

# Íslandsbanki hf. Base Prospectus

February 2013

# Íslandsbanki hf.

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

**ISK 25,000,000,000**

## **Bond Programme**

*Under this ISK 25,000,000,000 Bond Programme, Íslandsbanki hf. (the “**Issuer**”) may issue in a continuous and repeated manner bonds (the “**Bonds**”) denominated in any Specified Currency.*

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

*The maximum aggregate nominal amount of all Bonds issued under the Programme will not exceed ISK 25,000,000,000 (or its equivalent in other currencies calculated as described herein). The Bonds may be issued on a continuing basis.*

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

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

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

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

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

**Íslandsbanki hf.**

The date of this Base Prospectus is 7 February 2013

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

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

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

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

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

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

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

**CONTENTS**

Summary of the Base Prospectus ..... 4

Risk Factors ..... 11

Statements ..... 20

Notice to investors ..... 22

Applicable Final Terms ..... 23

Terms and conditions of the Bonds ..... 43

Information about the Issuer ..... 70

Financial Information ..... 84

Risk Management ..... 88

Taxation ..... 107

Documents on Display ..... 108

Documents incorporated by reference ..... 109

## SUMMARY OF THE BASE PROSPECTUS

This summary must be read as an introduction to this Base Prospectus and any decision to invest in any Bonds should be based on a consideration of this Base Prospectus as a whole. Following the implementation of the relevant provisions of the Prospectus Directive (Directive 2003/71/EC) in each Member State of the European Economic Area, a civil liability attaches to those persons in any such Member States who have tabled the summary, including any translation thereof, and applied for its notification, but only if the summary is misleading, inaccurate or inconsistent when read together with the other parts of this Base Prospectus. Where a claim relating to the information contained in this Base Prospectus is brought before a court in a Member State of the European Economic Area, the plaintiff may, under the national legislation of the Member State where the claim is brought, be required to bear the costs of translating this Base Prospectus before the legal proceedings are initiated.

Words and expressions defined in Condition 1 in the “**Definitions**” of the Terms and Conditions in this Base Prospectus have the same meanings in this summary.

For the life of this Base Prospectus, the Base Prospectus, issued Final Terms, the Consolidated Financial Statements of the Issuer for the years 2009-2011, the unaudited and unreviewed Condensed Consolidated Interim Financial Statement for the first nine months 2012 and 2011 and Íslandsbanki hf.’s articles of association are available for viewing at Íslandsbanki’s premises at Kirkjusandur 2, 155 Reykjavík, Iceland and at the Issuer’s website at: <http://www.islandsbanki.is/english/investor-relations/funding/>

### Essential characteristics and risks associated with the Issuer

Íslandsbanki hf., ID no. 491008-0160, having its registered office at Kirkjusandur 2, 155 Reykjavík, Iceland (the “**Issuer**”) is an Icelandic financial institution headquartered in Iceland. It considers Iceland as its primary market.

The Issuer’s Board of Directors consists of seven members. Six of which are elected by ISB Holding ehf. as holder of a 95% stake in the Issuer. The last member is appointed by the Icelandic State Financial Investments as holder of the remaining 5% of shares, based on nominations from a selection committee. Seven alternate members are also appointed, six as elected by ISB Holding ehf. and one as appointed by the Icelandic State Financial Investments.

Set forth below are the members of the Issuer’s Board of Directors

<b>Name</b>	<b>Title</b>
Mr. Fridrik Sophusson	Chairman
Mr. John E. Mack	Vice Chairman
Mr. Árni Tómasson	Member of the Board
Mr. Neil Graeme Brown	Member of the Board
Dr. Daniel Levin	Member of the Board
Ms. Marianne Økland	Member of the Board
Ms. María E. Ingvadóttir	Member of the Board

The alternate board members of the Board of Directors are as follows:

Ms. María Gudrún Sigurdardóttir

Ms. Eva Sóley Guðbjörnsdóttir

Mr. Baldur Pétursson

Mr. Brynjar Stefánsson

Mr. Jón Eiríksson

Ms. Sigríður Hallgrímsdóttir

Ms. Þórunn Jónsdóttir

The Executive Board consist of the following eight members:

Ms. Birna Einarsdóttir, *Chief Executive Officer*.  
Mr. Jón Guðni Ómarsson, *Chief Financial Officer*  
Mr. Sverrir Örn Thorvaldsson, *Chief Risk Officer*  
Mr. Stefán Sigurdsson, *Managing Director VÍB (Wealth Management)*  
Ms. Sigríður Olgeirsdóttir, *Chief Operating Officer*  
Ms. Una Steinsdóttir, *Managing Director Retail Banking*  
Mr. Vilhelm Már Thorsteinsson, *Managing Director Corporate Banking*  
Mr. Tryggvi Björn Davíðsson, *Managing Director Markets*

Deloitte hf., ID no. 521098-2449, registered office being Smáratorg 3, 201 Kópavogur, Iceland is the Issuer's accountant.

According to the unaudited and unreviewed Financial Statement for the Issuer's operations for the period 1 January to 30 September 2012, profit amounted to ISK 16,221 million, which corresponds to a 16.3% return on equity. The Issuer's total official capital ratio, calculated according to the Act on Financial Undertakings, was 23.5% and the Tier 1 ratio was 20.2%. The Issuer's total assets amounted to ISK 812,711 million at the end of the period. The Condensed Consolidated Interim Financial Statements for the first nine months of 2012 was unaudited and unreviewed. 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, market risk, liquidity risk, operational risk. The Issuer has also identified business risk, strategic risk and political risk as material to the Issuer's operations.

The Issuer's shareholders as of the date of this Base Prospectus are:

- ISB Holding ehf.: 9,500,000,000 shares or 95% of the share capital
- Government of Iceland: 500,000,000 shares or 5% of the share capital

Selected Financial information from the Issuer's Consolidated Statements for the years 2009, 2010 and 2011 and the unaudited and unreviewed Condensed Consolidated Interim Financial Statement for the first nine months 2012 and 2011 can be found in the chapter Financial Statements.

#### **Essential characteristics and risks associated with the Bonds**

The Bonds will be denominated in ISK or any Specified Currency. The aggregate nominal principal amount of Bonds outstanding at any one time will not exceed ISK 25,000,000,000 (*or its equivalent in other currencies calculated as described herein*).

Each relevant Bond constitutes unsubordinated obligations and ranks *pari passu* among themselves and any unsecured Senior Debt (if any). The Bonds and any unsecured Senior Debt (if any) 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 for the Issuer, the costs and debt (if any) of such administration will rank ahead of claims for payments of the Bonds and of the relevant Senior Debt (if any).

The Bonds will be issued in Series. Each Series may comprise one or more Tranches issued on different issue dates. The Bonds of each Series will all be subject to identical terms, except for the issue date, the date of the first payment of interest (if any), the amount, and/or the issue price which may be different in respect to different Tranches.

An application will be made to the NASDAQ OMX Iceland hf. for the Bonds issued under the Programme to be admitted to trading on the Main Market. However, Bonds may also be issued under the Programme whereby they will be admitted to listing and/or trading by other listing authorities, stock exchanges or may be issued on

the basis that they will not be admitted to listing and/or trading by such other listing authority or stock exchange.

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

Subject to compliance with all relevant laws, regulations and directives, the Bonds may be issued with any maturity as decided by the Issuer. The applicable Final Terms will indicate the scheduled maturity date of the Bonds and will also indicate whether such Bonds can be redeemed prior to their stated maturity.

The issue price and amount of the Bonds of any Tranche to be issued under the Programme will be determined by the Issuer at the time of the issue of such Tranche in accordance with prevailing market conditions.

The Issuer identifies the following main risks associated with the Bonds that may affect its ability to fulfill its obligations under the Programme.

- 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;
- an investment in the Bonds involves a reliance on the creditworthiness of the Issuer. The Bonds are not guaranteed by any third party. In addition, an investment in the Bonds involves the risk that subsequent changes in the actual or perceived creditworthiness of the Issuer may adversely affect the market value of the Bonds; and
- there is not, at present, an active and liquid secondary market for the Bonds and there can be no assurance that a secondary market for the Bonds will develop in the future.

## General description of the Programme

The following is a brief summary only and should be read in conjunction with the rest of this Base Prospectus and, in relation to any Bond, in conjunction with the applicable Final Terms and, to the extent applicable, the Terms and Conditions of the Bonds set out herein. Any capitalised term used in this section that is not defined herein will be found in the definition section of the Terms and Conditions chapter.

<b>Issuer:</b>	Íslandsbanki hf.
<b>Arranger(s):</b>	Íslandsbanki hf.
<b>Programme Amount:</b>	ISK 25,000,000,000 in aggregate nominal principal amount of Bonds outstanding at any one time.
<b>Issuance in Series:</b>	Bonds will be issued in Series. Each Series may comprise one or more Tranches issued on different issue dates. The Bonds of each Series will all be subject to identical terms, except that the issue date, the date of the first payment of interest (if any), the amount, and/or the issue price thereof may be different in respect of different Tranches.
<b>Use of proceeds:</b>	For general funding purposes of the Issuer.
<b>Final Terms:</b>	Each Tranche will be the subject of the Final Terms which, for the purposes of that Tranche only, completes the Terms and Conditions of the Bonds and this Base Prospectus and must be read in conjunction with this Base Prospectus. The terms and conditions applicable to any particular Tranche of Bonds are the Terms and Conditions of the Bonds as completed, amended and/or replaced by the relevant Final Terms.
<b>Distribution:</b>	Bonds may be distributed by way of private or public placement and in each case on a syndicated or non-syndicated basis.
<b>Currencies:</b>	Bonds will be denominated in the Specified Currency.
<b>Maturities:</b>	Subject to compliance with all relevant laws, regulations and directives, any maturity as agreed by the Issuer.
<b>Issue Price:</b>	Bonds may be issued at any price, as specified in the relevant Final Terms.
<b>Form of Bonds:</b>	The Bonds will be issued in bearer form, registered form or in the case of VS System Bonds, uncertificated book entry form, as described in "Form of Bonds" in relevant Final Terms. VS System Bonds will not be evidenced by any physical Bond or document of title. Entitlements to VS System Bonds will be evidenced by the crediting of VS System Bonds to account with the relevant clearing system (as the case may be).
<b>Clearing Systems:</b>	ISD, Euroclear, Clearstream Luxembourg, VP LUX, DTC and/or, in relation to any Tranche of Bonds, any other clearing system as may be specified in the relevant Final Terms.
<b>Status of the Bonds:</b>	Each Bond constitutes unsubordinated obligations and ranks <i>pari passu</i> among themselves, any unsecured Senior debt (if any) and 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 Bonds and of the relevant Senior Debt (if any).

**Fixed Rate Bonds:**

Bonds may provide for interest based on a fixed rate (“**Fixed Rate Bonds**”). Interest will be payable on Fixed Rate Bonds on such date or dates as may be agreed by the Issuer (as specified in the applicable Final Terms) and on redemption.

**Floating Rate Bonds:**

Bonds may provide for interest based on a floating rate (“**Floating Rate Bonds**”). Floating Rate 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 Bonds.

**Inflation-Linked Bonds:**

Bonds may provide for payments of interest to be linked to an index (“**Inflation-Linked Interest Bonds**”). Payments of principal in respect of Inflation-Linked Interest Bonds will be calculated by reference to such index and/or formula or to such other factors as the Issuer may decide (as specified in the applicable Final Terms).

**Other provisions in relation to Floating Rate Bonds and Inflation-Linked Interest Bonds:**

Floating Rate Bonds and Inflation-Linked Interest Bonds may also have a maximum interest rate, a minimum interest rate or both (as specified in the applicable Final Terms).

Interest on Floating Rate Bonds and Inflation-Linked Interest Bonds in respect of each Interest Period, as agreed prior to issue by the Issuer, will be payable on such Interest Payment Dates and will be calculated on the basis of such Day Count Fraction as may be decided by the Issuer.

**Zero Coupon Bonds:**

Bonds may provide that no interest is payable (“**Zero Coupon Bonds**”). Zero Coupon Bonds will be offered and sold at a discount to their nominal amount and will not bear interest.

**Redemption:**

The applicable Final Terms will indicate the scheduled maturity date of such Bonds (the “**Maturity Date**”) and will also indicate whether such Bonds can be redeemed prior to their stated maturity for taxation reasons or whether such Bonds will be redeemable at the option of the Issuer (“**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 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.

**Denominations:**

Bonds will be issued in such denominations as may be agreed by the Issuer but never less than EUR 50,000 or its equivalent in other currencies and as specified in the applicable Final Terms.

