date (Issue Date for the first Interest Payment Date).

xiii. 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:

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

where:

CP_{M-1} = CPI value published by Statistic Iceland in the month preceding month M

CP_{M-2} = CPI value published by Statistic Iceland 2 months prior to month M

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 Covered 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.	Rate(s) of Interest from Maturity Date to Extended Maturity Date:	[ ] per cent. per annum [payable [annually/semi-annually/quarterly] in arrear]
iii.	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*)
iv.	Day Count Fraction:	[Actual/Actual (ISMA)/[*specify other*]]
v.	Other terms relating to the method of calculating interest for Fixed Rate Covered Bonds:	[None/*Give details*]

19. Floating Rate Covered 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 Reykjavík 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.	Margin(s) from Maturity Date to Extended Maturity Date:		[+/-] [ ] per cent. per annum
x.	Minimum Rate of Interest:		[[ ] per cent. per annum/Not Applicable]
xi.	Maximum Rate of Interest:		[[ ] per cent. per annum/Not Applicable]
xii.	Day Count Fraction:		[Actual/Actual Actual/365 Actual/365 (Fixed) Actual/365 (Sterling) Actual/360 30/360

30E/360

Other]

(*See Condition 6.7 for alternatives*)

xiii.	Fallback provisions, rounding provisions and any other terms relating to the method of calculating interest on Floating Rate Covered Bonds, if different from those set out in the Terms and Conditions:	[ ]

20. Zero Coupon Covered 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 8.6.b) and 8.10 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 Covered Bonds and Inflation Linked Equal Principal Payment Covered Bonds, select "Applicable"*)

i.	Optional Redemption Date(s):	[ ]

(*N.B. For Inflation Linked Annuity Covered Bonds* *and Inflation Linked Equal Principal Payment Covered Bonds, select "Each Interest Payment Date"*)

ii. Optional Redemption Amount of each Covered Bond and method, if any, of calculation of such amount(s):	[[ ] per Covered Bond of [ ] Specified Denomination] [*specify formula*] [Condition 8.6 (a) applies] *(N.B. For Inflation Linked Annuity Covered Bonds and Inflation Linked Equal Principal Payment Covered Bonds, select "Condition 8.6 a) applies")*
iii. Early Redemption Amount:	[*As set out in Condition 8.6*]
iv. If redeemable in part:	
(i) Minimum Redemption Amount:	[ ]
(ii) Maximum Redemption Amount:	[ ]
v. 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 Covered Bond:	[ ] per Covered Bond of [ ] Specified Denomination/*specify other*/see Appendix] [Not Applicable] (N.B. *For Inflation Linked Annuity Covered Bonds and Inflation Linked Equal Principal Payment Covered Bonds, select "Not Applicable"*) *(N.B. In relation to any issue of Covered Bonds which are expressed at paragraph 6 above to have a minimum denomination and tradeable 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 Covered 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 COVERED BONDS

23. New Global Covered Bond:	[Yes/No]
24. Form of Covered Bonds:	[VS System Covered Bonds] [Temporary Bearer Global Covered Bond exchangeable for a Permanent Bearer Global Covered Bond which is exchangeable for definitive Covered Bonds [on 60 days' notice given at any time/only after an Exchange Event] [Temporary Bearer Global Covered Bond exchangeable for definitive Covered Bonds on and after the Exchange Date] [Permanent Bearer Global Covered Bond exchangeable for definitive Covered Bonds [on 60 days' notice given at any time/only after an Exchange Event]][1] [Registered Covered 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 Covered Bonds (and dates on which such Talons mature):	[Yes/No. (*If yes, give details)*]

[1] The option to exchange a Temporary or Permanent Global Covered Bond for a Definitive Covered 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 Covered 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 Covered Bonds and interest due on late payment:	[Not Applicable/*give details. N.B. a new form of Temporary Global Covered Bond and/or Permanent Global Covered Bond may be required for Partly Paid issues*]
28. Details relating to Instalment Covered 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 Covered Bonds described herein pursuant to the ISK 100,000,000,000 Covered 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 OMX Iceland/other (*specify*)/None]
ii.	Admission to trading:	[Application has been made for the Covered Bonds to be admitted to trading on [ ] with effect from [ ].] [Not Applicable.]

2. RATING

[Not Applicable/The Covered 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 Covered 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.]

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 Covered 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 Covered 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 Covered 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 Covered Bonds and Inflation Linked Equal Principal Payment Covered Bonds Only)*

The general cash-flow of the Covered 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
January	334.8	356.8	363.4	387.1	403.3	415.9	419.3	428.3
February	336.5	360.9	367.7	391.0	409.9	418.7	422.1	
March	334.5	362.9	371.2	395.1	410.7	419.7	426.4	
April	336.0	363.8	374.1	398.2	411.5	421.0	427.0	
May	339.8	365.3	377.6	398.1	411.3	421.3	428.2	
June	344.5	364.1	379.5	400.1	413.5	422.8	429.3	
July	345.1	361.7	379.9	397.2	412.4	422.1	430.0	
August	346.9	362.6	380.9	396.6	413.8	423.1	432.3	
September	349.6	362.6	383.3	399.6	415.2	422.6	430.6	
October	353.6	365.3	384.6	400.7	415.2	423.1	430.9	
November	356.2	365.5	384.6	402.0	416.7	420.9	429.4	
December	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
January	18.6	6.6	1.8	6.5	4.2	3.1	0.8	2.1
February	17.6	7.3	1.9	6.3	4.8	2.1	0.8	
March	15.2	8.5	2.3	6.4	3.9	2.2	1.6	
April	11.9	8.3	2.8	6.4	3.3	2.3	1.4	
May	11.6	7.5	3.4	5.4	3.3	2.4	1.6	
June	12.2	5.7	4.2	5.4	3.3	2.2	1.5	
July	11.3	4.8	5.0	4.6	3.8	2.4	1.9	
August	10.9	4.5	5.0	4.1	4.3	2.2	2.2	
September	10.8	3.7	5.7	4.3	3.9	1.8	1.9	
October	9.7	3.3	5.3	4.2	3.6	1.9	1.8	
November	8.6	2.6	5.2	4.5	3.7	1.0	2.0	
December	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[1].

- 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 ±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. 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.
- 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.

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 Covered 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

[1] 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:	i. [Yes][No]. ii. [Note that the designation "yes" simply means that the Covered Bonds are intended upon issue to be deposited with one of the ICSDs as common safekeeper and does not necessarily mean that the Covered 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 Covered Bonds must be issued in NGN form]

TERMS AND CONDITIONS OF THE COVERED BONDS

The following are the Terms and Conditions of the Covered Bonds which will be incorporated by reference into each Covered Bond (as defined below). The applicable Final Terms in relation to any Tranche of Covered 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 Covered Bonds. Reference should be made to "Form of the Covered 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 Covered Bonds.

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

Interest bearing Covered Bonds: Interest bearing definitive Bearer Covered 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. Covered 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 Covered 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 Covered Bonds) attached to or endorsed on this Covered Bond. The Final Terms (or such relevant provisions thereof) must be read in conjunction with these Terms and Conditions 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 Covered 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 Covered Bonds which are identical in all respects (including as to listing and admission to trading) and **Series** means a Tranche of Covered Bonds together with any further Tranche or Tranches of Covered 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/covered-bonds/. 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 Covered Bonds and Covered 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 Covered 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 Covered 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 9 (Taxation), any premium payable in respect of a Covered 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 9 (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 Covered Bonds;

1.7 VS System Covered Bonds are in dematerialised form, and any references in these Terms and Conditions to Coupons and Talons shall not apply to VS System Covered Bonds and no global or definitive Covered Bonds will be issued in respect thereof; and

1.8 If the Covered Bonds are Zero Coupon Covered Bonds, references to Coupons and Couponholders are not applicable.

Accrual Period	In accordance with Condition 6.7(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
Accrual Yield	In relation to a Zero Coupon Covered Bond, the meaning given in the applicable Final Terms
Act on Contracts	The Icelandic Act on Contracts, Agency and Void Legal Instruments No. 7/1936, which came into effect 1 February 1936, as amended (*Icelandic: Lög um samninga, umboð og ógilda löggerninga nr. 7/1936*)
Act on Covered Bonds	The Icelandic Act on Covered Bonds No. 11/2008 which came into effect 4 March 2008, as amended (*Icelandic: Lög um sértryggð skuldabréf nr. 11/2008*).
Act on Interest and Price Indexation	The Icelandic Act on Interest and Price Indexation No. 38/2001, which came into effect 1 July 2001, as amended (*Icelandic: Lög um vexti og verðtryggingu nr. 38/2001*)
Act on Financial Undertakings	The Icelandic Act on Financial Undertakings No. 161/2002 which came into effect 1 January 2003, as amended (*Icelandic: Lög um fjármálafyrirtæki nr. 161/2002*)
Act on Securities Transactions	The Icelandic Act on Securities Transactions No. 108/2007 which came into effect 1 November 2007, as amended (*Icelandic: Lög um verðbréfaviðskipti 108/2007*)
Additional Business Centre	The meaning (if any) given in the applicable Final Terms
Additional Financial Centre	The meaning (if any) given in the applicable Final Terms
Amortised Face Amount	The meaning given in Condition 8.6(b)
Agency Agreement	Shall mean the agency agreement to be entered into between the Issuer, Fiscal Agent and other agents.
Annuity Amount	The meaning given in Condition 7.1(a)
Annuity Covered Bonds	Covered 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
Automatic Extension	The meaning given in Condition 8.11(b).

Bankruptcy Act	The Icelandic Act on Bankruptcy etc., No. 21/1991 which came into effect 1 July 1992, as amended (*Icelandic: lög um gjaldþrotaskipti o.fl. nr. 21/1991*)
Bearer Covered Bond	Means Cover Bonds issued in bearer form
Business Day	As defined in Condition 6.7(a)
Business Day Convention	In respect of a Trance of Covered 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 6.7(b)
Calculation Agent	The meaning (if any) given in the applicable Final Terms
Clearstream, Luxembourg	Clearstream Banking, société anonyme, 42 Avenue JF KennedyL-1855,Luxembourg, or its successors
Common Depositary	The common depositary for Euroclear and Clearstream Luxembourg
CPI	The consumer price indexation, as calculated by Statistics Iceland in accordance with the Act on Price Indexation No. 12/1995 (Icelandic: *Lög um vísitölu neysluverðs nr. 12/1995*) and published monthly in the Legal Gazette (Icelandic: Lögbirtingablaðið) in Iceland
Couponholders	The holders of the Coupons (which expression shall, unless the context otherwise requires, include the holders of the Talon
Coupons	Interest coupons in respect of definitive Covered Bonds
Cover Pool	A collection of bonds, substitute collateral and other assets listed in the Register, as provided for in Chapter VI of the Act on Covered Bonds, in which the Covered Bondholders and Issuer´s counterparties have rights of priority pursuant to the provisions of the Act on Covered Bonds
Cover Pool Member States	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
Covered Bond	The covered bonds issued or to be issued by the Issuer under the Programme in accordance with the Act on Covered Bonds
Covered Bondholders	The holders for the time being of the Covered Bonds
Covered Bond Legislation	Act on Securities Transactions, Act on Covered Bonds, 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),
Dealer	Any dealer appointed by the Issuer (if any)
Defaulted Loan	Any mortgage in a Cover Pool which is three months or more in arrears
Designated Maturity	The meaning given in the ISDA Definitions