**Taxation:**

All payments in respect of the Bonds will be made without deduction for or on account of withholding taxes imposed within Iceland, subject to the Bondholder being a resident of a country which has a double taxation treaty with Iceland.

**Cross Default and other Events of Default:**

The Terms of the Bonds will contain, amongst others, the following events of default:

- a) Default in payment of any principal or interest due in respect of the Bonds, continuing for a specified period of time;
- b) Non-performance or non-observance by the Issuer of any of its other obligations under the Terms and Conditions continuing for a specified period of time;
- c) (i) any Financial Indebtedness of the Issuer becomes due and repayable prematurely by reason of an event of default (however described); (ii) the Issuer fails to make any payment in respect of any Financial Indebtedness on the due date for payment; (iii) any security given by the Issuer for any Financial Indebtedness becomes enforceable; or (iv) default is made by the Issuer or in making any payment due under any guarantee and/or indemnity given by it in relation to any Financial Indebtedness of any other person, which events either alone or together with any of the other events specified in (i) to (iv) above amount to at least U.S.\$5,000,000; and
- d) Events relating to the insolvency or winding up of the Issuer.

**Approval, Listing and Admission to Trading:**

This Base Prospectus has been approved by the FME as a base prospectus. Application will be made to the NASDAQ OMX Iceland for the Bonds issued under the Programme to be admitted to trading on the NASDAQ OMX Iceland regulated market.

Bonds issued under the Programme may be listed or admitted to trading, as the case may be, on such other or further securities exchanges or markets as may be determined by the Issuer in relation to each Series. Bonds that are neither listed nor admitted to trading on any market may also be issued.

The applicable Final Terms will state whether or not the relevant Bonds are to be listed and/or admitted to trading and, if so, on which stock exchanges and/or markets.

**Governing Law:**

The Bonds (except for the ISD System Bonds) and any non-contractual obligations arising out of or in connection with them will be governed by, and construed in accordance with English Law

except for Condition 3 (Status of Bonds), which will be governed by, and construed in accordance with Icelandic Law.

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

VS System Bonds must comply with the relevant regulations of the ISD, Euroclear, Clearstream Luxembourg, VP LUX and DTC and the holders of VS System Bonds will be entitled to the rights and are subject to the obligations and liabilities which arise under the relevant regulations and legislation.

**Ratings:**

Tranches of Bonds issued under the Programme may be rated or unrated. Where a Tranche of Bonds is rated, such rating will not necessarily be the same as the ratings assigned to the Programme, and will be specified in the relevant Final Terms. A security rating is not a recommendation to buy, sell or hold securities and may be subject to suspension, reduction or withdrawal at any time by the assigning rating agency.

## **RISK FACTORS**

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

At year end 2011, the Issuer's loan portfolio was exposed to concentration in certain industry sectors, namely households, financial institutions, 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.**

##### **LITIGATION THREATS**

Several former customers of the Issuer's predecessor, Glitnir private banking services, have threatened litigation against the Issuer in order to claim compensation for alleged mistakes made by Glitnir's employees. Some of those customers have already filed a lawsuit against the Issuer with the Reykjavík District Court. The Issuer has not accepted any liability and will challenge the lawsuits on the grounds that these claims relate to events that happened prior to the incorporation of the Issuer and the assignment of certain liabilities and assets on 14 October 2008 and therefore are not the responsibility of the Issuer in any way. The District Court of Reykjavík has now ruled in favour of the Issuer in the case of Hrafninn ehf. vs. Íslandsbanki (case no. E-10867.2009) stating that the Issuer cannot be held responsible for Glitnir banki hf. employees' mistakes. This ruling has not been appealed. The Issuer estimates the total amount of compensation liabilities currently claimed by customers of Glitnir to be ISK 5.5 billion.

##### **NETTING AGREEMENT**

When certain assets and obligations were transferred from Glitnir to the Issuer, the FME ruled that customers would, upon liquidation of Glitnir, maintain their right to claim netting of assets and liabilities held by Glitnir prior to its acquisition on 14 October 2008. As a result, the Issuer anticipates that it may have to write off those assets netted against liabilities in Glitnir.

The Issuer has made an agreement with Glitnir that the latter will compensate the Issuer for losses that may result from the netting of assets and liabilities. The claims in question are priority claims on the liquidated assets of Glitnir and the netting exercise is unlikely to affect either the net asset value or the earnings of the Issuer.

##### **ALLOCATION OF LIENS, GUARANTEES AND COMPARABLE RIGHTS**

When certain assets and obligations were transferred from Glitnir to the Issuer, the FME ruled that the Issuer would take over all rights used to secure the performance of obligations of the debtors of Glitnir, including all liens, guarantees and other comparable rights connected to the claims of the Issuer.

The Issuer should, however, be accountable to Glitnir for specific collateral of certain of its customers, due to claims and derivatives which were not transferred to the Issuer. The Issuer has, in accordance with this decision, transferred to Glitnir certain collateralised obligations of customers. A customer has filed a lawsuit against the Issuer with the Reykjavík District Court challenging the Issuer's decision to transfer the customer's money market deposit to Glitnir, which the Issuer, in good faith, identified as collateral for a foreign exchange future contract. The claim was for approximately ISK 450 million. The District Court ruled in favour of the Issuer, and after appeal the decision was confirmed by a ruling of the Supreme Court (case no. 129/2011). Any future allocation of collateral will be made under an agreement with Glitnir, whereby Glitnir indemnifies the Issuer against any future claims arising from the transfer of such rights.



## **INDEXED LOANS AND FOREIGN CURRENCY LOANS**

In order to address the uncertainty surrounding which foreign currency loans should be deemed to be illegally linked to foreign currency, the Icelandic Parliament introduced in 2010 a new legislation proposing a change to the Act on Interest and Price Indexation. The legislation was passed as an Amendment to the Act on Interest and Price Indexation No. 151/2010, coming into force 28 December 2010. Based on the context of this new law, the Issuer treated all foreign currency dominated mortgages and car loans according to the method previously set forth in a September 2010 ruling of the Supreme Court concerning car loans/leasing contracts. All individuals with foreign currency residential mortgages were presented with an offer of having their mortgage recalculated according to a similar formula, regardless of the validity of the contract in question. The definition of a mortgage in the new legislation refers to tax law. The recalculation had to be offered if the debtor was eligible for a refund in part of paid interest (interest subsidy). The Issuer decided to expand this definition to cover all residential loans to individuals, although the debtors were not obliged to accept the offer. The interest rate on car loans will, according to the law, be replaced by a non-indexed rate. The same applies to mortgages during the first five years, after which the interest rates will revert back to market rates. Alternatively, customers have a choice of Consumer Price indexed rate. At the end of the five year term, mortgages will revert back to market rates.

In April 2011, the District Court of Reykjavík ruled on a dispute regarding the nature of a financial leasing contract between the Issuer and a customer. The court ruled that although the contract had the form of a lease, it was by nature a loan contract, thereby subject to the Act on Interest and Price Indexation. The contract was denominated in foreign currency, and the court further ruled that the contract had an illegal foreign currency indexation, citing the precedent set by the Supreme Court in June 2010. In October 2011, the District Court ruling was upheld by the Supreme Court. Each affected contract was recalculated as a result of the ruling. On 15 February 2012, the Supreme Court in Iceland passed a ruling (no. 600/2011) that affects the previous recalculation of loans that are illegally linked to the value of foreign currencies. The ruling states that Act 151/2010, which the Icelandic Parliament passed in December 2010 and instructed banks on how to recalculate foreign currency linked mortgages, violates the provisions of the Icelandic constitution that protects the freedom to hold private property, as the legislator cannot pass a law that retroactively deprives a person of an asset without adequate compensation. While some uncertainty remains on how the ruling should be interpreted, a recent ruling of the Supreme Court (no. 464/2012) clarified some of the issues outstanding from the prior ruling. The Issuer had made an assessment to the effect that the impact of this prior ruling could amount to a loss of ISK 12.1 billion, depending on later rulings. This recent ruling does not alter that assessment. The Issuer has subsequently commenced recalculation of the loans affected by the rulings. The Issuer recognised a provision at year end 2011 and the financial statements therefore reflect the impact of the court rulings at the time. The Issuer still maintains a capital ratio above the minimum requirement of 16% set by the FME.

The ruling on financial leasing contracts does not appear to set new precedent affecting other loan contracts, as the dismissal of the disputed contract's currency indexation is based on the Supreme Court's ruling from June 2010. It should also be noted that although the currency indexation has been deemed illegal, the customer's debt obligation in ISK at the signing of the contract is still valid.

The District Courts have ruled in favour of the Issuer in a few cases regarding disputed foreign currency denominated loan contracts, thereby confirming that the disputed loans were indeed legitimate foreign currency loans. These rulings are somewhat offset by the June 2011 Supreme Court's ruling on a case (case no. 155/2011) regarding a disputed loan contract between Landsbankinn and its customer (Landsbankinn vs. MótorMax). Although the case did not involve the Issuer, the disputed contract in the case must be regarded as typical of many foreign currency corporate loans granted by the Issuer. The Supreme Court decided that the disputed contract contained an illegal foreign currency indexation. Following the June 2011 ruling, the Issuer has evaluated all corporate contract forms and assessed which forms are affected by the ruling and which are, by the Issuer's estimation, legal foreign currency loan contracts.

On 7 June 2012, the Supreme Court ruled on a foreign currency bond (the box form) very similar to residential mortgages. The Supreme Court ruled that because the disputed bond was by its nature not affected by the Supreme Court's previous rulings (including the June 2010 and 2011 rulings). The Supreme Court specifically

mentions in the ruling that the bond's principal is stated in foreign currencies, and reiterates that a correctly drafted foreign currency debt agreement is in fact not prohibited by the Act on Interest and Price Indexation.

Because of the widespread use of the box form and its predecessors, the impact of the decision may be significant, mainly in three ways. First, the 15 February 2012 ruling does not affect the bulk of the mortgage loans as far as further recalculation is concerned. Second, the Issuer is not obliged to recalculate similar loans not categorised as mortgage loans. Third, the Issuer is not obliged to change the method of recalculation in most loans belonging to the same category.

The above is valid as far as Islandsbanki's mortgages is concerned. However, the merger with Byr in 2011 introduced a portfolio of approx. 300-350 mortgages which will be affected by the constitutional factor mentioned above. Likewise, some general loan contracts, corporate and individual, are also subject to that ruling, but the final number is dependent on a ruling by the Supreme Court in February 2013

Furthermore, the Supreme Court ruled in June that a loan contract containing similar features as the one disputed in the MótórMax case mentioned above was valid on account of the lender actually having received payment in foreign currency.

The Issuer has estimated the financial effect caused by the latest rulings of the Supreme Court and the downside case of the ruling expected in February 2013. In its estimates, the Issuer has taken into account the fact that customers have already been offered a principal adjustment of foreign currency debt, and that a ruling has been made by the Supreme Court on replacement interest rates. The Issuer has divided all foreign currency loans into four categories, depending on the risk of the loans being deemed illegal. The Issuer holds provisions for the expected financial effect for the highest risk category. Meanwhile, the message to the customers is that they should proceed with regular payments.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

There is not, at present, an active and liquid secondary market for the Bonds and there can be no assurance that a secondary market for the Bonds will develop. If a secondary market does develop it may not continue for the life of the Bonds or it may not provide Bond holders with liquidity of investment with the result that a Bondholder may not be able to find a buyer to buy its Bonds readily or at prices that will enable the Bond holder to realise a desired yield.

#### **GENERAL RISK FACTORS**

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

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

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

#### **CHANGES OF LAW**

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

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

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

#### **EXCHANGE RATE RISKS**

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

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

#### **INTEREST RATE RISKS**

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

#### **INFLATION RISK**

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

#### **LIQUIDITY RISK**

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

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

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

## STATEMENTS

### ISSUER'S AND ARRANGER'S STATEMENT

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

Reykjavík, Iceland, 7 February 2013

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 2009, 2010 AND 2011

#### To the readers of this base prospectus

We have audited the annual reports for the financial year 2009, 2010 and 2011 presented and published by Management of Íslandsbanki hf., from which the consolidated financial information on pages 86-87 have been extracted. We conducted our audit of the consolidated financial statements and the financial statements in accordance with International Standards on Auditing. Our independent audit opinion on the consolidated financial statements 2009, 2010 and 2011 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 reports 2011, on 19 March 2012.

We draw attention to that our independent auditor's report with the consolidated financial statements for 2010 and 2011 had an emphasis of matter paragraphs.