Determination Date	The meaning given in the applicable Final Terms
Determination Period	The meaning given in condition 6.7(d)
Directors	The directors for the time being of the Issuer as defined in the Icelandic Act No. 2/1995, on Limited Liability Companies (*Icelandic: lög um hlutafélög nr. 2/1995*)
Distribution Compliance Period	The period that ends 40 days after completion of the distribution of each Tranche of Covered Bonds, as certified by the relevant Dealer
Early Redemption Amount	The amount calculated in accordance with Condition 8.6
Equal Payment Amount	The meaning given in Condition 7.1(b)
Established Rate	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
EU	The European Union
EURIBOR	Euro-zone inter-bank offered rate
Euroclear	Euroclear Bank S.A./N.V., 1, Boulevard du Roi Albert II B - 1210 Brussels, or its successor
Extended Maturity Date	Means the date falling no later than thirty-six months from the Maturity Date of the Covered Bonds
Final Redemption Amount	The meaning given in the applicable Final Terms
Final Terms	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 Covered 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 Covered Bonds are the Terms and Conditions of the Covered Bonds as completed, amended and/or replaced by the relevant Final Terms.
Fiscal Agent	Íslandsbanki hf., or any successor agent appointed as such
Fixed Rate Covered Bonds	Covered 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
Floating Rate	The meaning given in the ISDA Definitions
Floating Rate Convention	The meaning given in Condition 6.7(b)(i)
Floating Rate Covered Bonds	Covered Bonds which bear interest at a rate determined: (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 (ii) on the basis of a reference rate appearing on the agreed screen page of a commercial quotation service; or (iii) on such other basis as may be agreed between the Issuer and the relevant Dealer, or as set out in the applicable Final Terms
Following Business Day Convention	The meaning given in Condition 6.7(b)(ii)
FME	The Financial Supervisory Authority, Iceland (Fjármálaeftirlitið)
Glitnir	Glitnir banki hf., with its registered office at Sóltún 26, 105 Reykjavík Id.no. 550500-3530.
Global Covered Bonds	Global Covered Bonds comprising Temporary Global Covered Bonds and Permanent Global Covered Bonds
Government Bond	Bonds issued by the Icelandic State or other Cover Pool Member States, municipality in Iceland or in another Cover Pool Member State, or guaranteed by such Cover Pool Member State, in accordance with Article 5 of the Act on Covered Bonds
Group	The Issuer and its Subsidiaries
IFRS	International Financial Reporting Standards
Inflation Linked Annuity Covered Bonds	Covered Bonds that pay an Annuity Amount on such date or dates as decided by the Issuer and set out in the Final Terms
Inflation Linked Equal Principal Payment Covered Bonds	Covered Bonds that pay an Equal Payment Amount on such date or dates as decided by the Issuer and set out in the Final Terms
Instalment Amounts	In respect of Instalment Covered Bonds, each amount specified as such in the applicable Final Terms
Instalment Covered Bonds	Covered Bonds which will be redeemed in Instalment Amounts and on the Instalment Dates specified in the applicable Final Terms
Instalment Dates	In respect of Instalment Covered Bonds, each date specified as such in the applicable Final Terms
Interest Amount	The amount of interest payable on the Floating Rate Covered Bonds in respect of each Specified Denomination for the relevant Interest Period, as calculated in accordance with Condition 6.4(d) or the amount of interest payable on Inflation Linked Annuity Covered Bonds or Inflation Linked Equal Payment Covered Bonds in respect of each Specified Denomination for the relevant Interest Period, as calculated in accordance with Conditions 6.1 and 6.2 respectively
Interest Commencement Date	In the case of interest-bearing Covered Bonds, the date specified in the applicable Final Terms from (and including) which the relevant Covered Bonds will accrue interest

Interest Determination Date	In respect of Floating Rate Covered Bonds to which Screen Rate Determination is applicable, the meaning given in the applicable Final Terms
Interest Payment Date	In respect of Fixed Rate Covered Bonds, Inflation Linked Annuity Covered Bonds and Inflation Linked Equal Payment Covered Bonds, the meaning given in the applicable Final Terms and in respect of Floating Rate Covered Bonds the meaning given in Condition 6.4(a)
Interest Period	In accordance with condition 6.7(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
Investor's Currency	The currency or currency unit that an investor's financial activities are denominated in, other than the Specified Currency
ISD	The Icelandic Securities Depositary with its registered office at Laugavegur 182, 105 Reykjavík (*Icelandic: Verðbréfaskráning Íslands*)
ISD System Account Manager	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 Covered Bonds.
ISD System Covered Bonds	Shall mean Covered Bonds issued in a dematerialised, uncertified book entry form cleared through ISD.
ISDA	International Swaps and Derivatives Association, Inc.
ISDA Definitions	The meaning given in Condition 6.4(b)
ISDA Determination	If specified as applicable in the applicable Final Terms Document, the manner in which the Rate of Interest on Floating Rate Covered Bonds is to be determined in accordance with Condition 6.4(b)
ISDA Rate	The meaning given in Condition 6.4(b)
ISK or Icelandic Krona or krónur	The lawful currency of the Republic of Iceland
Issue Date	Each date on which the Issuer issues a Tranche of Covered Bonds under the Programme, as specified in the applicable Final Terms
Issue Price	The price, generally expressed as a percentage of the nominal amount of the Covered Bonds, at which a Tranche of Covered Bonds will be issued
Issuer	Íslandsbanki hf., ID.No. 491008-0160, having its registered office at Kirkjusandur 2, 155 Reykjavík, Iceland
Issuer Call	If specified as applicable in the applicable Final Terms, the provision by which the Issuer may redeem a Series of Covered Bonds in accordance with Condition 8.3
Issuer Cover Pool	The Cover Pool has the meaning given to it in the chapter Issuer Cover

	Pool in this Base Prospectus.
LIBOR	London inter-bank offered rate
Margin	As specified in the applicable Final Terms (if any).
Maturity Date	As specified in the applicable Final Terms.
Maximum Rate of Interest	In respect of a Floating Rate Covered Bond, the percentage rate per annum (if any) specified in the applicable Final Terms
Maximum Redemption Amount	The amount specified as such in the applicable Final Terms
Member State	A state which is a member of the European Economic Area
Minimum Rate of Interest	In respect of Floating Rate Covered Bonds, the percentage rate per annum (if any) specified in the applicable Final Terms
Minimum Redemption Amount	The amount specified as such in the applicable Final Terms
Modified Following Business Day Convention	The meaning given in Condition 6.7(b)(iii)
MiFID	Market in Financial Instruments Directive 2004/39/EC (*Icelandic: Tilskipun Evrópuþingsins og Ráðsins 2004/39/EB*)
Mortgage	Each mortgage loan referenced by its mortgage loan identifier number and comprising the aggregate of all principal sums, interest, costs, charges, expenses and other moneys due or owing with respect to that mortgage loan under the relevant mortgage terms by a borrower to the Issuer on the security of a Mortgage from time to time outstanding or, as the context may require, the borrower's obligations in respect of the same, and eligible to be added to the Cover Pool.
NASDAQ OMX Iceland	The regulated market of the NASDAQ OMX Iceland hf. with its registered office at Laugavegur 182, 105 Reykjavík.
Optional Redemption Amount	The meaning (if any) given in the applicable Final Terms
Optional Redemption Date	The meaning (if any) given in the applicable Final Terms
Overcollateralisation	The certain percentage level by which the Value of the Cover Pool will exceed the nominal value of the liabilities, relating to the issued Covered Bonds, along with all accrued interests.
Partial Redemption	The meaning given in Condition 8.11(f)
Paying Agents	The Principal Paying Agent and any other paying agent appointed (if any)
Payment Day	The meaning given in Condition 7.4
Preceding Business Day Convention	The meaning given in Condition 6.7(b)(iv)
Principal Amount Outstanding	In accordance with condition 6.7(f) means in respect of a Covered Bond, except an Inflation Linked Annuity Covered Bond and an Inflation Linked

	Equal Principal Payment Covered Bond on any day, the principal amount of that Covered Bond on the relevant Issue Date thereof less principal amounts received by the relevant Covered Bondholder in respect thereof on or prior to that day and in respect of an Inflation Linked Annuity Covered Bond and an Inflation Linked Equal Payment Covered Bond, the meaning given in the applicable Final Terms
Principal Paying Agent	The Issuer, Íslandsbanki hf.
Programme	ISK 100,000,000,000 covered bond programme established by the Issuer on the Issue Date which shall currently not exceed a limit of ISK 70,000,000,000. Any increases of the Programme shall be subject to the FME confirmation.
Property	A residential property in Iceland which is subject to a Mortgage
Prospectus Directive	Directive 2003/71/EC (*Icelandic: Tilskipun Evrópuþingsins og Ráðsins 2003/71/EB*)
Rate of Interest	In respect of a Series of interest-bearing Covered Bonds, the rate of interest payable from time to time in respect of such Covered Bonds determined in accordance with the Terms and Conditions and the applicable Final Terms
Redeemed Covered Bonds	The meaning given in Condition 8.3
Reference Price	In respect of a Zero Coupon Covered Bond, the meaning given in the applicable Final Terms
Reference Rate	In respect of Floating Rate Covered Bonds to which Screen Rate Determination applies, the meaning given in the applicable Final Terms
Registrar	Any registrar to be appointed in accordance with an Agency Agreement
Register	A special register in respect of covered bonds and the cover pool, together with any derivative agreements an issuer must maintain in accordance with Chapter VI of the Act on Covered Bonds and Chapter VI of the Regulation.
Registered Covered Bond	Means Covered Bonds issued in registered form.
Rules	The rules of 3 June 2008 No. 528/2008 on covered bonds issued by the FME under the authority conferred on it by Article 25 of the Act on Covered Bonds, which came into effect 3 June 2008, as amended.
Regulation S	Regulation S under the US Securities Act
REIBOR	Reykjavík Inter Bank Offering Rate
Relevant Screen Page	In respect of Floating Rate Covered Bonds to which Screen Rate Determination applies, the meaning given in the Final Terms
Reset Date	The Meaning given in the ISDA Definitions

Residential Mortgages	Bonds which have been issued against mortgages in residential housing in Cover Pool Member States, in accordance with Article 5 of the Act on Covered Bonds.
Resolution Committee	Committee appointed under Act No. 125/2008 to maximise the recovery value of Glitnir's assets for the benefit of Glitnir's creditors
EU Savings Directive	The European Council Directive 2003/48/EC
Screen Rate Determination	If specified as applicable in the applicable Final Terms, the manner in which the Rate of Interest on Floating Rate Covered Bonds is to be determined in accordance with Condition 6.4(b)
Security Interest	The meaning given in Condition 4.1
Selection Date	The meaning given in Condition 7.3
Senior Debt	Means loans that may be taken out to purchase assets which are in turn added to the Cover Pool in the event that the Issuer is required to post additional collateral
Series	A Tranche of Covered Bonds together with any further Tranche or Tranches of Covered 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
Specified Currency	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.
Specified Denomination	In respect of a Series of Covered Bonds, the denomination or denominations of such Covered Bonds at the minimum amount of EUR 50,000 as specified in the applicable Final Terms
Specified Interest Payment Date	In respect of Floating Rate Covered Bonds, the meaning (if any) given in the applicable Final Terms
Subsidiary	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.
Sub-Unit	The meaning given in Condition 6.7(g)
Talons	Talons for further Coupons in respect of interest-bearing definitive Covered Bonds
TARGET System	The meaning given in Condition 6.7(a)
Temporary Bearer Global Covered Bond	The temporary global covered bond in bearer form which will initially

	represent the Bearer Covered Bond of each Tranche
Terms and Conditions or Conditions	The terms and conditions of the Covered Bonds
US Securities Act	U.S. Securities Act of 1933, as amended
Tranche	An issue of Covered Bonds which are identical in all respects (including as to listing and admission to trading)
Value	The nominal par value of the Cover Pool along with all accrued interest (but excluding the nominal par value of each mortgage within the Cover Pool which is in arrears for 90 days or longer at the relevant time).
VS System Covered Bonds	Means Covered Bonds issued in uncertificated book entry form cleared through the ISD, Euroclear, Clearstream and/or, in relation to any Tranche of Covered Bonds, any other clearing system as may be specified in the relevant Final Terms (as the case may be)
VP LUX	means VP Lux S.à. r.l., 32, Boulevard Royal, L-2449 Luxembourg, or its successors.
Yen or **JPY**	The lawful currency for the time being of Japan
Zero Coupon Covered Bonds	Covered Bonds which will be offered and sold at a discount to their nominal amount and which will not bear interest
€, Euro or **euro**	The currency introduced at the start of the third stage of European economic monetary union pursuant to the Treaty
£ or **Sterling**	The lawful currency for the time being of the United Kingdom of Great Britain and Northern Ireland
$, U.S.$ or **U.S. Dollars** or **US Dollars**	The lawful currency for the time being of the United States of America

2. FORM, DENOMINATION AND TITLE

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

The Covered Bonds may be an Inflation Linked Annuity Covered Bond, an Inflation Linked Equal Principal Payment Covered Bond, a Fixed Rate Covered Bond, a Floating Rate Covered Bond, a Zero Coupon Covered 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 Covered 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 Covered 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 Covered Bonds issued in the form of Bearer Covered Bonds will initially be represented by a Temporary Bearer Global Covered Bond without Coupons, Receipts or Talons which will (i) if the global Covered Bonds are intended to be issued in a new global covered bond form ("**NGCB**"), 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 Covered Bonds are not intended to be issued in NGCB Form, 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 Covered Bond will be exchanged either for interests in a Permanent Bearer Global Covered Bond or, where specified in the applicable Final Terms (subject to such notice period as is specified in the Final Terms), for definitive Bearer Covered Bonds on or after the date (the "**Exchange Date**") which is the later of (i) 60 days after the Temporary Bearer Global Covered 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 Covered Bonds is not a U.S. person or other person who has purchased such Covered 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 Covered Bonds occurs whilst such Covered Bonds are represented by a Temporary Bearer Global Covered 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 Covered 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 Covered Bond is improperly withheld or refused. Payment of principal or interest (if any) on a Permanent Bearer Global Covered Bond will be made through Euroclear or Clearstream, Luxembourg (against presentation or surrender, as the case may be, of the Permanent Bearer Global Covered Bond if the Permanent Bearer Global Covered Bond is not intended to be issued in NGCB form) without any further requirement for certification. Pursuant to the Agency Agreement the Fiscal Agent shall arrange that, where a further Tranche of Covered Bonds is issued, the Covered Bonds of such Tranche shall be assigned a common code and ISIN by Euroclear and Clearstrem, Luxembourg which are different from the common code and ISIN assigned to Covered Bonds of any other Tranche of the same Series until at least expiry of the Distribution Compliance Period applicable to the Covered Bonds of such Tranche.

The applicable Final Terms will specify that either (i) a Permanent Bearer Global Covered Bond will be exchangeable (free of charge), in whole but not in part, for definitive Bearer Covered 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 Covered Bond) to the Fiscal Agent as described therein or (ii) a Permanent Bearer Global Covered Bond will be exchangeable (free of charge), in whole but not in part, for definitive Bearer Covered 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 Covered 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 9 (Taxation) which would not be required were the Covered Bonds represented by the Permanent Bearer Global Covered 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 Covered 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 Covered Bond) or the Covered 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 Covered 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 Covered 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 Covered 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 Covered Bonds, Receipts or Coupons.

Unless otherwise provided with respect to a particular Series of Registered Covered Bonds, the Registered Covered 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 Covered 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 Covered Bond, beneficial interests in a Reg. S. Global Covered 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 Covered Bond will bear a legend regarding such restrictions on transfer.

Registered Covered 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 Covered Bonds of each Tranche sold to QIBs will be represented by a Restricted Global Covered 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 Covered Bonds will be entitled or required, as the case may be, under the circumstances described below, to receive physical delivery of definitive Covered Bonds in fully registered form.

Payments of principal on the Registered Covered 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 Covered Bonds will be made on the relevant payment date to the person in whose name such Covered Bonds, Receipts and Coupons)) immediately preceding such payment date.

Payments of the principal of, and interest (if any) on, the Registered Global Covered Bonds will be made to the nominee of DTC as the registered holder of the Registered Global Covered 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 Covered Bonds or for maintaining, supervising or reviewing any records relating to such beneficial ownership interests.

For so long as any of the covered Bonds are represented by a Bearer Global Covered Bond held on behalf of Euroclear and/or Clearstrem, Luxembourg, or so long as DTC or its nominee is the registered holder of a Registered Global Covered Bond or so long as the Covered Bond is a VS Systems Covered 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 Covered 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 Covered 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 Covered Bonds for all purposes other than (in the case only of Covered Bonds not being VS System Covered Bonds) with respect to the payment of principal or interest on the Covered Bonds, for which purpose, in the case of Covered Bonds represented by a Bearer Global Covered Bond, the bearer of the relevant Global Bearer Covered Bond, or in the case of Covered Bonds where DTC or its nominee is the registered holder of a Registered

Global Covered Bond, DTC or its nominee shall be treated by the Issuer, the Fiscal Agent and any other Paying Agent as the holder of such Covered Bonds in accordance with and subject to the terms of the relevant global Covered Bond (and the expressions "**Covered Bondholder**" and "**holder of Covered Bonds**" and related expressions shall be construed accordingly).

Covered Bonds which are represented by a Bearer Global Covered 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 Covered 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 Covered Bonds will be issued in uncertificated and dematerialised book entry form. Legal title to the VS Systems Covered 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 Covered 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 Covered Bonds will take place in accordance with the rules and procedures for the time being of the ISD or VP LUX.

Covered Bonds that are represented by a global Covered Bond and VS System Covered 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 Covered 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 Covered 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 COVERED BONDS

The Covered Bonds constitute direct, unconditional, unsubordinated and secured obligations of the Issuer issued in accordance with the Act on Covered Bonds and appurtenant regulations and rank pari passu among themselves and with all other obligations of the Issuer that have been provided the same priority as debt instruments issued pursuant to the Act on Covered Bonds (save for certain obligations required to be preferred by law) (other than subordinated obligations, if any), from time to time outstanding. Senior Debt (if any) ranks thereafter. To the extent that claims in relation to the Covered Bonds, related derivative contracts and Senior Debt (if any) are not met out of the assets of the Cover Pool or the proceeds arising from it, the residual claims 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, to such extent as the cost is incurred due to efforts of the bankruptcy administrator concerning the Covered Bonds and the Cover Pool, will rank ahead of claims for payments of the Covered Bonds, of related derivative contracts and of the relevant Senior Debt (if any). Other cost of bankruptcy administration shall not be paid from the assets of the Cover Pool.

4. ISSUER COVENANTS

4.1 Negative Pledge.

In accordance with the Act on Covered Bonds, cf. Article 12(4), the Issuer undertakes, so long as any of the Covered Bonds, Receipts or Coupons remain outstanding, that it will not, and that it will procure that none of its Relevant Subsidiaries will, create or have outstanding any mortgage, charge, pledge, lien or other security interest (each a **Security Interest**) over the mortgages or other assets in the Cover Pool, other than any lien arising by operation of law (if any).

4.2 Maintenance of the Issuer Cover Pool.

For so long as the Covered Bonds are outstanding, the value of the Cover Pool will not at any time be less than the total aggregate outstanding principal amount of all Covered Bonds issued under the Programme plus an Overcollateralisation of 20 per cent. According to the Issuer´s license to issue the Covered Bonds the Overcollateralisation may however not exceed 30 per cent. unless increased demand has developed due to other provisions of the Act on Covered Bonds

For the avoidance of doubt, the Issuer shall not at any time reduce the Overcollateralisation which applies to the Programme if to do so would result in any credit rating then applying to the Covered Bonds by any rating agency appointed by the Issuer in respect of the Covered Bonds being reduced, removed, suspended or placed on credit watch.

4.3 Composition of the Cover Pool.

For so long as any of the Covered Bonds are outstanding the Issuer shall ensure that the Cover Pool maintained or to be maintained by the Issuer shall at all times comply with the requirements of the Act on Covered Bonds.
For so long as any of the Covered Bonds are outstanding the Issuer covenants that no Mortgages in commercial real estate will be contained in the Cover Pool.

4.4 Interest Cover

The amounts of interest received by the Issuer in respect of the Cover Pool and under the related derivative contracts entered into by the Issuer shall be at least equal to or exceed the amounts payable by the Issuer under the Covered Bonds and the related derivative contracts entered into by the Issuer.

5. REDENOMINATION

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

The election will have effect as follows:

5.1 the Covered 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 Covered Bond equal to the principal amount of that Covered 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 Covered Bondholders, the stock exchange (if any) on which the Covered Bonds may be listed of such deemed amendments;

5.2 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 Covered Bonds will be calculated by reference to the aggregate principal amount of Covered 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;

5.3 if definitive Covered 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 Covered Bondholders;

5.4 if issued prior to the Redenomination Date, all unmatured Coupons denominated in the Specified Currency (whether or not attached to the Covered Bonds) will become void with effect from the date on which the Issuer gives notice (the **Exchange Notice**) that replacement euro-denominated Covered 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 Covered Bonds and Receipts so issued will also become void on that date although those Covered Bonds and Receipts will continue to constitute valid exchange obligations of the Issuer. New redenominated Covered Bonds, Receipts and Coupons will be issued in exchange for Covered 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 Covered 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 Covered Bonds;

5.5 after the Redenomination Date, all payments in respect of the Covered Bonds, other than payments of interest in respect of periods commencing before the Redenomination Date, will be made solely in the redenomination currency;

5.6 if the Covered Bonds are Fixed Rate Covered Bonds, Inflation Linked Annuity Covered Bonds or Inflation Linked Equal Principal Payment Covered 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

5.7 if the Covered Bonds are Floating Rate Covered Bonds, the applicable Final Terms will specify any relevant changes to the provisions relating to interest.

6 INTEREST

6.1 Interest on Inflation Linked Annuity Covered Bonds

Each Inflation Linked Annuity Covered 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.

6.2 Interest on Inflation Linked Equal Principal Payment Covered 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.

6.3 Interest on Fixed Rate Covered Bonds

Each Fixed Rate Covered 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.

The Issuer will calculate the amount of interest (each an Interest Amount) payable on the Fixed Rate Covered 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.

6.4 Interest on Floating Rate Covered Bonds

a) Interest Payment Dates

Each Floating Rate Covered 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 Covered Bonds will be determined in the manner specified in the applicable Final Terms.

ISDA Determination for Floating Rate Covered 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 Covered 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 Covered 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 Covered Bonds is specified in the applicable Final Terms as being other than LIBOR or EURIBOR, the Rate of Interest in respect of such Covered 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 Covered 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 Covered 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 Covered Bonds, Inflation Linked Annuity Covered Bond or Inflation Linked Equal Principal Payment Covered 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 6.4, shall (in the absence of wilful default, bad faith or manifest error as aforesaid) be binding on the Issuer and all Covered Bondholders, Receiptholders and Couponholders.

6.5 Accrual of interest

Each Covered Bond (or in the case of the redemption of part only of a Covered Bond, that part only of such Covered 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 in accordance with these Terms and Conditions. In the event of non-payment of a Zero Coupon Covered Bond, interest will accrue as provided in Condition 8.10.

a) The Covered Bonds shall bear interest from (and including) the Maturity Date to (but excluding) the earlier of the relevant Interest Payment Date after the Maturity Date on which the Covered Bonds are redeemed or the Extended Maturity Date, subject to Condition 6. In that event, interest shall be payable on those Covered Bonds at the rate determined in accordance with Condition 6.6 (b) on the Principal Amount Outstanding of the Covered Bonds on each Interest Payment Date after the Maturity Date in respect of the Interest Period ending immediately prior to the relevant Interest Payment Date, subject as otherwise provided in the applicable Final Terms. The final Interest Payment Date shall fall no later than the Extended Maturity Date;:

b) The rate of interest payable from time to time under Condition 6.5(a) will be as specified in the applicable Final Terms and, where applicable, determined by the Calculation Agent so specified, three Business Days after the Maturity Date in respect of the first such Interest Period and thereafter as specified in the applicable Final Terms; and

c) In the case of Covered Bonds which are Zero Coupon Covered Bonds, for the purposes of this Condition 6.5 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.

6.6 Interest Payments up to the Extended Maturity Date.

If an Extended Maturity Date is specified in the applicable Final Terms as applying to a Series of Covered Bonds and the maturity of those Covered Bonds is extended beyond the Maturity Date in accordance with Condition 8.11:

a) the Covered Bonds shall bear interest from (and including) the Maturity Date to (but excluding) the earlier of the relevant Interest Payment Date after the Maturity Date on which the Covered Bonds are redeemed or the Extended Maturity Date. In that event, interest shall be payable on those Covered Bonds at the rate determined in accordance with Condition 6.6 (b) on the Principal Amount Outstanding of the Covered Bonds on each Interest Payment Date after the Maturity Date in respect of the Interest Period ending immediately prior to the relevant Interest Payment Date, subject as otherwise provided in the applicable Final Terms. The final Interest Payment Date shall fall no later than the Extended Maturity Date;

b) the rate of interest payable from time to time under Condition 6.6 (a) will be as specified in the applicable Final Terms and, where applicable, determined by the Issuer so specified, three Business Days after the Maturity Date in respect of the first such Interest Period and thereafter as specified in the applicable Final Terms; and

c) in the case of Covered Bonds which are Zero Coupon Covered Bonds, for the purposes of this Condition 6.6 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.

6.7 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 6.4 (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 Covered 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 Covered 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 Covered 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 Covered Bond except an Inflation Linked Annuity Covered Bond and an Inflation Linked Equal Payment Covered Bond, on any day the principal amount of that Covered Bond on the Issue Date less principal amounts (if any) received by the holder of such Covered Bond in respect thereof on or prior to that day. In respect of an Inflation Linked Annuity Covered Bond and an Inflation Linked Equal Payment Covered 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.

7 PAYMENTS

7.1 Payments in respect of Inflation Linked Covered Bonds

a) Payments in respect of Inflation Linked Annuity Covered Bonds

In case of an Inflation Linked Annuity Covered 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 Covered Bonds

In case of an Inflation Linked Equal Payment Covered 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.