#### Emphasis of Matter for the Financial Statements for the financial year ended December 31 2011

Without qualifying our opinion we draw your attention to:

Notes 2.3 b) and 60 in the consolidated Financial Statements, which discuss the uncertainties relating to the interpretation of a recent Supreme Court ruling and describes the principal risks and uncertainties currently faced by the Bank.

#### Emphasis of Matter for the Financial Statements for the financial year ended December 31 2010

Without qualifying our opinion we draw your attention to:

The notes 2.4 and 2.5 in the consolidated Financial Statements, which discuss the uncertainties in the valuation of acquired assets at deep discount. The note 2.4 also refers to note 60 which discusses further contingencies relating to the acquired loan assets.

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

Management is responsible for the correct extraction of the consolidated financial information on pages 86-87 from the annual reports for the financial years 2009, 2010 and 2011. Our responsibility is based on our work to express an opinion on the extraction of the financial information from the published annual reports.

### **Basis of opinion**

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 86-87 are, in all material respects, in accordance with the published annual reports, from which they have been extracted.

### **Opinion**

In our opinion, the consolidated financial information presented on pages 86-87 are, in all material respects, in accordance with the published annual reports for the financial year 2009, 2010 and 2011, from which they have been extracted, taken into account the reclassifications described on pages 86-87. This opinion excludes other financial information presented on the above mentioned pages, which have been extracted from the unaudited interim financial statements for the periods 1.1 – 30.9 2012 and 1.1. – 30.9 2011.

Kópavogur, Iceland, 7 February, 2013  
On behalf of Deloitte hf.

Pálína Árnadóttir State Authorised Public Accountant  
Páll Grétar Steingrímsson State Authorised Public Accountant

### **THIRD PARTY INFORMATION**

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

## NOTICE TO INVESTORS

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

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

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

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

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

## APPLICABLE FINAL TERMS

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

[Date]

**ÍSLANDBANKI HF.**  
**Issue of [Aggregate Nominal Amount of Tranche] [Title of Bonds]**  
**under the ISK 25,000,000,000**

**Bond Programme**

### PART A – CONTRACTUAL TERMS

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

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

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

- |   |   |
|---|---|
| <b>1. Issuer:</b>                           | Íslandsbanki hf.  |
| <b>2.</b>                                   |   |
| i. Series Number:                           | [ ]   |
| ii. Tranche Number:                         | [ ]   |
|   | <i>(If fungible with an existing Series, details of that Series, including the date on which the Bonds become fungible)</i> |
| <b>3. Specified Currency or Currencies:</b> | [ ]   |
| <b>4. Aggregate Nominal Amount:</b>         |   |
| I. Series:                                  | [ ]   |
| II. Tranche:                                | [ ]   |
| <b>5. Issue Price:</b>                      | [ ] per cent. of the Aggregate Nominal Amount<br>[plus accrued interest from [insert date] (if applicable)]                 |



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

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

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

**15. Method of distribution:**

[Syndicated/Non-syndicated]

**PROVISIONS RELATING TO INFLATION LINKED ANNUITY BONDS**

**16. Inflation Linked Annuity Bonds:**

[Applicable/Not Applicable]

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

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

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

Where

A = Principal repayment factor

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

c = The rate of interest of the relevant bond

f = The number of interest payments per year

n = Number of Interest Payment Dates

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

vi. Interest Payment(s):

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

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

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.)

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

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

where:

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

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

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

where:

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

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

$d$  = the relevant calendar date

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

Provided that if the Reference Index in i) or ii) is lower than the Base Index, the Reference Index shall equal the Base Index.

And

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

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

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

the new index; and

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

**PROVISIONS RELATING TO INFLATION LINKED EQUAL**

**PRINCIPAL PAYMENT BONDS**

**17. Inflation Linked Equal Principal Payment**

**Bonds:**

[Applicable/Not Applicable]

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

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

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

where:

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

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

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

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

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

xii. Index Ratio:

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

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

where:

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

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

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

where:

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

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

**d** = the relevant calendar date

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

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

equal the Base Index.

And

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

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

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

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

**18. Fixed Rate Bond Provisions:**

[Applicable/Not Applicable]

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

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

**19. Floating Rate Bond Provisions:**

[Applicable/Not Applicable]

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



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

- Reset Date:
- viii. Margin(s) to Maturity Date:  +/-  per cent. per annum
- ix. Minimum Rate of Interest:  per cent. per annum/Not Applicable
- x. Maximum Rate of Interest:  per cent. per annum/Not Applicable
- xi. Day Count Fraction:
  - Actual/Actual
  - Actual/365
  - Actual/365 (Fixed)
  - Actual/365 (Sterling)
  - Actual/360
  - 30/360
  - 30E/360
  - Other]

*(See Condition 5.6 for alternatives)*
- xii. Fallback provisions, rounding provisions and any other terms relating to the method of calculating interest on Floating Rate Bonds, if different from those set out in the Terms and Conditions:

**20. Zero Coupon Bond Provisions:**

[Applicable/Not Applicable]

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

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

**PROVISIONS RELATING TO REDEMPTION**

**21. Issuer Call:**

[Applicable/Not Applicable]

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

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

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

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

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

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

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

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

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

## GENERAL PROVISIONS APPLICABLE TO THE BONDS

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

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

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

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

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

[Registered Bond]

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

[Not Applicable/*give details*]

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

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

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

---

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

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

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

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

i. Instalment Amount(s): [Not Applicable/give details]

ii. Instalment Date(s): [Not Applicable/give details]

**29. Redenomination applicable:**

Redenomination [not] applicable

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

**30. Other final terms:**

[Not Applicable/give details]

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

## DISTRIBUTION

**31.**

i. If syndicated, names of Managers : [Not Applicable/give names ]

ii. Stabilising Manager (if any): [Not applicable/give name]

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

**33. Additional selling restrictions:** [Not Applicable/give details]

**[LISTING AND ADMISSION TO TRADING APPLICATION**

These Final Terms comprise the final terms required to list and have admitted to trading, the issue of Bonds described herein pursuant to the ISK 25,000,000,000 Bond Programme of Íslandsbanki hf.]

**RESPONSIBILITY**

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

Signed on behalf of the Issuer:

By: .....

*Duly authorised*

## PART B – OTHER INFORMATION

### 1. LISTING

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

### 2. RATING

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

[S & P: [•]]

[Moody's: [•]]

[Fitch: [•]]

[Other: [•]]

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

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

### 3. NOTIFICATION

The [*name of competent authority in home Member State*] [has been requested to provide/has provided – *include first alternative for an issue which is contemporaneous with the establishment or update of the Programme and the second alternative for subsequent issues*] the [*names of competent authorities of host Member States*] with a certificate of approval attesting that the Base Prospectus has been drawn up in accordance with the Prospectus Directive.

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

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

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

- I. Use of proceeds: [For general funding purposes of the Issuer]
- II. Estimated net proceeds: [ ]
- III. Estimated total expenses: [ ]

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

Indication of yield: [ ]



[Calculated as on the Issue Date.

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

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

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

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

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

Based on data from Statistics Iceland, the year to year inflation, measured as changes in the CPI, has been positive for the last 30 years ranging from 1.3 per cent in 1998 to 67.7 per cent in 1982. The average value over the period is 20 per cent with standard deviation of 21.4 per cent. The same statistics for the last 10 years is an average inflation rate of 3.6 per cent and standard deviation of 2.5 per cent.

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

	2005	2006	2007	2008	2009	2010	2011	2012
January	239.2	249.7	266.9	282.3	334.8	356.8	363.4	387.1
February	239.7	249.5	268.0	286.2	336.5	360.9	367.7	391.0
March	241.5	252.3	267.1	290.4	334.5	362.9	371.2	395.1
April	242.0	255.2	268.7	300.3	336.0	363.8	374.1	398.2
May	240.7	258.9	271.0	304.4	339.8	365.3	377.6	398.1
June	242.4	261.9	272.4	307.1	344.5	364.1	379.5	400.1
July	242.7	263.1	273.0	310.0	345.1	361.7	379.9	397.2
August	243.2	264.0	273.1	312.8	346.9	362.6	380.9	396.6
September	246.9	265.6	276.7	315.5	349.6	362.6	383.3	399.6
October	248.4	266.2	278.1	322.3	353.6	365.3	384.6	400.7
November	248.0	266.1	279.9	327.9	356.2	365.5	384.6	402.0
December	248.9	266.2	281.8	332.9	357.9	366.7	386.0	402.2

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:

	2005	2006	2007	2008	2009	2010	2011	2012
January	4.0%	4.4%	6.9%	5.8%	18.6%	6.6%	1.8%	6.5%
February	4.5%	4.1%	7.4%	6.8%	17.6%	7.3%	1.9%	6.3%
March	4.7%	4.5%	5.9%	8.7%	15.2%	8.5%	2.3%	6.4%
April	4.3%	5.5%	5.3%	11.8%	11.9%	8.3%	2.8%	6.4%
May	2.9%	7.6%	4.7%	12.3%	11.6%	7.5%	3.4%	5.4%
June	2.8%	8.0%	4.0%	12.7%	12.2%	5.7%	4.2%	5.4%
July	3.5%	8.4%	3.8%	13.6%	11.3%	4.8%	5.0%	4.6%
August	3.7%	8.6%	3.4%	14.5%	10.9%	4.5%	5.0%	4.1%
September	4.8%	7.6%	4.2%	14.0%	10.8%	3.7%	5.7%	4.3%
October	4.6%	7.2%	4.5%	15.9%	9.7%	3.3%	5.3%	4.2%
November	4.2%	7.3%	5.2%	17.1%	8.6%	2.6%	5.2%	4.5%
December	4.1%	7.0%	5.9%	18.1%	7.5%	2.5%	5.3%	4.0%

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

The main target of monetary policy is price stability. A formal inflation target was adopted on March 27, 2001<sup>2</sup>. The Central Bank of Iceland aims to maintain an average rate of inflation, measured as the annual 12-month increase in the CPI, of as close to 2,5% as possible.

If inflation deviates by more than  $\pm 1,5$  percentage point from the target, the Central Bank of Iceland is obliged to submit a report to the Government of Iceland explaining the reasons for the deviations from the target, how the Central Bank of Iceland intends to react and how long it will take to reach the inflation target again in the bank's assessment. The report shall be made public.

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

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

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

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

---

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

## 9. OPERATIONAL INFORMATION

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

## TERMS AND CONDITIONS OF THE BONDS

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

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

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

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

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

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

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

### 1 DEFINITIONS

Interpretation: In these Conditions:

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

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

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

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

Icelandic Act No. 2/1995, on Limited Liability Companies (*Icelandic: lög um hlutafélög nr. 2/1995*)

<b>Distribution Compliance Period</b>	The period that ends 40 days after completion of the distribution of each Tranche of Bonds, as certified by the relevant Dealer
<b>Early Redemption Amount</b>	The amount calculated in accordance with Condition 7.6
<b>Equal Payment Amount</b>	The meaning given in Condition 6.1(b)
<b>Established Rate</b>	Means the rate for the conversion of the Specified Currency (including compliance with rules relating to roundings in accordance with applicable European Community regulations) into other Specified Currency
<b>EU</b>	The European Union
<b>EURIBOR</b>	Euro-zone inter-bank offered rate
<b>Euroclear</b>	Euroclear Bank S.A./N.V., 1, Boulevard du Roi Albert II B - 1210 Brussels, or its successor
<b>Final Redemption Amount</b>	The meaning given in the applicable Final Terms
<b>Final Terms</b>	Each Tranche will be the subject to the Final Terms which, for the purposes of that Tranche only, completes the Terms and Conditions of the Bonds and this Base Prospectus and must be read in conjunction with this Base Prospectus. The terms and conditions applicable to any particular Tranche of Bonds are the Terms and Conditions of the Bonds as completed, amended and/or replaced by the relevant Final Terms.
<b>Fiscal Agent</b>	Íslandsbanki hf., or any successor agent appointed as such
<b>Fixed Rate Bonds</b>	Bonds that pay a fixed rate of interest on such date or dates as may be agreed between the Issuer and the relevant Dealer and on redemption calculated on the basis of such Day Count Fraction as may be agreed between the Issuer and the relevant Dealer
<b>Floating Rate</b>	The meaning given in the ISDA Definitions
<b>Floating Rate Convention</b>	The meaning given in Condition 5.6(b)(i)
<b>Floating Rate Bonds</b>	Bonds which bear interest at a rate determined: <ul style="list-style-type: none"><li>(I) on the same basis as the floating rate under a notional interest rate swap transaction in the relevant Specified Currency governed by an agreement incorporating the ISDA Definitions; or</li><li>(II) on the basis of a reference rate appearing on the agreed screen page of a commercial quotation service; or</li><li>(III) on such other basis as may be agreed between the Issuer and the relevant Dealer, or</li></ul> as set out in the applicable Final Terms