7.2 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 9.

7.3 Presentation of Covered Bonds and Coupons

a) Covered Bonds: Payments of principal in respect of definitive Bearer Covered Bonds will (subject as provided below) be made in the manner provided in Condition 7.2 (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 Covered Bonds, and payment of interest in respect of definitive Bearer Covered 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 Covered Bonds: Fixed Rate Covered Bonds in definitive bearer form (other than, Inflation-Linked Covered 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 9

(Taxation)) in respect of such principal (whether or not such Coupon would otherwise have become void under Condition 10 (Prescription)).

Up on any Fixed Rate Covered 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 Covered Bonds: Upon the date on which any Floating Rate Covered Bond or Inflation-Linked Covered 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 Covered Bond is not an Interest Payment Date, interest (if any) accrued in respect of such definitive Bearer Covered 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 Covered Bond.

(iii) VS System Covered Bonds: Payments of principal and interest in respect of VS System Covered Bonds will be made to the Covered 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).

7.4 Payment Day

If the date for payment of any amount in respect of any Covered 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 10) 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 Covered Bonds shall be deemed to include, as applicable:

the Final Redemption Amount of the Covered Bonds;

the Early Redemption Amount of the Covered Bonds;

the Optional Redemption Amount(s) (if any) of the Covered Bonds;

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

in relation to Zero Coupon Covered Bonds, the Amortised Face Amount (as defined in Condition 8.6); and

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

8 REDEMPTION AND PURCHASE

8.1 Redemption of Inflation Linked Annuity Covered Bonds and Inflation Linked Equal Payment Covered Bonds

Unless previously redeemed or purchased and cancelled, each Inflation Linked Annuity Covered Bond and each Inflation Linked Equal Payment Covered Bond will, subject to Condition 7.1(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.

8.2 Final Redemption

Unless previously redeemed or purchased and cancelled, each Covered 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.

8.3 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 Covered 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 Covered 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 Covered Bonds, the Covered Bonds to be redeemed (**Redeemed Covered Bonds**) will be selected individually without involving any part only of a Bearer Covered Bond, in the case of Redeemed Covered Bonds represented by definitive Covered 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 Covered 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 Covered Bonds represented by definite Covered Bonds, a list of the serial numbers of such Redeemed Covered 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 Covered Bonds represented by definitive Covered Bonds shall bear the same portion to the aggregate nominal amount of all Redeemed Covered Bonds as the aggregate nominal amount of definite Covered Bond outstanding bears to the aggregate nominal amount of the Covered Bonds outstanding, in each case on the Selection Date. No exchange of the relevant Covered 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 8.3 and notice to that effect shall be given by the Issuer to the Covered Bondholders in accordance with Condition 11 at least five days prior to the Selection Date.

8.4 Redemption due to illegality or invalidity

If the Covered Bonds become illegal and/or invalid, the Covered 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 Covered Bondholders (which notice shall be irrevocable).

Covered Bonds redeemed pursuant to this Condition 8.4 will be redeemed at their Early Redemption Amount referred to in Condition 8.6 together (if appropriate) with interest accrued (and, if this is an Inflation Linked Annuity Covered

Bond or an Inflation Linked Equal Principal Payment Covered Bond, adjusted for indexation in accordance with the provisions set out in the applicable Final Terms) to (but excluding) the date of redemption.

8.5 Certification

The publication of any notice of redemption pursuant to Condition 8.6 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 Covered Bondholders, Receiptholders and Couponholders.

8.6 Early Redemption Amounts

For the purpose of Condition 8.4, each Covered Bond will be redeemed at its Early Redemption Amount calculated as follows:

a) in the case of a Covered Bond (other than a Zero Coupon Covered Bond but including an Instalment Covered 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 Covered Bond or an Inflation Linked Equal Principal Payment Covered 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 Covered Bond, at an amount (the Amortised Face Amount) calculated in accordance with the following formula:

   Early Redemption Amount = RP × (1 + 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 Covered Bonds to (but excluding) the date fixed for redemption or (as the case may be) the date upon which such Covered 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.

8.7 Instalments

Instalment Covered 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 8.6.

8.8 Purchases

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

8.9 Cancellation

All Covered 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 Covered Bonds so cancelled and any Covered Bonds purchased and surrendered for cancellation pursuant to Condition 8.8 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 Covered 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.

8.10 Late Payment on Zero Coupon Covered Bonds

If the amount payable in respect of any Zero Coupon Covered Bond upon redemption of such Zero Coupon Covered Bond pursuant to Conditions 8.2, 8.3 or 8.4 above, the amount due and repayable in respect of such Zero Coupon Covered Bond shall be the amount calculated as provided in Condition 8.6 (b) above as though the references therein to the date fixed for the redemption or the date upon which such Zero Coupon Covered 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 Covered 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 Covered Bonds has been received by the Issuer and notice to that effect has been given to the Covered Bondholders in accordance with Condition 11.

8.11 Extension of Maturity Date

a) Extended Maturity Date:

An Extended Maturity Date shall be specified in the applicable Final Terms as applying to each Series of Covered Bonds unless to do so would result in the Issuer being unable to obtain if applicable the relevant credit rating from the relevant rating agencies appointed by the Issuer at the relevant time in respect of a Series of Covered Bonds.

b) Automatic Extension:

If an Extended Maturity Date is specified in the applicable Final Terms as applying to a Series of Covered Bonds and the Issuer fails to redeem the relevant Covered Bonds in full on the Maturity Date or within three Business Days thereafter, the maturity of the outstanding Covered Bonds and the date on which such Covered Bonds will be due and repayable for the purposes of these Terms and Conditions will be automatically extended up to but no later than the Extended Maturity Date, subject as otherwise provided for in the applicable Final Terms. In that event, the Issuer may redeem all or any part of the principal amount outstanding of the Covered Bonds on any Interest Payment Date falling in any month after the Maturity Date up to and including the Extended Maturity Date or as otherwise provided for in the applicable Final Terms. The Issuer shall give notice to the Covered Bondholders (in accordance with Condition 11 (Notices)) of its intention to redeem all or any of the principal amount outstanding of the Covered Bonds at least five Business Days prior to the relevant Interest Payment Date. Any failure by the Issuer to notify such persons shall not affect the validity or effectiveness of any redemption by the Issuer on the relevant Interest Payment Date, or give rise to rights to any such person.

c) Zero Coupon Bonds:

In the case of Covered Bonds which are Zero Coupon Covered Bonds to which an Extended Maturity Date is specified under the applicable Final Terms, for the purposes of this Condition (8.11) 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 Terms and Conditions.

d) Extension Irrevocable:

Any extension of the maturity of Covered Bonds under this Condition (8.11) shall be irrevocable. Where this Condition (8.11) applies, any failure to redeem the Covered Bonds on the Maturity Date or any extension of the maturity of Covered Bonds under this Condition (8.11) shall not constitute an event of default or acceleration of payment for any purpose or give any Covered Bondholder any right to receive any payment of interest, principal or otherwise on the relevant Covered Bonds other than as expressly set out in these Terms and Conditions.

e) Payments:

In the event of the extension of the maturity of Covered Bonds under this Condition (8.11) Interest Rates, Interest Periods and Interest Payment Dates on the Covered Bonds from (and including) the Maturity Date to (but excluding) the Extended Maturity Date shall be determined and made in accordance with the applicable Final Terms.

f) Partial Redemption after Maturity Date:

If the Issuer redeems part and not all of the principal amount outstanding of Covered Bonds on any Interest Payment Date falling after the Maturity Date, the redemption proceeds shall be applied rateably across the Covered Bonds and the principal amount outstanding on the Covered Bonds shall be reduced by the level of that redemption. If any partial redemption after the Maturity Date is not sufficient to redeem all outstanding Interest Payments, then the remainder of any Interest Payment shall be added to the principal amount of the Covered Bonds.

g) Restriction on Further Issues:

If the maturity of any Covered Bonds is extended up to the Extended Maturity Date in accordance with this Condition 8.11 subject as otherwise provided for in the applicable Final Terms, for so long as any of those Covered Bonds remains outstanding, the Issuer shall not issue any further Covered Bonds, unless the proceeds of issue of such further Covered Bonds are applied by the Issuer on issue to redeem in whole or in part the relevant Covered Bonds in accordance with the terms hereof.

8.12 Redemption for Tax Reasons

The Covered 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 Covered Bondholders (which notice shall be irrevocable), if:

a) on the occasion of the next payment due under the Covered Bonds, the Issuer has or will become obliged to pay additional amounts as provided or referred to in Condition 9 (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 Covered Bonds; and
b) such obligation cannot be avoided by the Issuer taking reasonable measures available to it.

Covered Bonds redeemed pursuant to this Condition 8(12) will be redeemed at their Early Redemption Amount together (if appropriate) with interest accrued to (but excluding) the date of redemption.

9 TAXATION

All payments of principal and interest in respect of the Covered 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 Covered 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 Covered 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 Covered 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 Covered Bond or Coupon by reason of it having some connection with Iceland other than the mere holding of such Covered 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 Covered 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.

10 PRESCRIPTION

The Covered Bonds, Receipts and Coupons will become void in accordance with Act on the Expiration of Debt and other Obligations No. 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 7.3 or any Talon which would be void pursuant to Condition 7.3.

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 Covered Bondholders in accordance with Condition 11.

11 NOTICES

All notices regarding the Covered 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 Covered 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 Covered Bondholders in order to send notices to each Covered Bondholder directly.

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

12 FURTHER ISSUES

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

13 GOVERNING LAW AND JURISDICTION

The Covered Bonds (except for the ISD System Covered Bonds), the Receipts, the Coupons are governed by, and shall be construed in accordance with, English law except for Condition 3 (Status of Covered 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 Covered Bonds, the Coupons, the Receipts (except for the ISD System Covered Bonds) shall be subject to the exclusive jurisdiction of the Courts of England.

The ISD System Covered 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 Covered 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.

SUMMARY OF ICELANDIC LEGISLATION RELATING TO COVERED BONDS

The Issuer is licensed under the Icelandic Act on Covered Bonds to issue covered bonds. The following is a brief summary of certain features of Icelandic law governing the issuance of covered bonds in Iceland, at the date of this Base Prospectus, which law may be supplemented, amended, modified or varied whether by legislative enactment or by way of judicial decisions and administrative pronouncements, including possibly, with retroactive effect. The summary does not purport to be, and is not, a complete description of all aspects of the Icelandic legislative and regulatory framework pertaining to covered bonds. The original language of the Icelandic Act on Covered Bonds is Icelandic. The following summary is provided in English only for the sake of convenience. In the event of any doubt, the original Icelandic version of the relevant legislation, executive orders and or regulations should be consulted.

THE LEGISLATION

As of the date of this Base Prospectus, the main legislation which governs the issuance of covered bonds is the Act on Covered Bonds and the Rules issued by the FME under the authority conferred on it by Article 25 of the Act on Covered Bonds.

Under the Act on Covered Bond the FME grants licences for the issuance of covered bonds pursuant to the Act on Covered Bonds. Licences to issue covered bonds will only be granted to certain financial undertakings which meet the general definitions of a financial undertaking and have been granted an operating license as provided for in the terms of the Act on Financial Undertakings. Furthermore issuers must comply with the Act on Covered Bonds, and the budget of issuers, as attested by a certified public accountant, demonstrates that its financial situation is sufficiently sound so that the issuance of covered bonds will not jeopardise the interests of other creditors.

The Issuer, which is a financial undertaking as defined in the Act on Financial Undertakings, has received the required operating license, and has demonstrated that it fulfils the conditions set forth in the Act on Covered Bonds for granting a license to issue covered bonds.

The Act on Covered Bond provides that holders of covered bonds (and also, if applicable, counterparties under derivatives contracts entered into for hedging purposes in relation to the covered bonds) have an exclusive and prioritised right of claim, on a *pari passu* basis between themselves over a pool of certain security assets (the **Cover Pool**). Under Icelandic law, an issuer of bonds, such as an issuer of covered bonds, is authorised to register the bonds in dematerialised book entry form by electronic registration in the ISD in accordance with Act No. 131/1997 on electronic registration of title to securities.

THE REGISTER

The issuer of covered bonds must maintain a register (the **Register**) of the issued covered bonds, the related derivatives agreements, and the Cover Pool pertaining to such covered bonds and the relevant derivatives agreements concluded in accordance with the Act on Covered Bonds. The assets included in the Register are included on, and are a part of, the issuer's balance sheet. Each item in the Register must be clearly identified and the Register must be updated on a regular basis to include any changes in the relevant information. The Act on Covered Bonds also stipulates the type of information that must be recorded in the Register with respect to each item. The Register must at all times contain detailed information on the nominal value of the covered bonds, the assets which constitute the Cover Pool and their valuation, substitute collateral (if any), cash inflow from the Cover Pool and the derivates agreements. Bonds in a cover pool must be endorsed showing they are part of a cover pool and have been entered in a register as provided for in Chapter VI of the Act on Covered Bonds. The endorsement shall also indicate that the debt instrument is to secure priority rights of a specific class of covered bonds.

BENEFIT OF A PRIORITISED CLAIM

Pursuant to the Act on Covered Bonds, if an issuer is declared bankrupt, enters into debt negotiations pursuant to the Bankruptcy Act, is liquidated, or is placed under public administration, the holders of covered bonds issued by the relevant issuer shall have exclusive, equal and *pro rata* rights of priority to bonds and other assets in the cover pool and payments received on the above mentioned assets, provided they have been entered into the Register. The nature of claims and rights of priority of covered bonds to the assets shall be as provided for in Art. 111 of the Bankruptcy Act which characterises secured claims. The prioritised claims will rank ahead of all other claims, save for claims relating to the fees and expenses of a bankruptcy estate and derivative agreements concluded in accordance with the Act on Covered Bonds. Derivative contracts shall enjoy priority as provided for in Point 3 of Article 110 of the Bankruptcy Act, cf. Article 111 of the Bankruptcy Act.

By virtue of the priority established by the Act on Covered Bonds, claims of the holders of covered bonds against an issuer which has issued covered bonds will rank ahead of claims of all other creditors of the credit institution with respect to the Cover Pool (save for the priority described above granted to a bankruptcy estate in respect of fees and expenses and claims of the counterparties to the relevant derivative contracts).

Cost of bankruptcy administration, to such extent as this is incurred due to efforts of the bankruptcy administrator concerning covered bonds, bonds and other assets in the cover pool, payments with respect to these assets or derivative contracts connected with the cover pool, shall be paid from the assets of the cover pool or funds which are substituted for them. Other cost of bankruptcy administration shall not be paid from the assets of the cover pool and fulfilment of derivative contracts connected with the pool if such exist.

Pursuant to the Act on Covered Bonds, loans and other assets included in the cover pool may not be pledged.

COVER POOL – COMPOSITION OF ASSETS

Pursuant to the Act on Covered Bonds, a cover pool may only consist of certain assets, which include bonds secured by various types of mortgages, on other registered assets, bonds granted to or guaranteed by certain governmental bodies (**Government Bonds**), receivables in the form of certain derivatives agreements and substitute collateral.

The real property and the registered assets which serve as security for the bonds included in the Cover Pool must be located in a member state of the European Economic Area, the European Free Trade Association Treaty, or the Farao Islands (each a **Cover Pool Member State** and together the **Cover Pool Member States**). The mortgages may include residential mortgages, mortgages over other title documents relating to residences (together with the former **Residential Mortgages**), and mortgages over other real property (**Commercial Mortgages**) and lastly mortgages over farms and other real estate used for agricultural purposes in Cover Pool Member States (**Agricultural Mortgages**).

Government Bonds must be either guaranteed or issued by governmental bodies which belong to a Cover Pool Member State.

Substitute collateral is intended to ensure that the interests of covered bond holders are not prejudiced despite changes which may occur to assets in the Cover Pool. Substitute collateral may only consist of; 1. Demand deposits with a financial undertaking; 2. Deposits with or claims against a Cover Pool Member State or central bank in a Cover Pool Member State; 3. Claims against other legal entities which in the FME's estimation, do not involve greater risk than those in previous points 1 and 2. Substitute collateral may not comprise more than 20% of the value of the cover pool. The FME may however authorise an increase in the proportion of substitute collateral in the cover pool to as much as 30% of its value.

LOAN-TO-VALUE (LTV) RATIO AND COVER POOL COMPOSITION

Mortgages listed in the Register, must on the date of registration fulfil the following conditions:

- The LTV ratio of Residential Mortgages must not exceed 80%.
- The LTV ratio of Commercial Mortgages must not exceed 60%.
- The LTV ratio of Agricultural Mortgages must not exceed 70%. Production quotas, allocated to registered farms, may not be included in the calculations of market value.

Residential Mortgages and Commercial Mortgages may not be listed in a cover pool if payment is in arrears of 90 days or more. Should an issuer intend to include more than one class of bonds in its cover pool, mention must be made thereof in the license application to the FME.

REGULAR ASSESSMENT OF THE MARKET VALUE FOR COVER POOL ASSETS

The aggregate present value of mortgages, including accrued interest and indexation, and other assets in the cover pool which is to serve as collateral for a specific class of covered bonds, must always exceed the aggregate current value of this same covered bond class.

An issuer must regularly monitor and have appraised the market value of the mortgages of the Cover Pool. If the market value of collateral of the Cover Pool decreases substantially, the amount of the mortgages included in the Cover Pool shall be increased to ensure that the LTV lies within the above limits specified by the Act on Covered Bonds.

Valuation of Cover Pool, administration etc.

Market value of the mortgages shall be based on the selling price in recent transactions with comparable properties. If the market value of real estate based on the foregoing considerations is not available it shall be determined by a specific valuation. The valuation shall be based on generally accepted principles for market valuation of real estate. Data on real estate price developments from the Registers Iceland (*Icelandic: Þjóðskrá Íslands*), for instance, may be used as a basis, together with other systematic collection of real estate price data.

If an issuer assesses the market value of real estate in accordance with the foregoing, the Independent Inspector provided for in Chapter VIII of the Act on Covered Bonds (see *Independent Inspector* below) must verify that the appraisal is based on accepted methodology. The Independent Inspector may re-assess the market price of one or more properties if it is believed to be valued incorrectly. An appraisal of the market value of real estate must be in writing and specify what methodology is used, who has carried out the appraisal and when it was made.

Additional provisions regarding quantitative and qualitative requirements placed on the assets forming part of the Cover Pool are set out in the Act on Covered Bonds and the Rules. In order to qualify for inclusion in the Cover Pool all legislative requirements must be met. However, if the Cover Pool assets at a later stage cease to meet the requirements of the Act on Covered Bonds and/or the Rules in relation to ratios, or proportion limits etc., such assets may nevertheless form part of the Cover Pool, but will be excluded from the calculation of the value of the Cover Pool.

According to the Act on Covered Bonds, bonds, substitute collateral and other assets placed by an issuer in a cover pool shall be valued having regard to exchange rates, interest rates, maturities and other factors of significance, in order to maintain a suitable balance between the cover pool and the corresponding class of covered bonds. An issuer may conclude derivative agreements for the purpose of achieving this balance.

Moreover the Act on Covered Bonds states an issuer must ensure that instalments and other payment flows accruing on assets in the cover pool, and from derivative agreements, match payments on the covered bonds so that all commitments towards the covered bond holders and counterparties to derivative agreements can be met. To this end the issuer shall keep instalments and other payments accruing on assets in the cover pool segregated from the issuer's other assets, including other cover pools, as well as their accrued instalments and other payments. An issuer must preserve assets such as instalments and other payments accruing on assets in the cover pool in a separate account and keep them segregated from its other assets.

Bonds and other cover pool assets shall not be subject to claims by the issuer's creditors.

Supervision by an Independent Inspector

The Act on Covered bonds demands that an issuer appoint an Independent Inspector to supervise the issuance of covered bonds licensed by the FME. The Independent Inspector must fulfil the eligibility criteria prescribed in the Act on Covered Bonds and his/her appointment is subject to the approval of the FME. If the FME is of the opinion that the Independent Inspector does not fulfil these requirements it may revoke its approval. In seeking the FME's approval for an Independent Inspector's appointment, an issuer must disclose any possible ties between the Independent Inspector and the issuer and the issuer's principal leaders.

The Independent Inspector must ensure that a Register is maintained, as described above, and verify that valuation of collateral for bonds in the Cover Pool is based on proper methodology. The Independent Inspector shall provide the FME with information which he/she obtains in the course of work as frequently and in such format as the FME decides, or above and beyond this if exceptional circumstances so warrant.

Cover Pool administration in the event of bankruptcy of the Issuer

The Act on Covered Bonds prescribes that if an issuer's estate is subject to bankruptcy proceedings, covered bonds it has issued shall not be accelerated unless a specific agreement to this effect has been concluded. The estate shall maintain rights and obligations subject to derivative agreements concluded in accordance with the provisions of the Act on Covered Bonds.

If an issuer's estate is subject to bankruptcy proceedings, covered bonds it has issued shall have rights of priority to bonds and other assets in the Cover Pool and payments received on the abovementioned assets, provided they have been entered into a Register.

The administrator, who is appointed by the relevant district court, will manage the Cover Pool and the rights of the Covered Bondholders and counterparties to derivative contracts. The administrator of the bankrupt estate must keep bonds and other assets in a Cover Pool, as provided for in the Act on Covered Bonds, segregated from other assets in the issuer's estate as further specified in the Register at any given time. The same shall apply to funds and other assets substituted for the bonds and other assets in the Register, or paid towards such assets. Such separation shall be maintained until claims arising from covered bonds have been paid in full. The bankruptcy administrator shall also keep derivative agreements, and funds returned by such assets or which must be paid from the cover pool to counterparties in derivative agreements, separate from other assets of the estate. An administrator's fees and any other expenses in connection with the administration are to be paid by the administration estate.

If an issuer is granted a debt moratorium, the assisting administrator for the debt moratorium shall ensure that obligations arising from covered bonds and derivative agreements are fulfilled using the assets of the Cover Pool, substitute collateral and payments made on these assets.

An administration estate cannot be closed until (a) the obligations of the estate and the assets of the Register have been transferred to a a third party credit institution holding a license to issue covered bonds, (b) all the covered bonds for which the assets in the Register serve as collateral have been repaid and the derivative contracts have matured or (c) the estate has filed for bankruptcy and the bankruptcy estate has been closed.

If an issuer's estate is subject to bankruptcy proceedings, covered bonds it has issued shall not be foreclosed unless a specific agreement to this effect has been concluded. The estate shall maintain rights and obligations subject to derivative agreements concluded in accordance with the provisions of the Act on Covered Bonds.

Rescission of Actions

Actions taken by an issuer, whether they involve delivery of funds to a cover pool, delivery of substitute collateral to the Cover Pool, payments on assets in the Cover Pool or disposal of funds from the Cover Pool to fulfil obligations under a bond covered by it or a derivative agreement concluded in accordance with the Act on Covered Bonds and in connection with the Cover Pool, shall not be subject to rescission, cf. Chapter XX of the Act on Bankruptcy etc. The same shall apply to payments to an issuer under a derivative agreement concluded in accordance with the provisions of this Act.

No Rights in certain circumstances

No covered bondholders, counterparties to derivative contracts can claim early repayment of payment obligations on the basis of a bankruptcy order against an issuing bank or an issuing bank's failure to satisfy the requirement for additional collateral. Moreover, the relevant borrower(s) of the underlying loan(s) will retain the right to repay their loans in full or in part without variation. Furthermore, it is not possible for individual covered bondholders, counterparties to the derivative contracts to initiate claims against the issuing bank during the issuing bank's bankruptcy. The Act on Covered Bonds makes it clear that the administrator is acting on behalf of all covered bondholders, counterparties to the derivative contracts and lenders of Senior Debt, if any, and that only the administrator may prove claims against the bankruptcy estate for any assets required to cover the claims of the covered bondholders and counterparties to derivative contracts.

Supervision of the FME

According to the Act on Covered Bonds the FME shall monitor compliance with the Act on Covered Bonds, including compliance by the Issuer with the provisions of the Act on Covered Bonds and other rules applicable to their operations.

The FME may revoke the Issuer´s license to issue the Covered Bonds if (i) the Issuer no longer fulfils the requirements to issue covered bonds, (ii) the Issuer's budget, as attested to by a certified public accountant, demonstrates that its financial situation is no longer sufficiently sound so that the issuance of covered bonds will jeopardise the interests of other creditors, or (iii) the Issuer violates provisions of the Act on Covered Bonds or rules adopted by virtue of it.

If a license to issue covered bonds is revoked, the FME shall decide how to terminate the activities of the Issuer. The FME may, for instance, appoint a new custodian for the Issuer's Cover Pool and take such measures as it considers necessary to ensure the rights of the Covered Bondholders.