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



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

<b>Maximum Redemption Amount</b>	The amount specified as such in the applicable Final Terms
<b>Member State</b>	A state which is a member of the European Economic Area
<b>Minimum Rate of Interest</b>	In respect of Floating Rate Bonds, the percentage rate per annum (if any) specified in the applicable Final Terms
<b>Minimum Redemption Amount</b>	The amount specified as such in the applicable Final Terms
<b>Modified Following Business Day Convention</b>	The meaning given in Condition 5.6(b)(iii)
<b>MiFID</b>	Market in Financial Instruments Directive 2004/39/EC ( <i>Icelandic: Tilskipun Evrópuþingsins og Ráðsins 2004/39/EB</i> )
<b>NASDAQ OMX Iceland</b>	The regulated market of the NASDAQ OMX Iceland hf. with its registered office at Laugavegur 182, 105 Reykjavík.
<b>Optional Redemption Amount</b>	The meaning (if any) given in the applicable Final Terms
<b>Optional Redemption Date</b>	The meaning (if any) given in the applicable Final Terms
<b>Paying Agents</b>	The Principal Paying Agent and any other paying agent appointed (if any)
<b>Payment Day</b>	The meaning given in Condition 6.4
<b>Preceding Business Day Convention</b>	The meaning given in Condition 5.6(b)(iv)
<b>Principal Amount Outstanding</b>	In accordance with condition 5.6(f) means in respect of a Bond, except an Inflation Linked Annuity Bond and an Inflation Linked Equal Principal Payment Bond on any day, the principal amount of that Bond on the relevant Issue Date thereof less principal amounts received by the relevant Bondholder in respect thereof on or prior to that day and in respect of an Inflation Linked Annuity Bond and an Inflation Linked Equal Payment Bond, the meaning given in the applicable Final Terms
<b>Principal Paying Agent</b>	The Issuer, Íslandsbanki hf.
<b>Programme</b>	ISK 25,000,000,000 bond programme established by the Issuer on the Issue Date
<b>Prospectus Directive</b>	Directive 2003/71/EC ( <i>Icelandic: Tilskipun Evrópuþingsins og Ráðsins 2003/71/EB</i> )
<b>Rate of Interest</b>	In respect of a Series of interest-bearing Bonds, the rate of interest payable from time to time in respect of such Bonds determined in accordance with the Terms and Conditions and the applicable Final Terms
<b>Redeemed Bonds</b>	The meaning given in Condition 7.3
<b>Reference Price</b>	In respect of a Zero Coupon Bond, the meaning given in the

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

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

## 2 FORM, DENOMINATION AND TITLE

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

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

Interest bearing definitive Bearer Bonds have interest coupons (“**Coupons**”) and, if indicated in the applicable Final Terms, talons for further Coupons (“**Talons**”) attached on issue. Any reference herein to Coupons or

coupons shall, unless context otherwise requires, be deemed to include a reference to Talons or talons. Definitive Bearer Bonds repayable in instalments have receipts (“**Receipts**”) for the payment of the instalments of principal (other than the final instalment) attached on issue.

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

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

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

exchange shall occur not later than 30 days after the date of receipt of the first relevant notice by the Fiscal Agent.

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

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

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

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

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

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

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

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

For so long as any of the Bonds are represented by a Bearer Global Bond held on behalf of Euroclear and/or Clearstream, Luxembourg, or so long as DTC or its nominee is the registered holder of a Registered Global Bond or so long as the Bond is a VS Systems Bond, each person who is for the time being shown in the records of Euroclear and/or Clearstream, Luxembourg, DTC, or the ISD, as the case may be, as the holder of a particular nominal amount of such Bonds (in which regard any certificate or other document issued by Euroclear, Clearstream, Luxembourg, DTC or its nominee, or the ISD as to the nominal amount of such Bonds standing to the account of any person shall be conclusive and binding for all purposes save in the case of manifest error) shall be treated by the Issuer, the Fiscal Agent and any other Paying Agent as the holder of such nominal amount of such Bonds for all purposes other than (in the case only of Bonds not being VS System Bonds) with respect to the payment of principal or interest on the Bonds, for which purpose, in the case of Bonds represented by a Bearer Global Bond, the bearer of the relevant Global Bearer Bond, or in the case of Bonds where DTC or its nominee is the registered holder of a Registered Global Bond, DTC or its nominee shall be

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

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

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

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

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

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

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

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

### **4 REDENOMINATION**

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

The election will have effect as follows:

- 4.1 the Bonds shall be deemed to be redenominated into euro or other Specified Currency in the denomination of euro 0.01 or as applicable to other Specified Currency with a principal amount for each Bond equal to the principal amount of that Bond in the Specified Currency, converted into euro or other Specified Currency at the Established Rate, provided that, if the Issuer determines, that the then market practice in respect of the redenomination into euro or other Specified Currency of internationally offered securities is different from the provisions specified above, such provisions shall

be deemed to be amended so as to comply with such market practice and the Issuer shall promptly notify the Bondholders, the stock exchange (if any) on which the Bonds may be listed of such deemed amendments;

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

## **5 INTEREST**

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



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

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

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

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

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

#### *5.3 Interest on Fixed Rate Bonds*

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

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

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

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

#### *5.4 Interest on Floating Rate Bonds*

##### a) Interest Payment Dates

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

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

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

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

b) Rate of Interest

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

*ISDA Determination for Floating Rate Bonds*

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

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

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

*Screen Rate Determination for Floating Rate Bonds*

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

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

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

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

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

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

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

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

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

e) Certificates to be final

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

### *5.5 Accrual of interest*

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

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

- c) In the case of Bonds which are Zero Coupon Bonds, for the purposes of this Condition 5.5 the principal amount outstanding shall be the total amount otherwise payable by the Issuer on the Maturity Date less any payments made by the Issuer in respect of such amount in accordance with these Conditions.

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

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

- a) In these Terms and Conditions, **Business Day** means:

- (i) a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in London, Reykjavík and any Additional Business Centre specified in the applicable Final Terms; and
- (ii) either (A) in relation to any sum payable in a Specified Currency other than euro, a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in the principal financial centre of the country of the relevant Specified Currency as specified in Applicable Final Terms (if other than London, Reykjavík and any Additional Business Centre and which if the Specified Currency is Australian dollars or New Zealand dollars shall be Sydney and Auckland, respectively) or (B) in relation to any sum payable in euro, a day on which the Trans-European Automated Real-Time Gross Settlement Express Transfer (TARGET) System (the **TARGET System**) is open.

- b) If a **Business Day Convention** is specified in the applicable Final Terms and (x) if there is no numerically corresponding day in the calendar month in which an Interest Payment Date should occur or (y) if any Interest Payment Date would otherwise fall on a day which is not a Business Day, then, if the Business Day Convention specified is:

- (i) in any case where Specified Periods are specified in accordance with Condition 5.4 (a), **the Floating Rate Convention**, such Interest Payment Date (1) in the case of (x) above, shall be the last day that is a Business Day in the relevant month and the provisions of (2) below shall apply mutatis mutandis, or (2) in the case of (y) above, shall be postponed to the next day which is a Business Day unless it would thereby fall into the next calendar month, in which event (I) such Interest Payment Date shall be brought forward to the immediately preceding Business Day, and (II) each subsequent Interest Payment Date shall be the last Business Day in the month which falls the Specified Period after the preceding applicable Interest Payment Date occurred; or
- (ii) the **Following Business Day Convention**, such Interest Payment Date shall be postponed to the next day which is a Business Day; or
- (iii) the **Modified Following Business Day Convention**, such Interest Payment Date shall be postponed to the next day which is a Business Day unless it would thereby fall into the next calendar month, in which event such Interest Payment Date shall be brought forward to the immediately preceding Business Day; or
- (iv) the **Preceding Business Day Convention**, such Interest Payment Date shall be brought forward to the immediately preceding Business Day.

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

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

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

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

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

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

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

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

if **30E/360** or **Eurobond Basis** is specified in the applicable Final Terms, the number of days in the Interest Period divided by 360 (the number of days to be calculated on the basis of a year of 360 days with 12 30-day months, without regard to the date of the first day or last day of the Interest Period unless, in the case of the final Interest Period, the Maturity Date is the last day of the month of February, in which case the month of February shall not be considered to be lengthened to a 30-day month); or

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

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

## 6 PAYMENTS

### 6.1 Payments in respect of Inflation Linked Bonds

- a) Payments in respect of Inflation Linked Annuity Bonds

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

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

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

### 6.2 Method of payment

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

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

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

### 6.3 Presentation of Bonds and Coupons

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

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

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

### 6.4 Payment Day

If the date for payment of any amount in respect of any Bond, Receipt or Coupon is not a Payment Day, the holder thereof shall not be entitled to payment of the relevant amount due until the next following Payment Day and shall not be entitled to any interest or other sum in respect of any such delay. For these purposes, Payment Day means any day which (subject to Condition 9) is:

- a) a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in:
  - the relevant place of presentation;

Reykjavík; and

any Additional Financial Centre specified in the applicable Final Terms.

- (i) either (i) in relation to any sum payable in a Specified Currency other than euro, a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in the principal financial centre of the country of the relevant Specified Currency (if other than the place of presentation, Reykjavík and any Additional Financial Centre) or (ii) in relation to any sum payable in euro, a day on which the TARGET System is open.

- (ii) Interpretation of principal

Any reference in these Terms and Conditions to principal in respect of the Bonds shall be deemed to include, as applicable:

the Final Redemption Amount of the Bonds;

the Early Redemption Amount of the Bonds;

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

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

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

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

## **7 REDEMPTION AND PURCHASE**

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

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

### *7.2 Final Redemption*

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

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

If an Issuer Call is specified in the applicable Final Terms, the Issuer may, having given not less than 15 nor more than 30 days' notice to the Bondholders in accordance with Condition 11 (which notices shall be irrevocable and shall specify the date fixed for redemption), redeem all or some only of the Bonds then outstanding on any Optional Redemption Date and at the Optional Redemption Amount(s) specified in, or determined in the manner specified in, the applicable Final Terms together, if appropriate, with interest accrued to (but excluding) the relevant Optional Redemption Date. Any such redemption must be of a nominal amount not less than the Minimum Redemption Amount and not more than the Maximum Redemption Amount, in each case as may be specified in the applicable Final Terms. In the case of a partial redemption of Bonds, the Bonds



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

*7.4 Redemption due to illegality or invalidity*

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

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

*7.5 Certification*

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

*7.6 Early Redemption Amounts*

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

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

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

where:

**RP** means the Reference Price;

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

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

### *7.7 Instalments*

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

### *7.8 Purchases*

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

### *7.9 Cancellation*

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

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

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

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

### *7.11 Redemption for Tax Reasons*

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

- a) on the occasion of the next payment due under the Bonds, the Issuer has or will become obliged to pay additional amounts as provided or referred to in Condition 8 (Taxation) as a result of any change in, or amendment to, the laws or regulations in Iceland or any political subdivision or any authority thereof or any authority or agency therein having power to tax, or any change in the

- application or official interpretation of such laws or regulation, which change or amendment becomes effective on or after the Issue Date of the first Tranche of the Bonds; and
- b) such obligation cannot be avoided by the Issuer taking reasonable measures available to it.

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

## 8 TAXATION

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

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

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

## 9 PRESCRIPTION

The Bonds, Receipts and Coupons will become void in accordance with Act on the Expiration of Debt and other Obligations No. 150/2007 (*Icelandic: Lög um fyrningu kröfuréttinda nr. 150/2007*) unless presented for payment within 10 years (in the case of principal) and four years (in the case of interest or any other amount) after the Relevant Date (as defined below).

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

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

## 10 EVENTS OF DEFAULT

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

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

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

For the purposes of these Conditions:

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

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

## **11 NOTICES**

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

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

## **12 FURTHER ISSUES**

The Issuer shall be at liberty from time to time without the consent of the Bondholders, the Receiptholders or the Couponholders to create and issue further Bonds having terms and conditions the same as the Bonds or the same in all respects save for the amount and date of the first payment of interest thereon and so that the same shall be consolidated and form a single Series with the outstanding Bonds.