THE ISSUERS LICENSE TO ISSUE COVERED BONDS

On 10 January 2011, the Issuer applied to the FME for a licence to issue the Covered Bonds under the Icelandic Act on Covered Bonds. Pursuant to the terms of such a licence, the Issuer would be able, from time to time, to issue Covered Bonds that entitle the holder to the benefit of a statutory preferred creditor status in respect of the assets contained in the Issuer Cover Pool in the event of the insolvency of the Issuer.

The licence which was granted on 30 September 2011 has since been reviewed and is as of 20 November 2015 subject to the requirements specified here below:

- The Programme shall currently not exceed a limit of ISK 70,000,000,000. Any increases of the Programme shall be subject to the FME confirmation.
- The Programme and the Cover Pool shall be composed of bonds issued in ISK. The Cover Pool shall only consist of bonds in accordance with item 1 of Paragraph 1 of Article 5 of the Act on Covered Bonds and replacement collateral in accordance with Article 6 of the Act.
- The aggregated total amount of the Cover Pool shall not exceed a level of 30% above the issued Covered Bonds at any time unless increased demand has developed due to other provisions of the Act on Covered Bonds, such as due to stress test present value calculations. If the Cover Pool exceeds the aforementioned limit the Issuer shall notify the FME and the Independent Inspector immediately. The Issuer will have 14 days to remedy the level.
- The Independent Inspector shall on a bi-annual basis file his reports to the FME regarding his supervision duties. The report shall contain information stipulated in Paragraph 3 of Article 16 of the Rules. This requirement shall be revised twelve months from the issuance of the Covered Bonds.
- The Independent Inspector shall at any Issue Date verify that the provisions of Chapters II and III of the Act on Covered, regarding the Cover Pool and Mortgages, are satisfied.
- The Issuer shall at least weekly execute stress tests and calculate the present value of the Cover Pool.
- The Issuer shall at least quarterly inform the owners of the Covered Bonds about key figures regarding the Programme, e.g. outcome of any stress tests and the calculation of the present value of the Cover Pool. Furthermore, the Issuer shall allow the Independent Inspector to submit its remarks, if any, regarding the Issuer´s obligations above.

The aforementioned conditions, which are all subject to review, were set by the FME to ensure proper diligence and to safeguard the position of the unsecured creditors of the Issuer.

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. 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 1990 Útvegsbanki Íslands, Alþýðubanki Íslands, Iðnaðarbanki Íslands and Verslunarbanki Íslands merged into Íslandsbanki hf. 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 of the merger, the bank further solidified its connections with the corporate sector, particularly in the seafood industry. In the years 2000 to 2007, the bank expanded its business beyond 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 per cent. 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 of 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 and retaining a strong sense of social responsibility.

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

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 resided 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, Íslandssjóðir 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% market share of the retail banking market according to a Capacent Gallup market survey conducted in December 2014.
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 and 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 risks 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 AND 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 division is responsible for recruiting, training, and dismissing the Issuer's employees. The division further works closely with management on corporate development and the 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 cooperation 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 audits 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 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.

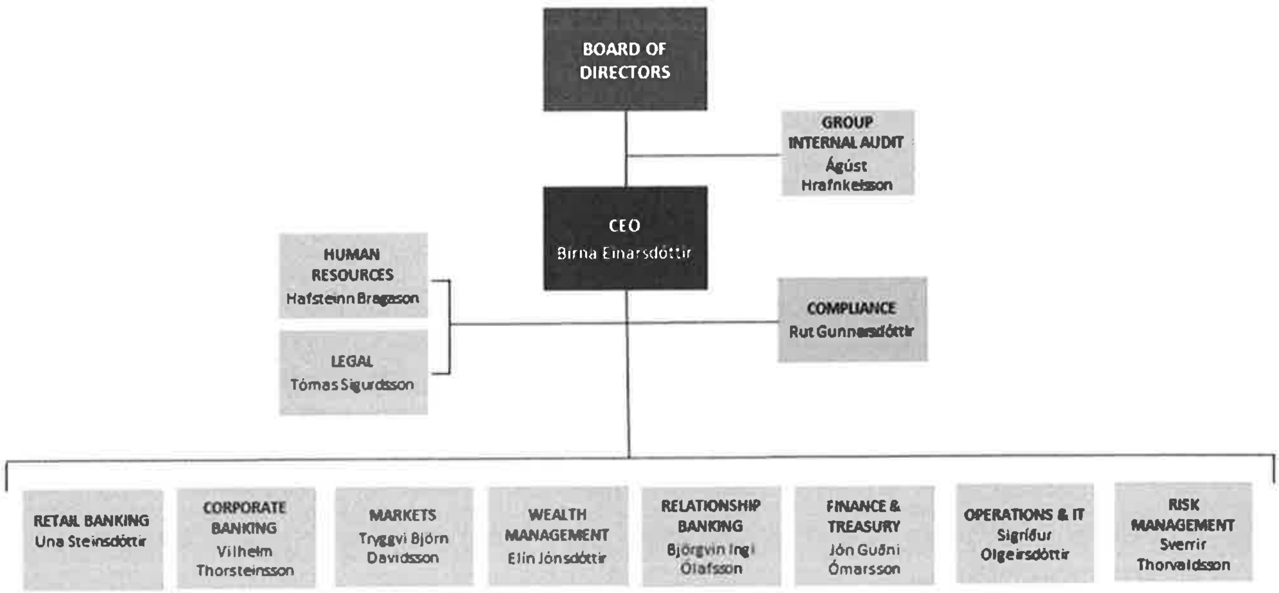


Figure 2: Organisational Structure

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 copany
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 19-20.

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
Ms. Anna Þórðardóttir	Member of the Board of Directors
Ms. Auður Finnbogadóttir	Member of the Board of Directors
Mr. Árni Stefánsson	Member of the Board of Directors
Mr. Hallgrímur Snorrason	Member of the Board of Directors
Ms. Heiðrún Jónsdóttir	Member of the Board of Directors
Ms. Helga Valfells	Member of the Board of Directors

Mr. Fridrik Sophusson (Chairman)

Fridrik Sophusson has nearly forty years of experience in fiscal policy making, management and public service in Iceland. He has also served as a board member in several companies and institutions. He was Managing Director of the Icelandic Management Association from 1972-1978, when he was elected to Parliament. During his tenure as a member of Parliament, he held the position of Minister of Industry and Energy from 1987 to 1988 and Minister of Finance from 1991 to 1998. He was appointed the Chief Executive Officer of Landsvirkjun, the National Power Company of Iceland, in 1999 and has held that position for almost 11 years.

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

Ms. Anna Þórðardóttir (Member of the Board of Directors)

Anna Þórðardóttir has been a board member of a number of companies. She served as a member of the board of KPMG ehf. and the institute of State Authorized Public Accountants in Iceland. She is currently a member of the board of Framtíðarsetur Íslands ehf. She has been an employee of KPMG from 1988 to 2015 and a partner since 2009, and was responsible for the audit of the following companies: Reitir, Hagar, 365, Baugur Group, Vodafone, Landfestar, Landey, 10-11 and Félagsbústaðir.

Ms. Þórðardóttir graduated with a cand. merc degree in financial studies from handelhojskolen in Århus, Denmark. She is a chartered accountant and holds a B.S. degree in business from the University of Iceland.

Ms. Auður Finnbogadóttir (Member of the Board of Directors)

Auður Finnbogadóttir has extensive experience in the field of financial markets. She was the managing director of Lífsverk pension fund, the pension fund for employees for the municipality of Kópavogur, A verðbréf hf. and MP banki hf. She has held the position of chairman of the board of the Competition Authority in Iceland and been a member of the board of the Icelandic Pension Funds Association, Icelandair Group hf., Landsnet and Nýi Kaupþing banki hf.

Ms. Finnbogadóttir holds a B.Sc. in business majoring in international business from the University of Colorado and an MBA from Reykjavík University

Mr. Árni Stefánsson (Member of the Board of Directors)

Árni Stefánsson has extensive management experience in heavy industries in Iceland. He is currently a managing director with Rio Tinto Alcan. He has been a member of the board of Norðurál in Grundartangi, a director with Landsnet and a director with Landsvirkjun.

Mr. Stefánsson holds an M.Sc. degree and B.Sc. degree in electrical engineering from Alborg University in Denmark.

Mr. Hallgrímur Snorrason (Member of the Board of Directors)

Hallgrímur Snorrason is an independent consultant in public economic reporting. He was the director of Statistics Iceland and vice-president of the National Economic Institute of Iceland. He has been a member of the board of several companies, including Útvegsbanki Íslands hf., Skýrr hf., Auður Capital and Virðing hf. He also has been a chairman of a number of governmental committees, both domestic and in relation to Nordic cooperation, the EFTA, the EC and the OECD.

Mr. Snorrason holds an M.Sc. degree in economics from Lund University in Sweden and a B.Sc. from the University of Edinburgh.

Ms. Heiðrún Jónsdóttir (Member of the Board of Directors)

Heiðrún Jónsdóttir is an attorney at law with Fjeldsted and Blöndal legal services. She was a managing director at Eimskipafélag Íslands hf., Lex Legal Services and KEA. She has been a member of the boards of a number of companies since 1988, including Norðlenska, Íslensk Verðbréf, Olíuverslun Íslands hf., Síminn hf., Reiknistofa Bankanna, the Icelandic Pension Funds Association, Silicor Materials Iceland ehf. and Gildi Pension Fund.

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

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.

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

Name	Title
Ms. Herdís Gunnarsdóttir	Alternate Member of the Board of Directors
Mr. Pálmi Kristinsson	Alternate Member of the Board of Directors

Ms. Herdís Gunnarsdóttir (Alternate Member of the Board of Directors)

Herdís Gunnarsdóttir is an alternate board member since April 2016. Herdís holds an MBA from the University of Iceland and an MSc and BSc in nursing from the University of Iceland. Herdís is currently the CEO of the Health Care Institution of South Iceland.

Mr. Pálmi Kristinsson (Alternate Member of the Board of Directors)

Pálmi Kristinsson in an alternate board member since April 2016. Pálmi holds a BSc degree in construction engineering from the University of Iceland and a MSc degree in engineering from Danmarks Tekniske Højskole. Pálmi is currently a private consultant.

SENIOR MANAGEMENT

The Executive Board consists of the following nine members:

Ms. Birna Einarsdóttir, Chief Executive Officer.

Birna Einarsdóttir worked at Iðnaðarbankinn 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´s 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 the Capital Markets division at Glitnir from 2000 to 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

Sigrídur 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 among other things worked in credit control and service management. Ms. Steinsdóttir was a branch manager in Keflavik for eight years, from 1999 to 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 in 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 Davídsson 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.

Mr. 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 issues, 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 Consolidated 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 Flows are accessible in the explanatory notes in the relevant financial statements incorporated into this Base Prospectus, by reference[1].

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 capital ratio, calculated according to the Act on Financial Undertakings, was 30.1% and the Tier 1 ratio was 28.3%. Current capital ratios are well in excess of both internal and regulatory

[1] 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 Statements 2013 .

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 1,045,769million at the end of the year 2015.

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)
Net interest income	28,010	27,105	28,430
Fee and commission income	20,737	17,984	16,695
Fee and commission expense	(7,567)	(6,501)	(6,262)
Net fee and commission income	13,170	11,483	10,433
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
Other net operating income	3,493	3,855	3,734
Total operating income	44,673	42,443	42,597
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)
Total operating expenses	(27,705)	(26,400)	(28,888)
Profit before loan impairment charges and net valuation c	16,968	16,043	13,709
Loan impairment charges and net valuation changes	8,135	8,810	16,299
Profit before tax	25,103	24,853	30,008
Income tax	(5,851)	(6,239)	(7,866)
Profit for the year from continuing operations	19,252	18,614	22,142
Profit from discontinued operations, net of income tax	1,326	4,136	927
Profit for the year	20,578	22,750	23,069

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
Assets			
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
Total Assets	1,045,769	911,328	866,009
Liabilities			
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
Total Liabilities	843,542	725,841	698,691
Equity			
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
Total equity attributable to the equity holders of Ísla	198,290	183,823	166,019
Non-controlling interests	3,937	1,664	1,299
Total Equity	202,227	185,487	167,318
Total Liabilities and Equity	1,045,769	911,328	866,009

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 risks. Managing these risks 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 2015 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 functionThe 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 it´s 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 are referred to a more senior committee. If credit decisions exceed the limit 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 and liquidity risk poliies. 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 comprises 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 ISAT 2008, 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	-	1,668	1,831	52	29	219	363	11,605
Undrawn loan commitments	-	-	1,385	9,339	10,222	-	11,207	757	-	4,226	5,549	42,685
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	2	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
Total maximum credit exposure	**309,250**	**289,650**	**108,985**	**37,301**	**15,413**	**51,048**	**78,207**	**21,338**	**17,208**	**106,416**	**93,744**	**1,128,560**

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	1,874	975	1,361	28,947
Credit card commitments	23,183	-	3,455	477	31	167	906	166	818	197	144	29,544
Total maximum credit exposure	296,902	183,223	95,118	31,597	14,282	52,795	69,158	16,833	22,570	106,323	83,993	972,794

* 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 the claim value of loans, not carrying amount, and is measured without including the effect of overcollateralisation. 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:

At 31.12.2015	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
Total	425,053	78,274	9,597	38,604	42,650	594,178

At 31.12.2014

	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
Total	391,139	74,032	8,491	33,473	24,174	531,309

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.