## **13 GOVERNING LAW AND JURISDICTION**

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

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

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

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

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

## INFORMATION ABOUT THE ISSUER

### NAME, INCORPORATION AND REGISTRATION

The Issuer's legal and commercial name is Íslandsbanki hf. The Issuer is a public limited company incorporated in Iceland on 14 October 2008. It is registered with the Register of Enterprises (*Fyrirtækjaskrá Ríkisskattstjóra*) in Iceland and bears the registration number 491008-0160. The registered office of the Issuer is at Kirkjusandur 2, 155 Reykjavik, Iceland, and the telephone number is +354 440 4000. The Issuer's homepage is: [www.islandsbanki.is](http://www.islandsbanki.is).

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 FME.

### HISTORY & DEVELOPMENT OF THE ISSUER

The Issuer traces its roots back to 1904 when the original Íslandsbanki hf. was founded as the first privately-owned bank in Iceland. Útvegsbanki Íslands took over Íslandsbanki's operations in 1930 and in the year 1990 Útvegsbanki Íslands, Alþýðubanki Íslands, Iðnaðarbanki Íslands and Verslunarbanki Íslands merged into Íslandsbanki. Indeed, the Issuer's heritage as a private company has impacted its progress right up until the present, having absorbed a number of institutions in the past 20 years and in so doing leading the market in Iceland in terms of financial sector consolidation. Of particular significance was the merger with FBA - The Icelandic Investment Bank - in the year 2000, itself a merger of three state-owned credit funds, forming Íslandsbanki-FBA hf. As a result, the bank further solidified its connections with the corporate sector, particularly in the seafood industry. In the years 2000-2007, the bank expanded its business away from Iceland by firstly lending to seafood enterprises in northern Europe and North America, then 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 the Issuer was established on the base of what was Glitnir. The Issuer was initially named New Glitnir banki hf. By decree of the newly passed Act on the Authority for Treasury Disbursements due to Unusual Financial Market Circumstances etc. No. 125/2008 the Issuer assumed the domestic assets and liabilities of Glitnir while the remainder of Glitnir's assets, mostly foreign, were left within Glitnir under the supervision of a Resolution Committee (the "Resolution Committee") appointed to maximise the recovery value of those assets for the benefit of its creditors. The Issuer then reverted back to its previous brand name of Íslandsbanki hf., on 20 February 2009.

On 13 September 2009, Glitnir, on behalf of its creditors, and the Icelandic Government reached an agreement on the settlement of assets and liabilities between the Issuer and Glitnir. Under the agreement the Resolution Committee acquired a 95% stake in the Issuer. Glitnir therefore assumed majority control of the Issuer and a new Board of Directors was appointed on 25 January 2010. The stake is now owned by ISB Holding ehf., a holding company wholly owned by GLB Holding ehf. which is a subsidiary of Glitnir.

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 merger became official on 29 November 2011 and was fully completed in the first quarter of 2012. As a result of the merger the balance sheet of the Issuer increased by approximately 20% and the total capital ratio of the Issuer remains well above the minimum requirements laid down by the Act on Financial Institutions.

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

### BUSINESS OVERVIEW

The Issuer is an Icelandic bank headquartered in Iceland. It considers Iceland as its primary market.

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, that offers comprehensive services to the retail and corporate sectors and is one of the

country's three main banks. The Issuer maintains a strong market share<sup>3</sup> across the spectrum of banking services in the country. It seeks to provide the highest quality services to households and corporations, with a focus on building value whilst retaining a strong sense of social responsibility.

The Issuer operates 22 branches, the majority of which are based around the Reykjavík metropolitan area but maintains a presence in larger municipalities across the country.

When assuming the domestic operations of Glitnir it was further decided that the Issuer would 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 services to these industries, both in terms of lending and advising. In May 2010, it was announced that the Issuer would set up a subsidiary based in New York which will focus on advisory to the seafood industry in the United States. The subsidiary has a brokerage license by the Securities and Exchange Commission in New York.

**The Issuer's business lines**



Figure 1: Issuer's business lines

**CORPORATE BANKING**

The primary activities of Corporate Banking ("CB") include credit services and other related services to medium- to large-sized companies and professional investors. This entails providing services and additional offerings to current customers, as well as business development with potential new customers.

Business managers within the business management division are responsible for the customer relationship- and credit management supported by credit experts who support the business managers in servicing the customers as well as monitor and manage the credit exposure.

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.

CB furthermore co-ordinates the Issuer's larger corporate restructuring projects in a special unit called Corporate Solutions ("CS"). CS is independent from general corporate banking activities and are as such only involved in the financial restructuring aspect of the division's operations.

**WEALTH MANAGEMENT**

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

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

**RETAIL BANKING**

Retail Banking's operations serve private customers and small and medium-sized enterprises. Retail Banking operates through 22 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

<sup>3</sup> According to Capacent Gallup market surveys Íslandsbanki has an approximately 28% market share among individuals (December 2012), a market share of 34,3% among small-medium enterprises (December 2012) and a 45.5% market share among the country's 300 largest companies (December 2012)



Issuer is one of the three leading retail banks in Iceland with an approximate 30% market share on the retail market according to a Capacent Gallup market survey conducted in December 2011.

Retail Banking is the largest generator of profit and revenue stream for the Issuer. The Issuer is the only Icelandic bank with an asset-based financing unit, ERGO, situated within the branch network. This unit provides customers with financing for the purchase or leasing of cars, equipment and heavy machinery.

## **MARKETS**

The markets division is comprised of five units, securities sales, foreign exchange (“FX”) sales, interbank markets, corporate finance and research. In the current economic climate product offering is heavily dependent on market access and capital flow restrictions. The sluggish recovery in capital markets, with few companies being listed and capital controls putting heavy limits on the ability to trade in foreign currencies means that the Issuer’s income from this business division is still modest. The completion of restructuring should give rise for a corporate bond market to emerge whereas the only really active market at the present time is the government bond market.

Securities sales and FX sales deal with professional clients and institutions, providing them access to financial markets. The securities sales team offers spot deals in equities and fixed income as well as forward deals and options on fixed income. FX sales carries out spot deals, forward and swap deals on various currencies as well as FX options.

Interbank markets are responsible for trading and market making in foreign exchange, bonds, money market and equities. In addition, the team handles the cash- and interest rate risk management, is responsible for the Issuer’s short term liquidity position, reserve requirements and operations in the domestic payment systems.

The corporate finance unit offers a full range of services, including sales, acquisitions, mergers, rights issues, listings and de-listings, as well as restructuring advice. The Corporate Finance unit mainly targets medium- to large-size Icelandic enterprises.

The research team carries out in-depth market analysis and issues regular forecasts on the main economic indicators in Iceland. Research publishes a daily newsletter both in English and Icelandic.

Present capital controls have a material effect on the operation within markets, whereas currency trades are limited to transactions that can be verifiably linked to external trade in goods and services.

## **SUPPORT DIVISIONS**

### **FINANCE**

Finance includes the finance, and accounting divisions as well as treasury and financial institutions and investor relations. Further, the division manages and oversees shareholding in the Issuer’s subsidiaries.

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

Risk management & credit control is a core unit within the Issuer. The role of risk management is to oversee, monitor and manage risk in the Issuer’s operations. Risk management reports on risk to internal and external stakeholders and ensures that all limits on risk are adhered to and in line with the Issuer’s risk appetite as defined by the Board of Directors. Credit control is accountable for the execution of the credit process in accordance with credit rules and credit policies.

### **OPERATIONS & INFORMATION TECHNOLOGY**

The operations and information technology division (“IT”) are responsible for a number of important support functions such as the Issuer’s IT platform, systems and software development. Further IT’s responsibilities include branch services, back office, quality management and operational services.

### **LEGAL**

The legal division is divided into two departments: legal department and legal collection. The legal department provides general legal advice and participation and assistance in negotiating contracts with customers and management of legal disputes on the Issuer’s behalf. The legal collection department has the role of enforcing

obligations of customers in default with their payment obligations and to manage and monetize foreclosed real estate.

**HUMAN RESOURCES**

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

**MARKETING**

The marketing division is responsible for the Issuer’s marketing policy, advertising, product development in co-operation with the business segments and event management.

**CORPORATE COMMUNICATIONS**

The corporate communications team is responsible for internal and external relations as well as media relations. Further the division is responsible for the Issuer’s social media strategy and social corporate responsibility policy.

**COMPLIANCE**

The Issuer’s compliance division has an independent position within the Issuer’s organisational chart. 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. Compliance, in co-operation with internal audit, performs a special fit and properness test by virtue of gathering information via questionnaires and assessments to management and key employees.

**INTERNAL AUDIT**

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

**ORGANISATIONAL STRUCTURE**

ISB Holding ehf., ID-No. 660309-1010 owns 95% of the Issuer’s share capital. The remaining 5% is owned by the Government of Iceland. ISB Holding ehf. is fully owned by GLB Holding ehf., ID no. 481100-2240 which is fully owned by Glitnir.

The following chart illustrates the Issuer’s organisational structure. The current organisational chart has been in place since 1 July 2010.

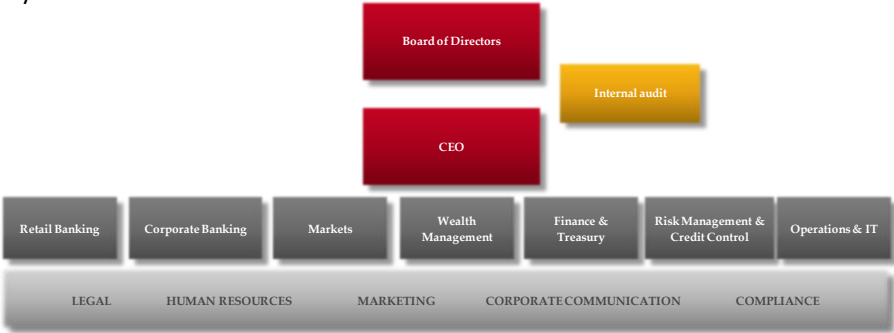


Figure 2: Organisational Structure

The Issuer's interest in its subsidiaries can be seen in the table below, along with a specification of the nature of business of all the subsidiaries (as of 30 September 2012):

<b>Subsidiary</b>	<b>Ownership</b>	<b>Company description</b>
Borgun hf.	61,29%	Credit card company
Island Fund S.A. (formerly Glitnir Asset Management)	99,9%	Asset management company, Luxembourg
Glacier Geothermal and Seafood Corp.	100%	Holding company
Glacier Secutities LLC	100%	Broker dealer advisory firm
Manston Properties Limited (Formerly Air Atlanta Properties Ltd.)	100%	Real estate holding company
Íslandssjódir hf.	100%	Fund management company
Ergo ehf. (Formerly Lómur ehf.)	100%	Dormant
Rivulus ehf	100%	Real estate holding company
Kreditkort ehf. (Formerly Audengi hf.)	100%	Financial transactions for Midengi
Eik Properties ehf.	100%	Holding company
Glitnir Real Estate Fund hf.	64,64%	Real estate holding company
Hofdatorg	72,5%	Real estate holding company
Geysir Green Investment Fund slhf.	100,0%	Investment company
Geysir General Partner ehf	100,0%	Holding company
SPV fjárfesting hf	100,0%	Investment company
Lava Capital Ltd. UK	100%	Investment company
Sparibréf ehf	100%	Real estate holding company
Costa Properties ehf	100%	Real estate holding company
Lava Capital ehf	100%	Investment company
Hringur Eignarhaldsfélag ehf.	100%	Holding company
Allianz Íslandi hf.	100%	Sales agent for insurance
StjórnarZ ehf	100%	Holding company
D-1 ehf	100%	Real estate company
SPK fjárfesting ehf	100%	Investment company
Sparvernd ehf	100%	Real estate holding company
Rekstrarfélag Byrs hf.	100%	Fund management company
Njardarnes ehf	100%	Real estate holding company
SPN Fjárfesting ehf	100%	Investment company
Landkostaland ehf	100%	Real estate holding company
Midengi ehf.	100%	Holding company
Fastengi ehf.	100%	Real estate holding company
Bréfabaer ehf	100%	Real estate holding company

Fjárvari ehf	100%	Real estate holding company
Básbryggja ehf.	100%	Real estate holding company
Laugarakur ehf.	100%	Real estate holding company
Smyrllaheidi ehf.	100%	Real estate holding company
Strandhogg i Nordri ehf.	100%	Real estate holding company
SPW ehf.	71,1%	Holding company
Bláfugl ehf.	71,1%	Cargo airline
IG Invest ehf.	71,1%	Aircraft trading company
Hafnargata 7 ehf.	100%	Real estate holding company
Saevarhofdi 2 ehf.	100%	Real estate holding company

In addition, the Issuer acquired five dormant companies as part of the merger with Byr.