At 31.12.2015	Neither past due nor impaired	Past due but not impaired	Classified as impaired	Total carrying amount
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
Total	976,745	24,359	7,921	1,009,025

At 31.12.2014	Neither past due nor impaired	Past due but not impaired	Classified as impaired	Total carrying amount
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
Total	832,266	27,762	14,128	874,156

* 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 its 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 1-4	Risk class 5-6	Risk class 7-8	Risk class 9	Risk class 10	Unrated	Total
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
Total	117,110	288,954	164,733	56,345	4,403	5,141	636,686

	Risk class 1-4	Risk class 5-6	Risk class 7-8	Risk class 9	Risk class 10	Unrated	Total
At 31 December 2014							
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
Total	130,989	254,713	140,332	53,855	11,676	4,338	595,903

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. Information on other financial assets is new. Past due but not impaired loans are as follows:

At 31.12.2015	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
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
Total	11,116	4,975	1,292	6,976	24,359

At 31.12.2014	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
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
Total	12,742	5,383	1,391	8,246	27,762

* 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 reference 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 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.

Liquidity coverage ratio	31.12.2015	31.12.2014
Total	143%	130%
Foreign currencies	467%	617%

Net stable funding ratio	31.12.2015	31.12.2014
Total	120%	112%
Foreign currencies	141%	126%

2014 figures are not audited

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

Maturity analysis 31 December 2015

Financial liabilities	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
Total financial liabilities	837,808	412,817	145,765	77,573	194,106	50,502	-	880,763

* 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:

Off-balance sheet liabilities	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
Total	119,536	-	-	-	-	-	119,536

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:

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

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:

Financial assets	Carrying amount	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
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
Total financial assets	1,021,606	72,605	286,481	69,342	228,319	346,170	21,155	1,024,072

Derivative financial assets	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Gross settled derivatives							
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
Total	-	308	613	1,029	20	-	1,970

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

Maturity analysis 31 December 2014

Financial liabilities	Carrying amount	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
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
Total financial liabilities	719,519	397,188	92,454	100,764	118,739	42,707	-	751,852

Off-balance sheet liabilities	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
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
Total	98,638	-	-	-	-	-	98,638

	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Total non-derivative financial liabilities and off-balance sheet liabilities	495,826	92,454	100,764	118,739	42,707	0	850,490

Derivative financial liabilities	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Gross settled derivatives							
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)
Total	-	(54)	(407)	(3,639)	-	-	(4,100)

*** 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".**

Financial assets	Carrying amount	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
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
Total financial assets	878,757	53,991	187,779	82,448	211,665	332,049	13,675	881,607
Derivative financial assets								
Gross settled derivatives								
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
Total		-	744	675	791	(265)	-	1,945

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.

Composition and amount of liquidity back-up	31.12.2015	31.12.2014
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
Composition and amount of liquidity back-up	314,451	213,532

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
Total	366,631		72,231		180,014	618,876

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
Total	317,745		67,425		170,073	555,243

The 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 such as 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)
Total	45,521	0.63	(2.89)	50,032	0.68	(3.38)

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
Total	4,811	3.27	1.58	73	7.39	0.05

Net position of trading bonds and debt instruments	40,710	0.32	(1.31)	49,959	0.67	(3.33)

*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 Market value	BPV	31/12/2014 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)
Total	41,331	(0.85)	46,592	(1.35)

*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.

Sensitivity analysis for trading bonds and debt instruments		31.12.2015		31.12.2014	
		Profit or (loss)			
Currency (ISK million)	Parallel shift in yield curve (basis points)	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	60	12	(12)	15	(15)
Other total	60	4	(4)	-	-
Total		222	(222)	239	(239)

*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 Issues 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

Assets	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
Total assets	747,502	23,209	39,139	131,035	2,857	8,426	952,167
Off-balance sheet items	73,020	9,571	1,456	35,196	-	-	119,243
Liabilities							
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
Total liabilities	661,679	25,839	21,579	56,277	16,918	6,409	788,701
Off-balance sheet items	87,095	6,446	5,968	28,872	2,976	-	131,357
Net interest gap on 31 December 2015	71,748	495	13,048	81,082	(17,037)	2,017	151,352

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

Assets	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
Total assets	620,771	47,768	30,030	98,282	2,159	10,176	809,185
Off-balance sheet items	68,186	7,508	21,649	112	-	-	97,455
Liabilities							
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
Total liabilities	579,302	13,467	23,790	36,804	20,075	-	673,438
Off-balance sheet items	77,732	3,272	7,701	17,850	-	-	106,555
Net interest gap on 31 December 2014	31,923	38,537	20,188	43,740	(17,916)	10,176	126,647

*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 theses 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	
		Profit or loss			
Currency (ISK million)	Parallel shift in yield curve (basis points)	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)
Total		5,372	(5,372)	4,709	(4,709)

*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

Assets	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
Total assets	119,185	52,706	6,774	7,971	7,462	1,793	9,195	1,439	694	207,219
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
Total liabilities	130,724	28,233	5,882	1,929	1,733	22,840	10,361	1,109	1,450	204,261
On-balance sheet imbalance	(11,539)	24,473	892	6,042	5,729	(21,047)	(1,166)	330	(756)	2,958
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
Net off-balance sheet items	16,966	(23,686)	(657)	(6,061)	(5,703)	20,833	(914)	(353)	941	1,366
Net currency imbalance on 31 December 2015	5,427	787	235	(19)	26	(214)	(2,080)	(23)	185	4,324

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

Currency (shift)	Shift effect
EUR (2%) ..	(109)
USD (6%) ..	(55)
GBP (6%) ..	(14)
CHF (5%) ..	(1)
JPY (5%) ...	(2)
SEK (5%) ..	(11)
NOK (7%) ..	(146)
DKK (2%) ..	(0)
Other (8%)	(19)
Total	(357)

Sensitivity to currency risk 31 December 2014

Currency (shift)	Shift effect
EUR (3%) ..	(221)
USD (4%) ..	(208)
GBP (4%) ..	(116)
CHF (3%) ..	(14)
JPY (6%) ..	(15)
SEK (5%) ..	(55)
NOK (7%) .	(156)
DKK (3%) ..	(69)
Other (6%)	(19)
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			
Portfolio (ISK million)	Change in equity prices	Downward shift	Upward shift	Downward shift	Upward shift
Trading	11%	(368)	368	(194)	194
Banking book	28%	(2,891)	2,891	(1,602)	1,602
Total		(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 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, assuming 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
Total assets	257,067	252,572
Liabilities, CPI indexed linked		
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
Total liabilities	214,445	190,828
CPI Balance	42,622	61,744

* 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
Tier 1 capital		
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)	-
Total Tier 1 capital	198,117	184,347
Tier 2 capital		
Subordinated loans	19,517	21,306
Adjustment to eligible capital instruments	(3,903)	-
Other regulatory adjustments	(2,779)	-
Total capital base	210,952	205,653
Risk-weighted assets		
-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
Total Risk weighted assets	699,693	695,102
Capital ratios		
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.

ISSUER COVER POOL

AUTHORISATION

The establishment of the Programme and the issue of the Covered Bonds have been duly authorised by resolutions of the meetings of the Board of Directors of the Issuer dated 23 March 2010, 1 December 2010 and 25 October 2011.

COMPOSITION

The composition of the Cover Pool may vary from time to time but shall always fulfil the requirements laid down in any applicable FME licence to issue the Covered Bonds. Information relating to the type of assets (and where relevant, their location) that make up the Cover Pool will be provided quarterly, no later than 30 days from the end of each quarter, on the Issuer's website at (http://www.islandsbanki.is/english/investor-relations/funding/). For the avoidance of doubt and in accordance with the Act on Covered Bonds, the Cover Pool, and any proceeds derived therefrom, will be kept separate from the Issuer's other assets at all times in the Register, and thus there will be no commingling of the relevant underlying assets.

In respect to the loans to be included in the Cover Pool, the Issuer will include loans secured by mortgages over residential properties located in Iceland. However, other non-loan assets may be included in accordance with the Act on Covered Bonds and any applicable licence issued by the FME.

The Issuer will not treat any additional value as overcollateral for the purposes of determining the level of Overcollateralisation in the Cover Pool. The Issuer may enter into certain derivative contracts for the purpose of hedging risks between assets in the Cover Pools and the Covered Bonds. The Issuer will maintain an Overcollateralisation level of at least 20 per cent relating to the Covered Bonds. It is the opinion of the Issuer that the Overcollateralisation will be sufficient to manage the market risk of the Cover Pool and to enable the Covered Bonds to obtain and maintain an acceptable Programme and Cover Pool rating, as applicable. The Overcollateralisation may however not exceed 30 per cent. unless increased demand has developed due to other provisions of the Act on Covered Bonds.

ORIGINATION

The Mortgages in the original Cover Pool were primarily originated by the Issuer's predecessor, Glitnir. By decision of the FME dated 14 October 2008 all assets of Glitnir were allocated to the Issuer. All mortgages are owned, maintained and serviced by the Issuer. Other Mortgages going forward may be originated by the Issuer or separately acquired by the issuer.

PROCEEDS

All proceeds derived from the Mortgages will be allocated to an account by the Issuer, which is separated from the Issuer´s other assets and accounts (the "Proceeds Account"). The Proceeds Account will form a part of the Register, as further described in this Base Prospectus (Summary of Icelandic Legislation Relating to Covered Bonds). The Proceeds Account will be monitored by the Issuer and will eventually contain amounts that at a minimum are sufficient to pay an amount equal to 3 months forward looking accrued interest ("Minimum Account Amount"). After such date any proceeds exceeding the Minimum Account Amount can be allocated at the discretion of the Issuer, subject to the approval of the Independent Inspector as further described below, provided that any such allocation would not affect the Overcollateralisation.

INDEPENDENT INSPECTOR AGREEMENT

According to a letter of approval dated 31 January 2011 the FME has approved the Issuer's appointment Helga Harðardóttir, Id.no. 101059-2519, Hvannarima 20, 112 Reykjavík a certified public accountant and partner at KPMG hf. in Iceland as the Independent Inspector of the Programme in accordance with Chapter VIII. of the Act on Covered Bonds and the Rules (the Independent Inspector). The appointment was concluded by an agreement dated 31 January 2011 between the Issuer and the Independent Inspector and a renewed agreement was signed 4 September 2014 (the Independent Inspector Agreement). The principal duties of the Independent Inspector is the carrying out of the supervision set out in Chapter VIII of the Act on Covered Bonds and the Rules, including inter alia the maintenance of the Register in accordance with Chapter VI of the Act on Covered Bonds, verifying the collateral for bonds in a Cover Pool is based on proper methodology and provide the FME with information obtained in the course of her work as frequently and in such form as the FME may decide, or above and beyond that if exceptional circumstance so warrant. The Independent Inspector Agreement is governed by Icelandic law.

INDEPENDENT INSPECTOR'S OVERSIGHT

As further described in this Base Prospectus, the Register will be monitored by the Independent Inspector in accordance with the Act on Covered Bonds. The Independent Inspector must ensure that a Register is maintained, as described above, and verify that the valuation of collateral for bonds in the Cover Pool is based on proper methodology.

Additionally the Issuer must seek prior approval from the Independant Inspector before any assets are removed from the Register, other than may be required by law.

DERIVATIVE CONTRACTS

General

The Act on Covered Bonds allows the inclusion of derivative contracts in the Cover Pool. Such derivative contracts can be entered into in order to hedge interest rate, exchange rate or liquitity risks.

According to the requirements of the Act on Covered Bonds, any such derivative contract can only be entered into with i) the Icelandic State; i) member state; iii) municipality in a member state; iv) central bank in a member state; or v) other party deemed sufficiently solid to fulfil the obligations involved in the contract.

In addition, pursuant to the Act on Covered Bonds, the Register of assets within the Cover Pool shall, in relation to each derivative contract, identify the type of agreement and individual number, counterparty, nominal value, currency, interest terms, value of the net claim or net debt, as well as the start and expiry date of the agreement.

Currency Exchange Risk

If a particular Tranche of Covered Bonds or a part of the Cover Pool is denominated in a currency other than ISK, the Issuer shall enter into derivative contracts for the purpose of hedging any net currency exchange risk. The market value of cross currency swaps will fluctuate with exchange rates. Such market value fluctuations will be managed according to a Credit Support Annex (see below).

The Issuer also has the option to reverse existing swaps and enter into new ones at current exchange rates.

Interest Rate Risk

Interest rate exposure of the Issuer relating to assets within the Cover Pool may be managed through the derivative contracts. Interest rate swaps will be entered into with a hedge counterparty relating to both the Cover Pool and the Covered Bonds issued by the Issuer.

Under derivative contracts, with respect to interest rate hedging on the fixed rate Cover Pool, on a monthly basis the Issuer will enter into contract with a hedge counterparty to hedge on a net risk basis the fluctuations in the relevant assets held by the Issuer and which are included in the Cover Pool on the relevant date and with regards to the interest rate payable on the Covered Bonds with regards to the interest rate on the Mortgages contained in the Cover Pool.

Downgrade in Rating of Hedge Counterparty

Under the terms of the proposed derivative contracts to be entered into with the hedge counterparty, if the rating of any hedge counterparty short term unsecured, unsubordinated debt obligations falls below "F2" by Fitch, "P2" by Moody's or "A2" by S&P or the rating of any hedge counterparty long-term unsecured, unsubordinated debt obligations falls below "A-" by Fitch or "A-" by S&P or "A3" by Moody's at any time, the hedge counterparty will be required to take certain remedial measures which may include: (i) providing collateral for its obligations under the Hedging Contract; (ii) terminate the derivative contract and arrange for its obligations under the derivative contracts to be transferred to an entity with the ratings required by the relevant rating agency; or (iii) procuring another entity with the ratings required by the relevant rating agency to become co-obligor in respect of its obligations under the derivative contracts.

Restrictions on Use of Derivative Contracts

The Issuer uses derivatives in the Cover Pool, including the swaps described above, strictly for hedging purposes and these are designated as hedging instruments. Derivatives are not used in trading activities or for speculative purposes.

Under rules made under the Act on Covered Bonds, the Issuer is required to fix a limit on interest risk in relation to its own funds and potential losses resulting from 1 per cent. parallel shift in all interest rate curves.

In respect of assets within the Cover Pool, the Issuer complies with the currency matching requirements set out in the Rules made under the Act on Covered Bonds and provisions applicable to cover assets derivative contracts.

ORIGINATION CRITERIA

All loans, in the Cover Pool, were at the time of lending (or at the time of restructuring, if applicable), if not otherwise specifically mentioned, subject to various conditions (the **Origination Criteria**) being satisfied on the relevant date. These are as follows:

(i) no loan relates to a Property which is not a residential property;

(ii) all of the borrowers of each respective loan are individuals and were aged 18 years or older at the date of entering into the relevant loan and its related Mortgage;

(iii) each loan is denominated in ISK;

(iv) prior to the making of each advance under a loan, the requirements of the relevant standard documentation were met, so far as applicable to that loan;

(v) each loan complies fully with the Consumer Credit Act No.121/1994;

(vi) the whole of the outstanding principal balance on each loan and any arrears of interest and all accrued interest is secured by a Mortgage;

(vii) each loan and its Mortgage is valid and binding and enforceable in accordance with its terms;

(viii) insurance cover for each Property is or will at all times be available under a policy arranged by the borrower in accordance with the relevant Mortgage conditions;

(ix) prior to the making of each advance under a loan, the Origination Criteria and all preconditions to the making of that loan were satisfied in all material respects subject only to exceptions as would be acceptable to a reasonable, prudent mortgage lender.

THE ICELANDIC ECONOMY[4]

Following the rapid upswing in the Icelandic economy that started in the middle of the last decade, the economy has been through a banking and currency crisis over the past six years. The gross domestic product (**GDP**) contracted considerably, the value of assets deteriorated, real wages declined and unemployment rose. However, the economy has now been growing since 2010 and is currently doing quite well by international standards, with a GDP per capita among the highest in the world.

The Icelandic economy has a history of considerable volatility. The source of such volatility has historically been in the main export sector, the fisheries industry, and the business cycle was therefore linked to fish catch volumes and fluctuations in the prices of marine products on foreign markets. The development of heavy industry, which plays a predominant role in export activities, has also been the cause of some volatility. The business cycle of the last decade was partly driven by investments in this sector. However, these fluctuations can, to a greater extent, be attributed to systemic changes in the domestic financial market, which in a short period of time evolved from a capital controlled financial market with fixed exchange rates to an open financial market with a floating exchange rate and large international privately-run financial institutions. The currency and banking crisis was therefore preceded by the classical antecedents to a crisis of such kind and was sparked by the international financial crisis that prevailed at the time.

The International Monetary Fund (IMF) approached the Icelandic government at the end of 2008 with the promise of a credit facility in exchange for a letter of intent from the Icelandic government agreeing to changes in the Icelandic economy in three main areas: i.e. fiscal policy, the activities of financial institutions and stability of the foreign exchange market. Despite some initial delays, the main targets of this plan were met within a reasonable amount of time and the stand-by arrangement with the IMF came to an end on 26 August 2011.

Considering the scale of the financial crisis in 2008 and taking into account the large size of the banking sector when it collapsed in relation to the size of the overall economy, the subsequent recovery has been comprehensive. There has been an emphasis on assisting Icelandic households in the aftermath of the financial crisis. Despite measures to mitigate the effects of the financial crisis, households were significantly affected by a considerable depreciation of the ISK, soaring inflation, a decline in real wages, increased unemployment, a drop in housing prices, a deterioration in asset positions, and rising debt, which prior to the financial crisis was mainly CPI-linked and partly exchange-rate linked.

Economic indicators are now showing signs that the economy has been growing robustly since 2010. Consumption, investment and exports are all growing at a brisk pace and there is a turnaround in the development of real wages and real residential house prices. Inflation has fallen and has remained below the Central Bank of Iceland's inflation target since Q1 2014. Unemployment has also decreased to equilibrium levels. Rapid growth is being observed in specific areas of the export sector, especially tourism. Moreover, business investment is rising again, particularly in export sectors such as tourism and power intensive industry.. Economic forecasts expect considerable economic growth in 2016 and 2017.

[4] Sources: This chapter was compiled by Islandsbanki Research based on information from hagstofa.is, sedlabanki.is and oecd.org. No facts have been omitted which would render the reproduced information inaccurate or misleading.

THE ICELANDIC HOUSING MARKET

A relatively traditional price bubble formed in the Icelandic housing market around the middle of the last decade, fuelled by easier access to credit, a rapid increase in real wages and expectations of further property value increases. The economy experienced a vast upswing during this period, which was driven by, among other things, the newly found freedom on the financial market. A large quantity of residential housing were built during this period because the market prices of residential property considerably outweighed building costs.

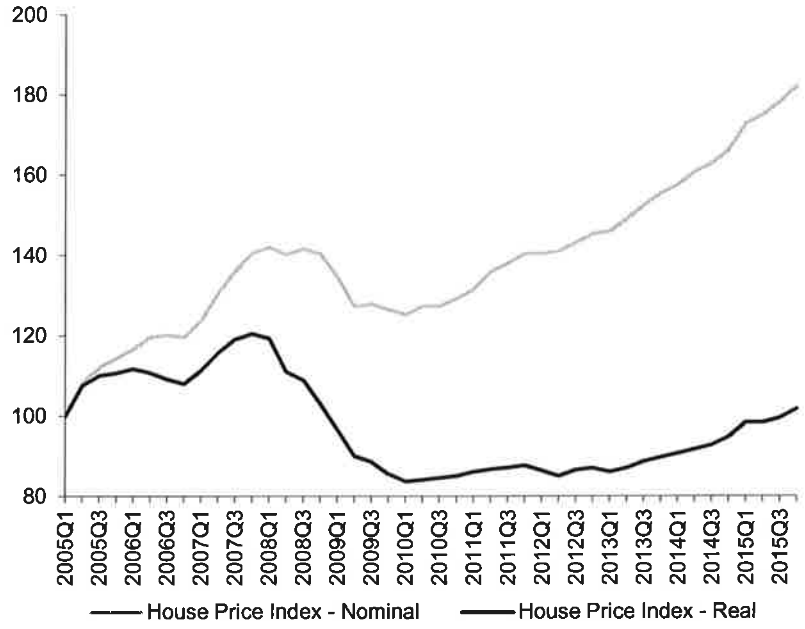
Historically, a large proportion of Icelandic households have owned the houses they have lived in, i.e. four out of five. The rental market, on the other hand, has been relatively small when compared to many other economies. Ownership has been encouraged with public subsidies on interest rates in the form of both government guarantees on the financing of the principal lenders' mortgage loans and interest rebates. Icelandic households have placed a rather large proportion of their savings into residential property. The majority of mortgage loans were CPI-indexed, but during the upswing a growing number of loans were also exchange rate-linked, as households sought to finance the purchases of their homes with the lower interest rates on foreign currencies. This made Icelandic households rather vulnerable to fluctuations in housing prices, as well as the exchange rate of the Icelandic króna and inflation. When the price bubble burst, capital rapidly shrank and repayments on loans as a percentage of disposable income suddenly soared. This has been a large part of the problem that the Icelandic economy has had to contend with since the currency and banking crisis erupted in 2008.

One of the distinguishing features of the Icelandic housing market has long been that decreases in real value are caused more by inflation than changes in nominal value. Thus business in this market contracted substantially at the same time as the Icelandic upswing came to a traditional end, as the currency depreciated and inflation soared. From this point of view, developments in the aftermath of 2008 crash were not unlike many other downturns in the history of the Icelandic economy. The real decrease in residential property value, which measured at 36% in Q1 2010 from when prices were at their peak at the end of 2008, is a result of the inflation that occurred during this period.

The housing market went through a turnaround in 2010 and real and nominal housing prices started to rise somewhat. Moreover, turnover on the housing market picked up. There were a number of reasons for this. Firstly, real wages increased, as did expectations that the bottom of the recession had been reached. Secondly, the demand was driven by expectations regarding the development of housing prices, since housing prices seemed to be rising again. Thirdly, the debt problems of households were tackled with debt forgiveness. In parallel with this, blockages at both the supply and demand end of the housing market have been cleared, which may partly explain the increase in turnover. This revaluation process is not over and will continue to characterise the housing market in the years ahead. From Q1 2010 to Q4 2015 housing prices have increased by 22% in real terms.

Despite the considerable drop in housing prices since 2008, residential property prices are not low from an historical point of view. The real value of housing is currently around 20% over the average of the past two decades and real house prices are now close to what they were in early 2005. Housing prices in proportion to wages are also close to the long-term average. It is therefore, to some extent, a victory for indebted households, who have placed a large proportion of their savings in their housing, that prices did not drop more during the recession, since there are examples of considerably steeper falls in property value in financial crises. In Finland in the early 1990's, for example, real housing prices dropped by 50%.

The chart below shows the development of housing prices in nominal and real terms.[5]



SOURCE: THE CENTRAL BANK OF ICELAND,

http://www.sedlabanki.is/library/Skraarsafn/Peningamal/2016/Februar-2016/QMM%20Gagnagrunnur%20(.xlsx)%2010.%20febrúar%202016.xlsx

[5] Sources: skra.is. *No facts have been omitted which would render the reproduced information inaccurate or misleading.*

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 Covered Bonds to be issued under the Programme. They may not apply to certain classes of person such as dealers. Prospective holders of Covered 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 Covered Bonds provided the Covered 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 Covered Bonds issued under the Programme with the Directorate of Internal Revenue in Iceland to exempt the Covered 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 Covered Bonds.

In the event that the Issuer is required to withhold tax then the provisions of Condition 9 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 Covered 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 Covered Bonds if, at the time of the death of the holder or the transfer of the Covered Bonds, such holder or transferor is not a tax resident of Iceland.

ICELANDIC TAX RESIDENTS

Beneficial owners of the Covered 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 Covered 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 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 6 May 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 and the
v. Independent Auditor's 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 Covered Bonds or any change in the condition of the Issuer which is material in the context of the Programme or the issue of Covered 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 Covered Bonds. Furthermore, the Issuer will, in connection with the listing of the Covered Bonds on NASDAQ OMX Iceland, so long as any Covered 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 Covered 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/.

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