Islandssjodir hf., Borgun hf., Midengi ehf., Glacier Geothermal and Seafood Corp, Kreditkort ehf. Rekstrarfélag Byrs hf., D-1 ehf., Hringur eignarhaldsfélag ehf., Ergo ehf., Rivulus ehf. and Island Fund S.A. are part of the Issuer's core business but the Issuer is not considered to be dependent upon them.

#### **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 overall operations of the Issuer since the last published Financial Statements.

#### **Legal and arbitration proceedings**

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

## ADMINISTRATIVE, MANAGEMENT AND SUPERVISORY BODIES

### BOARD OF DIRECTORS

The Issuer's Board of Directors consists of seven members. Six of which are elected by ISB Holding ehf. as holder of a 95% stake in the Issuer. The last member is appointed by the Icelandic State Financial Investments as holder of the remaining 5% of shares. Seven alternate members are also appointed, six as elected by ISB Holding ehf., one as appointed by the Icelandic State Financial Investments. 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
Mr. John E. Mack	Vice Chairman
Mr. Árni Tómasson	Member of the Board
Mr. Neil Graeme Brown	Member of the Board
Dr. Daniel Levin	Member of the Board
Ms. Marianne Økland	Member of the Board
Ms. María E. Ingvadóttir	Member of the Board

#### Mr. Fridrik Sophusson (Chairman)

Fridrik Sophusson has nearly forty years' wide-ranging experience in fiscal policy making, management and public service in Iceland. He was Managing Director of the Icelandic Management Association from 1972 – 1978 when he was elected to Parliament where he served as an Member of Parliament for a period of twenty years from 1978 to 1998. During his stretch as an MP he moreover held the position of Minister of Industry and Energy 1987 – 1988 and Minister of Finance from 1991 – 1998. Mr. Sophusson was appointed the CEO of Landsvirkjun, the national power company, in 1999 and held that position for almost 11 years, resigning in 2009. Among companies he has served as board member is Landsbanki Íslands hf. from 1990 – 1992, Pharmaco hf. (later Actavis hf.), Enex ehf. - a renewable energy solution company, Samorka - the Icelandic Energy and Utilities Association, Nordel-Nordic Transmission System Operators, Eurelectric - Union of the European Electricity Industry, and the Icelandic Chamber of Commerce. Mr. Sophusson is an independent director on the Issuer's Board of Directors, elected by ISB Holding ehf. Mr. Sophusson is an Alternate member of Board of Fondement ehf.

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

Options relating to shares in the Issuer: None.

Own holding of shares in the Issuer: None

Holdings of financially related parties in the Issuer: None.

#### Mr. John E. Mack (Vice Chairman):

John E. Mack, a US national, has many years' experience in international banking and M&A (mergers and acquisitions).

Mr. Mack was Corporate Executive Officer and CFO of Shinsai Bank in Tokyo from 2001 – 2005 and oversaw the listing of the bank on the Tokyo stock exchange. Prior to that, he spent 35 years working for Bank of America and its affiliates, most recently as a funding executive for the Parent Company. Mr. Mack has specific experience in corporate work-outs and problem loans, i.e. restructuring of loan portfolios through his role as director of Strategic Solutions, Inc., a majority-owned subsidiary of Bank of America. Mr. Mack is formally retired from daily work but has made himself available to serve as Board Member of the Issuer. Mr. Mack is an independent director on the Issuer's Board of Directors, elected by ISB Holding ehf.

Mr. Mack is a board member of Medley Capital Corporation from 2011, Incapital Holdings from 1999, Flowers National Bank from 2008 and Wilson TruboPower from 2007.

Mr. Mack holds an MBA from the University of Virginia, Darden School of Business and an undergraduate degree in Economics from Davidson College.

Options relating to shares in the Issuer: None.

Own holding of shares in the Issuer: None

Holdings of financially related parties in the Issuer: None.

**Ms. María E. Ingvadóttir (Alternate Member of the Board of Directors)**

María E. Ingvadóttir has over 20 years experience in management, finance and consulting. Since 2002 Ms. Ingvadóttir has been an independent consultant in the field of financial accounting and management. Prior to that, she held various positions in finance and trade among others as the CFO of Reykjavík – European Capital of Culture from 1998-2001 and as the CFO and later Trade Representative with the Icelandic Trade Council from 1987-1997. Ms. Ingvadóttir represents the Icelandic State Financial Investments on the Issuer's Board of Directors.

Ms. Ingvadóttir holds a Cand. Oecon. degree in Business Administration from the University of Iceland.

Options relating to shares in the Issuer: None.

Own holding of shares in the Issuer: None.

Holdings of financially related parties in the Issuer: None.

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

Árni Tómasson began his work in accounting in 1979 and has worked in bank and financial institution auditing since 1985. He was partner and later chairman of Deloitte hf. in Iceland until 2001. He has served as president of the Institute of State Authorised Public Accountants in Iceland (FLE) and held the same post for the Nordic Association of Accountants (NFR). Mr. Tómasson has a combined over 20 years of experience in teaching at Reykjavik University and the University of Iceland and has been chairman of the examination committee for the FLE for the past 6 years. Mr. Tómasson was CEO of the Agricultural Bank of Iceland (Búnadarbanki Íslands hf.) from 2001 – 2003 and has since worked as an independent consultant. Mr. Tómasson was appointed chairman of Glitnir's Resolution Committee in October 2008 and led the committee's work until October 2011 when he resigned from the committee. Mr. Tómasson is a director on the Issuer's Board of Directors, elected by ISB Holding ehf., representing Glitnir banki hf.

Mr. Tómasson is the owner of AT ráðgjöf and board member of Alfesca ehf., Kaffitár hf. and Gullberg ehf.

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

Options relating to shares in the Issuer: None.

Own holding of shares in the Issuer: None.

Holdings of financially related parties in the Issuer: 95%

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

Neil Graeme Brown, a British national, has spent the majority of his professional life dealing with finance and restructuring of international businesses. Among positions held by Mr. Brown are head of buyouts and financial services at Apax Partners and partner at Coopers & Lybrand (now PWC). Mr. Brown has 20 years of experience in international private equity and is an expert in US and European M&A (mergers and acquisitions) markets. Furthermore, he has overseen listings of companies on the London, AIM (Alternative Investment Market) and NASDAQ markets. Mr. Brown has served as a board member for a number of international companies. Mr. Brown is an independent director on the Issuer's Board of Directors, elected by ISB Holding ehf.

Mr. Brown is part owner of Subito Partners limited, Lanista Partners Limited, Trigold Crystal limited and Distribution Technology limited. He is also a Non Executive Director of Gate Group AG, Magma Leasing, Touch Group PLC, Iceland Foods Limited and Euro Car Parts Limited.

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

Options relating to shares in the Issuer: None.

Own holding of shares in the Issuer: None.

Holdings of financially related parties in the Issuer: None.

**Dr. Daniel Levin (Member of the Board of Directors)**

Daniel Levin, a US and Swiss national, is a member of the Board of the Liechtenstein Foundation for State Governance, a foundation launched by H.S.H. Reigning Prince Hans-Adam II of Liechtenstein to provide knowledge and tool transfer to countries worldwide in order to facilitate political, economic and social development. Dr. Levin has been advising governments and development agencies globally in the development of financial and capital markets, and has been working closely with supervisory agencies and regulators on the implementation of ethical and corporate governance standards for financial institutions. He has been actively involved in numerous financial legislation and parliamentary initiatives, with a particular focus on supervision of financial institutions, prosecutorial investigations, conflicts of interest prevention, privatisation transactions, and debt restructurings. Dr. Levin has represented corporate and sovereign issuers and borrowers as well as commercial and investment banks in the US capital markets, and regularly lectures at universities and conferences on his areas of expertise. Dr. Levin is an independent director on the Issuer’s Board of Directors, elected by ISB Holding ehf,

Dr. Levin owns a major share in CMD Group LLC and is a board member of the Liechtenstein Foundation for State Governance.

Daniel Levin holds lic.iur. (J.D.) and Dr.iur. (J.S.D./Ph.D.) degrees from the faculty of Law of the University of Zürich, Switzerland, and an LL.M. degree from Columbia University School of Law.

Options relating to shares in the Issuer: None.

Own holding of shares in the Issuer: None.

Holdings of financially related parties in the Issuer: None.

**Ms. Marianne Økland (Member of the Board of Directors):**

Marianne Økland, a Norwegian national, currently holds the position of Managing Director of Avista Partners, a London based consulting firm specialising in debt advisory and capital raising. Ms. Økland has spent most of her career in banking dealing with debt financing in various positions at JP Morgan and Union Bank of Switzerland (UBS). She worked for their DCM and debt origination divisions specialising in the Nordic Region. Ms. Økland is an independent director on the Issuer’s Board of Directors, elected by ISB Holding ehf.

From October 2011 Ms. Økland has been a Non Executive Director in Infrastructure Development Finance Company Limited.

Ms. Økland is also familiar with the consulting business from her work at Marsoft Limited, a Boston, Oslo and London based consulting firm specialising in shipping investments.

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

Options relating to shares in the Issuer: None.

Own holding of shares in the Issuer: None.

Holdings of financially related parties in the Issuer: None.

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

<b>Name</b>	<b>Title</b>
Ms. María Gudrún Sigurdardóttir	Alternate Member of the Board of Directors
Ms. Eva Sóley Guðbjörnsdóttir	Alternate Member of the Board of Directors
Mr. Baldur Pétursson	Alternate Member of the Board of Directors
Mr. Brynjar Stefánsson	Alternate Member of the Board of Directors
Mr. Jón Eiríksson	Alternate Member of the Board of Directors

Ms. Sigríður Hallgrímsdóttir

Alternate Member of the Board of  
Directors

Ms. Thórunn Jónsdóttir

Alternate Member of the Board of  
Directors

**Ms. María Guðrún Sigurdardóttir (Alternate Member of the Board of Directors)**

María Guðrún Sigurdardóttir has since 2000 been the financial director for NTC Ltd., a leading fashion retailer in Iceland. Before that Ms. Sigurdardóttir held various posts in finance and financial accounting at among others the Icelandic Investment bank (FBA), Eimskipafélagið hf. (a leading Icelandic shipping company) and at the Institution for Government Debt Management. She is an alternate member on Issuer's Board, elected by ISB Holding ehf. Ms. Sigurdardóttir holds a Cand. Oecon degree from the University of Iceland and a M.Sc. degree in International Banking and Financial Studies from the Herriott Watt University in Edinburgh, Scotland.

Options relating to shares in the Issuer: None.

Own holding of shares in the Issuer: None.

Holdings of financially related parties in the Issuer: None.

**Ms. Eva Sóley Guðbjörnsdóttir (Alternate Member of the Board of Directors)**

Eva Sóley Guðbjörnsdóttir has worked in the financial sector since 1999, both in Iceland and abroad.

Ms. Guðbjörnsdóttir served in various posts at Kaupthing Bank between 2003 and 2008 and held positions in treasury, funding and liquidity management, corporate banking and corporate finance.

In 2008, she became a managing director for the Resolution Committee of Kaupthing Bank and was the bank's chief financial officer between 2009 and 2011. She was responsible for overseeing the bank's financial and administrative areas along with unwinding the derivatives portfolio and portfolio management for cash, loans, securities and subsidiaries. She is an alternate member on Issuer's Board, elected by ISB Holding ehf.

Ms. Guðbjörnsdóttir holds B.Sc. and M.Sc. degrees in Financial Engineering from Columbia University in New York. She is also a certified securities broker in Iceland.

Options relating to shares in the Issuer: None.

Own holding of shares in the Issuer: None.

Holdings of financially related parties in the Issuer: None.

**Mr. Baldur Pétursson (Alternate Member of the Board of Directors)**

Baldur Pétursson has spent the larger part of his career working on domestic and international programmes and projects, finance, banking, analysis, competitiveness, investments and reconstruction of various sectors and businesses in almost 30 countries. He has worked in co-operation with international organisations like, European Bank for Reconstruction and Development, European Investment Bank, European Union, OECD, EFTA and WTO.

He has held various positions including, Executive Alternate Director for the European Bank for Reconstruction and Development (EBRD) in London and, member of the board of Directors and Governors, Head of Unit of Competitiveness at the Ministry of Industry and Commerce, and Counsellor at the Icelandic Mission to the EU in Brussels. Mr. Pétursson is an alternate member on Issuer's Board, elected by ISB Holding ehf.

Mr Pétursson holds an MSA degree in Multinational Commerce, and Certificate in International Relations for Business from Boston University, was a member of the Executive Programme in Business Strategy at Columbia University and holds a Cand. Oecon. in Business Administration from the University of Iceland.

Options relating to shares in the Issuer: None.

Own holding of shares in the Issuer: None.

Holdings of financially related parties in the Issuer: None.

**Mr. Brynjar Stefánsson (Alternate Member of the Board of Directors)**

Brynjar Stefánsson currently holds the position of managing director of sales and marketing for Reykjavík Energy (Orkuveita Reykjavíkur hf.). Prior to that he held similar positions for software development company Maritech ehf. (2002 – 2006) and Hugvit ehf. (1998 – 2002). Mr. Stefánsson is an alternate member on Issuer's Board, elected by ISB Holding ehf.



Mr. Stefánsson holds a B.Sc. degree in Business Administration from Bifröst University and an M.Sc. degree in International Business from Aarhus University in Denmark.

Options relating to shares in the Issuer: None.

Own holding of shares in the Issuer: None.

Holdings of financially related parties in the Issuer: None.

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

Jón Eiríksson became a partner in KPMG Iceland in 1985. He was a board member with KPMG in Iceland until 2009 and retired from his partnership in 2010. Mr. Eiríksson is an alternate member on Issuer's Board, elected by ISB Holding ehf.

Mr. Eiríksson became a state authorised public accountant in 1978.

Options relating to shares in the Issuer: None.

Own holding of shares in the Issuer: None.

Holdings of financially related parties in the Issuer: None.

**Ms Sigríður Hallgrímsdóttir (Alternate Member of the Board of Directors)**

Sigríður Hallgrímsdóttir holds a business degree and a MBA diploma from University of Reykjavík.

Ms. Hallgrímsdóttir has a comprehensive international experience both in general management and human resources management. She was vice CEO for Creditinfo Group hf. (Creditinfo), working out of Athens, where she also was in charge of operations in Malta and Cyprus. She also actively participated in opening offices for Creditinfo in Ukraine and Kazakhstan. After leaving Creditinfo Ms. Hallgrímsdóttir became the vice COO at Industria and as such worked both in Ireland and Bulgaria. Ms. Hallgrímsdóttir is an alternate member on Issuer's Board, elected by ISB Holding ehf.

In 2001 Ms. Hallgrímsdóttir co-founded the internet consulting company SJÁ ehf. She has also worked as consultant at KPMG in Iceland and before joining KOM ehf. she worked for H.F. Verðbréf hf. as a new business developer.

Ms. Hallgrímsdóttir extra curricular activities are varied. She is the chairman of the Educational association of the Economist and Business graduates, she sat on the board of the Icelandic Dance Company and currently she is a member of the Friends of the Icelandic Symphonic Orchestra society.

Options relating to shares in the Issuer: None.

Own holding of shares in the Issuer: None.

Holdings of financially related parties in the Issuer: None.

**Ms Thórunn Jónsdóttir (Alternate Member of the Board of Directors)**

Thórunn Jónsdóttir currently holds the position of Senior Executive Director of Administration at Reykjavik University. Her previous posts include; Managing Director of Business Communications at Audur Capital, VP of business development for Iceland's largest pharmaceutical agent and distributor group, Veritas Capital/Vistor and assistant professor, director and management consultant at Reykjavik University's School of Business. Ms. Ingvarsdóttir represents the Icelandic State Financial Investments on the Issuer's Board of Directors.

Ms. Jónsdóttir holds a doctorate degree (DBA) in the field of corporate governance from Cranfield University in the UK, and MBA degree from IESE, Barcelona as well a Master's Degree in Pharmaceuticals, as well as being a certified securities broker. Ms. Jónsdóttir has served on a number of corporate boards and is an experienced speaker and presenter at business venues in Iceland.

Options relating to shares in the Issuer: None.

Own holding of shares in the Issuer: None.

Holdings of financially related parties in the Issuer: None.

**SENIOR MANAGEMENT**

The Executive Board consists of the following eight members:

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

Birna Einarsdóttir joined Iðnaðarbankinn hf., a predecessor of Glitnir in 1987. After six years with Royal Bank of Scotland, from 1998 – 2004, she rejoined Glitnir in the fall of 2004 then as the Managing Director of Sales and

Marketing. She was appointed to the role of Executive Vice President of Retail Banking of Glitnir in August of 2007. Ms. Einarisdóttir assumed the role of CEO of the Issuer in October of 2008.

Ms. Einarisdóttir's work experience further includes work as head of marketing for the Icelandic Broadcasting Company Ltd. (Channel 2) and Managing Director for the Icelandic Football Pools (Íslensk getspá).

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

Options relating to shares in the Issuer: None

Own holding of shares in the Issuer: None.

Holdings of financially related parties in the Issuer: None.

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

Jón Guðni Ómarsson worked in Capital Markets at Glitnir from 2000-2002. He rejoined Glitnir in 2005 and has held various positions in Leverage Finance and Treasury, 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 a Master's degree in Financial Engineering from the Georgia Institute of Technology. He is a CFA charterholder.

Options relating to shares in the Issuer: None

Own holding of shares in the Issuer: None.

Holdings of financially related parties in the Issuer: None.

**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 a Master's degree in Financial Mathematics from Stanford University. He is a certified securities broker and a financial risk management specialist certified by the Global Association of Risk Professionals.

Options relating to shares in the Issuer: None

Own holding of shares in the Issuer: None.

Holdings of financially related parties in the Issuer: None.

**Mr. Stefán Sigurdsson, Managing Director VÍB (Wealth Management)**

Stefán Sigurdsson joined Glitnir's Corporate Finance unit in Copenhagen in 2006. He became Managing Director of Glitnir's Business Development division in May 2008 and was appointed Managing Director of the Issuer's Wealth Management (later rebranded as VÍB) in October 2008. He has worked in the financial sector since 1997 and has extensive experience of capital markets, treasury, corporate finance and business development.

Mr. Sigurdsson holds a B.Sc. degree in Economics from the University of Iceland and a M.Sc. degree in Economics from the University of Copenhagen.

Options relating to shares in the Issuer: None

Own holding of shares in the Issuer: None.

Holdings of financially related parties in the Issuer: None.

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

Sigríður Olgeirsdóttir was appointed Chief Operating Officer of the Issuer in September 2010. Ms Olgeirsdóttir has worked in the IT industry since 1984 and prior to joining the Issuer she was Executive Director of the IT 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 School in Odense, Denmark, holds a diploma in Business Operations from the Institute of Continuing Education at the University of Iceland and an MBA degree in International Management from Reykjavík University.

Options relating to shares in the Issuer: None

Own holding of shares in the Issuer: None.

Holdings of financially related parties in the Issuer: None.

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

Una Steinsdóttir joined Glitnir in 1991 as a specialist in International Banking. Ms. Steinsdóttir has over 17 years of experience in working for the Issuer and its predecessors and has amongst other things worked in credit control and service management. Ms. Steinsdóttir was a branch manager in Keflavik for eight years, from 1999-2007 or 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. oecón degree in business administration from the University of Iceland.

Options relating to shares in the Issuer: None

Own holding of shares in the Issuer: None.

Holdings of financially related parties in the Issuer: None.

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

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

Mr. Thorsteinsson holds a B.Sc. degree in Business Administration from Reykjavík University, an MBA from Pace University New York and is a licensed securities broker.

Options relating to shares in the Issuer: None

Own holding of shares in the Issuer: None.

Holdings of financially related parties in the Issuer: None.

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

Tryggvi Björn Davíðsson was appointed Managing Director of Markets in September 2011. Mr. Davíðsson has a broad experience of international financial markets. For the last seven years Tryggvi has been a Director of Distressed Debt at Barclays Capital in London. He built up some of the bank'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 in the Central Bank of Iceland.

Ms. Davíðsson holds an MBA degree from INSEAD in France and Singapore, and a Masters Degree in Finance and Econometrics from Université de Toulouse.

Options relating to shares in the Issuer: None

Own holding of shares in the Issuer: None.

Holdings of financially related parties in the Issuer: None.

**POTENTIAL CONFLICT OF INTEREST**

Mr. Árni Tómasson (Member of the Board) is a former chairman of Glitnir's Resolution Committee which through its subsidiary ISB Holding ehf., holds 95% of the shares in the Issuer. Mr. Tómasson resigned from the Resolution Committee on 1 October 2011, but will continue as a member of the Board of Directors of the Issuer. The Issuer and Glitnir, as owner of GLB Holding ehf. and ISB Holding ehf., may have different interests in relations to financial reorganisations for those customers who have obligations with both parties.

No other members of the management or supervisory bodies of the Issuer have any duties or private interests that can cause potential conflicts of interest.

**MAJOR SHAREHOLDERS**

The Issuer's shareholders as of the date of this Base Prospectus are:

ISB Holding Ltd.: 9,500,000,000 shares or 95% of the share capital

Government of Iceland: 500,000,000 shares or 5% of the share capital

**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**

It has been publicly declared by the Resolution Committee of Glitnir, which through its subsidiary controls 95% of the Issuer's shares, that its shares will be offered for sale, as it does not intend to be a long term owner of the Issuer. The Government of Iceland has also stated that they do not intend to be a long-term owner of Issuer.

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

To the extent known the Issuer is not directly or indirectly owned or controlled by parties other than the listed shareholders.

## FINANCIAL INFORMATION

### IFRS

The Financial Statements of the Issuer for the years 2009 - 2011 were prepared on a going concern basis in accordance with the International Financial Reporting Standards (IFRS) as adopted by the European Union. The Condensed Consolidated Interim Financial Statements for the period 1 January to 30 September 2012 and for the period 1 January to 30 September 2011 were unaudited and unreviewed.

The same accounting policies, presentation and methods of computation have been followed in these Condensed Consolidated Interim Financial Statements as were applied in the preparation of the Issuer's Consolidated Financial Statements for the year ended 31 December 2011.

### AUDITORS

Consolidated Financial Statements for 2009, 2010 and 2011 were audited by Deloitte hf., Smáratorgi 3, 201 Kópavogi.

For the last three years 2009, 2010 and 2011 Pálína Árnadóttir and Páll Grétar Steingrímsson were the Issuer's auditors on behalf of Deloitte. All of them are members in The Institute of State Authorized Public Accountants in Iceland (FLE).

Emphasis of Matter for the Financial Statements for 2010 and 2011 can be found on page 20 and 21 in this Base Prospectus (only emphasis of matter in 2010 and 2011).

### AGE OF LATEST FINANCIAL STATEMENT

The latest audited Consolidated Financial Statements were published on 19 March 2012 and is for the year ended 31 December 2011.

The Issuer's latest financial information is the unaudited and unreviewed Condensed Consolidated Interim Financial Statement for the first nine months 2012 which was published on 29 November 2012.

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<sup>4</sup>.

### SELECTED FINANCIAL INFORMATION

Following is a summary of the Issuer's Consolidated Financial Statements. This information should be read together with each Consolidated Financial Statement due to changes in methodology between years. The Consolidated Financial Statements 2009 – 2011 and the Interim Financial Statement for the first nine months 2011 and 2012 can be found on the Issuer's website: <http://www.islandsbanki.is/english/investor-relations/financials/>.

Profit from the Issuer's operations for the period 1 January to 30 September 2012 amounted to ISK 16,221 million, which corresponds to a 16.3% return on equity. Bank equity, according to the Consolidated Financial Position, amounted to ISK 140,045 million at 30 September 2012. The Bank's total official capital ratio, calculated according to the Act on Financial Undertakings, was 23.5% and the Tier 1 ratio was 20.2%. The official capital ratio is based on reviewed retained earnings at 30 June 2012. Capital requirements in excess of

---

<sup>4</sup> Notes 4 to 51 in the Consolidated Interim Financial Statements ended 30 September 2012, notes 4 to 48 in the Consolidated Interim Financial Statements ended 30 September 2011, notes 4 to 82 in the Consolidated Financial Statement 2011, notes 4 to 84 in the Consolidated Financial Statement 2010., notes 4 to 73 in the Consolidated Financial Statement 2009.

the legal minimum of 8% of risk weighted assets are now discretionary based on the outcome of the results from the Bank's Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP) conducted by the FME. Current capital ratios are well in excess of both internal and regulatory requirements. The Bank's total assets amounted to ISK 812,711 million at the end of the period.

## Consolidated Statement of Comprehensive Income

	2011	2010	2009	2012 1.1-30.09*	2011 1.1-30.09*
Interest income .....	52.671	61.776	86.913	42.476	40.123
Interest expense .....	( 21.446)	( 26.902)	( 54.929)	( 19.191)	( 15.972)
<b>Net interest income</b>	31.225	34.874	31.984	23.285	24.151
Net valuation changes on loans and receivables .....	( 1.296)	14.507	801	2.782	( 831)
Provision for latent impairment .....	76	( 514)	( 477)	( 579)	12
<b>Net valuation changes</b>	( 1.220)	13.993	324	2.203	( 819)
<b>Net interest income after net valuation changes</b>	30.005	48.867	32.308	25.488	23.332
Fee and commission income .....	8.698	11.306	10.130	10.613	6.188
Fee and commission expense .....	( 2.732)	( 3.926)	( 3.069)	( 3.909)	( 1.822)
<b>Net fee and commission income</b>	5.966	7.380	7.061	6.704	4.366
Net financial income .....	2.649	( 910)	285	2.099	( 337)
Net foreign exchange gain .....	937	( 963)	2.621	1.544	408
Other net operating income .....	894	1.186	2.760	815	968
<b>Other net operating income</b>	4.480	( 687)	5.666	4.458	1.039
<b>Total operating income</b>	40.451	55.560	45.036	36.650	28.737
Administrative expenses .....	( 19.870)	( 17.866)	( 15.440)	( 17.888)	( 13.752)
Impairment of goodwill .....	( 17.873)	-	-	-	-
Contribution to the Depositors' and Investors' Guarantee Fund .....	( 965)	( 607)	( 673)	( 798)	( 684)
Share of profit of associates .....	39	-	-	-	-
<b>Profit before tax</b>	1.782	37.087	28.923	17.964	14.301
Income tax .....	( 75)	( 7.214)	( 4.678)	( 4.463)	( 3.097)
Bank tax .....	( 682)	( 221)	-	( 631)	( 509)
<b>Profit for the year from continuing operations</b>	1.025	29.652	24.245	12.870	10.695
Profit (loss) from discontinued operations, net of income tax .....	841	( 283)	( 263)	3.351	651
<b>Profit for the year</b>	1.866	29.369	23.982	16.221	11.346

### \*Unaudited and unreviewed information

The Issuer changed its presentation in the consolidated statement of comprehensive Income for the year 2011 where subtotals were added for Net valuation changes and Other net operating income. The Issuer did then also change its presentation of Profit for discontinued operations and is now presenting it net of income tax. In addition, contribution to the Depositors' and Investors' Guarantee Fund is shown separately in the statement. The comparable figures for the year 2010 were adjusted accordingly and in this extraction the figures for 2010 and 2009 are presented according to the above mentioned changes.

## Condensed Consolidated Statement of Financial Position

	30.9.2012*	31.12.2011	30.9.2011*	31.12.2010	31.12.2009
<b>Assets</b>					
Cash and balances with Central Bank .....	87.059	57.992	57.077	30.799	38.743
Derivatives .....	257	339	932	70	-
Bonds and debt instruments .....	52.127	58.662	52.429	68.024	66.701
Shares and equity instruments .....	9.878	11.107	3.284	3.022	2.250
Loans to credit institutions .....	60.942	43.655	29.913	30.870	87.416
Loans to customers .....	546.905	564.394	495.588	515.161	489.611
Investments in associates .....	912	1.070	744	354	827
Investment property .....	-	-	-	-	2.056
Property and equipment .....	5.545	5.276	5.608	5.419	1.771
Intangible assets .....	602	544	249	187	107
Deferred tax assets .....	1.533	2.629	200	283	84
Non-current assets and disposal groups held for sale .....	37.528	42.690	23.042	23.489	19.014
Other assets .....	9.423	7.557	10.022	5.544	8.761
<b>Total Assets</b>	<b>812.711</b>	<b>795.915</b>	<b>679.088</b>	<b>683.222</b>	<b>717.342</b>
<b>Liabilities</b>					
Financial liabilities .....	10.493	9.346	11.180	9.090	7.332
Derivatives .....	5.005	4.027	2.819	429	-
Deposits from Central Bank .....	13	73	19	26	28
Deposits from credit institutions .....	41.908	62.772	70.674	96.212	139.064
Deposits from customers .....	482.544	462.943	356.827	327.158	339.659
Debt issued and other borrowed funds .....	64.693	63.221	54.110	55.425	69.190
Subordinated loans .....	22.093	21.937	22.021	21.241	24.843
Current tax liabilities .....	306	2.670	9.524	9.024	4.807
Deferred tax liabilities .....	235	17	422	18	354
Non-current liabilities and disposal groups held for sale .....	5.080	7.317	6.170	16.442	16.905
Other liabilities .....	40.296	37.889	13.246	26.694	23.057
<b>Total Liabilities</b>	<b>672.666</b>	<b>672.212</b>	<b>547.012</b>	<b>561.759</b>	<b>625.239</b>
<b>Equity</b>					
Share capital .....	10.000	10.000	10.000	10.000	10.000
Share premium .....	55.000	55.000	55.000	55.000	55.000
Other reserves .....	2.731	2.661	2.550	2.498	2.059
Retained earnings .....	71.235	55.133	64.587	53.174	24.204
<b>Total equity attributable to the equity holders of Íslandsbanki hf.</b>	<b>138.966</b>	<b>122.794</b>	<b>132.137</b>	<b>120.672</b>	<b>91.263</b>
Non-controlling interests .....	1.079	909	( 61)	791	840
<b>Total Equity</b>	<b>140.045</b>	<b>123.703</b>	<b>132.076</b>	<b>121.463</b>	<b>92.103</b>
<b>Total Liabilities and Equity</b>	<b>812.711</b>	<b>795.915</b>	<b>679.088</b>	<b>683.222</b>	<b>717.342</b>

\*Unaudited and unreviewed information



## **RISK MANAGEMENT**

The Issuer is exposed to various risks through its use of financial instruments. Managing these risks is an integral part of the Issuer's operations. All amounts are presented in ISK million, unless otherwise stated.

### **RISK GOVERNANCE**

The ultimate responsibility for ensuring an adequate risk management framework lies with the Board of Directors. The Board defines and communicates the acceptable level of risk through the Issuer's risk management policies and risk appetite statement.

The implementation of the risk management framework, limit setting and monitoring is delegated to the Risk Committee, the Asset and Liability Committee (ALCO) and the Executive Board. The members of those boards are appointed by the CEO.

The Risk Committee is responsible for supervising and monitoring the Issuer's credit and credit concentration risks on a consolidated basis. The Risk Committee governs the Issuer's credit policies and procedures. The Risk Committee can delegate authorisation power to its subcommittees.

The ALCO supervises the Issuer's other financial risks including market risk, liquidity risk, interest rate risk, and the Issuer's capitalisation. The ALCO decides on and sets limits for these risks and the Issuer's capital allocation framework.

The Executive Board is responsible for the operational risk framework and for managing other risk factors such as reputational risk and business risk.

The Chief Risk Officer (CRO) is a member of the Executive Board and is responsible for the Issuer's risk management organisation. The CRO heads the Risk Management and Credit Control department. The CRO is also responsible for defining the daily tasks of the department and to assess the adequacy of its professional skills.

The compliance function is responsible for ensuring that the processes and the business conducted within the Issuer are in accordance with external laws and regulations and internal directives and instructions.

Internal Audit conducts independent evaluations and provides assurance for the internal controls and risk management for its appropriateness, effectiveness and its compliance to the Issuer's directives. The Chief Audit Executive (CAE) is appointed by the Board and accordingly has an independent position in the Issuer's organisational chart. The CAE is responsible for internal audit within the Issuer.

### **CREDIT RISK**

Credit risk is defined as current or prospective risk to earnings and capital arising from an obligor's potential failure to meet the terms of any contract with the Issuer or otherwise fail to perform as agreed. This risk comprises default risk, recovery risk, country risk, settlement risk and credit concentration risk.

Credit risk arises principally from the Issuer's loans and advances to customers and other Issuers but also from balances with the Central Bank of Iceland and off-balance sheet items such as guarantees, loan commitments and derivatives.

Credit concentration risk is the increased risk that is driven by common underlying factors, e.g. sector, geographical location, type of financial instrument or due to connections 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 identifying, 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. The Issuer also employs a range of policies and practices to mitigate credit risk. The most traditional of these is the taking of security in 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.

A thorough analysis of the counterparty's financial standing, analysis of past and estimated future cash flows as well as the borrower's general ability to repay its obligations forms the basis for all credit decisions. The Issuer

structures the levels 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 clients in accordance with internal and external criteria of connection between parties.

The Issuer employs a range of policies and practices to mitigate credit risk. The most traditional of these is the taking of security in 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.

The loan portfolio acquired from Glitnir is the largest part of the credit exposure of the Issuer. Due to the extraordinary circumstances in the Icelandic economy and the fact that the loan portfolio was acquired at a deep discount, care must be taken when interpreting conventional measures of credit risk.

## CREDIT RISK EXPOSURE

The Issuer's credit risk exposure is comprised of both on-balance sheet and off-balance sheet items. Maximum exposure to credit risk for on-balance sheet assets is the net carrying amount as reported in the statement of financial position. The maximum exposure for off-balance sheet items is the amount that the Issuer might have to pay out 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 Annex III of the European Parliament directive 2006/48/EC (Basel II).

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

The Issuer's credit exposure, before taking account of any collateral held or other credit enhancements, is as follows:

### Maximum exposure:

#### Maximum credit exposure

Maximum credit exposure 30.9.2012

	Individuals	Central Governments	Commerce and services	Construction	Energy	Financial services	Government secured customer loan	Industrials and transportation	Investment companies	Public sector and non-profit organisations	Real estate	Seafood	Total
Cash and balances with Central Bank	-	87,059	-	-	-	-	-	-	-	-	-	-	87,059
Derivatives	20	138	41	62	2	1,218	-	24	22	-	5	105	1,637
Bonds and debt instruments	-	47,114	309	-	-	2,711	-	-	1,096	15	882	-	52,127
Loans to credit institutions	-	-	-	-	-	60,942	-	-	-	-	-	-	60,942
Loans to customers:	239,533	-	64,901	18,010	2,851	175	-	43,079	17,301	9,637	80,659	72,300	548,446
Overdrafts	14,625	-	6,529	3,142	-	37	-	4,055	238	1,113	1,566	1,821	33,126
Credit cards	14,402	-	1,225	141	9	21	-	401	28	205	54	37	16,523
Mortgages	154,998	-	-	-	-	-	-	-	-	-	-	-	154,998
Leases	10,804	-	13,729	2,504	15	18	-	4,313	182	631	1,194	424	33,814
Other loans	44,704	-	43,418	12,223	2,827	99	-	34,310	16,853	7,688	77,845	70,018	309,985
Off-balance sheet items:													
Financial guarantees	1,245	-	1,912	2,020	4	1,501	-	1,207	320	54	329	503	9,095
Undrawn loan commitments	-	-	1,785	666	7,359	-	-	2,503	1	-	-	1,032	13,346
Undrawn overdraft	8,842	-	4,071	1,146	210	1,264	-	2,577	43	812	400	822	20,187
Credit card commitments	23,263	-	2,928	423	15	95	-	728	132	1,018	149	112	28,863
<b>Total maximum credit exposure</b>	<b>272,903</b>	<b>134,311</b>	<b>75,947</b>	<b>22,327</b>	<b>10,441</b>	<b>67,906</b>	<b>-</b>	<b>50,118</b>	<b>18,915</b>	<b>11,536</b>	<b>82,424</b>	<b>74,874</b>	<b>821,702</b>

Cont'd

Maximum exposure 31.12.2011

	Individuals	Central Governments	Commerce and services	Construction	Energy	Financial services	Government secured customer loan	Industrials and transportation	Investment companies	Public sector and non-profit organisations	Real estate	Seafood	Total
Cash and balances with Central Bank	-	57,992	-	-	-	-	-	-	-	-	-	-	57,992
Derivatives	10	58	71	54	2	1,161	-	13	41	-	1	70	1,481
Bonds and debt instruments	-	52,217	282	-	-	4,077	-	-	1,137	89	849	11	58,662
Loans to credit institutions	-	-	-	-	-	43,655	-	-	-	-	-	-	43,655
Loans to customers:	228,586	-	64,066	14,725	3,511	1,403	38,798	34,028	24,434	9,555	75,460	70,743	565,309
Overdrafts	14,531	-	6,647	3,528	28	1,187	-	3,563	489	1,289	1,075	1,202	33,539
Credit cards	15,796	-	1,569	129	5	17	8	194	22	117	39	30	17,926
Mortgages	140,762	-	-	-	-	-	-	-	-	-	-	-	140,762
Leases	11,196	-	8,921	2,749	16	8	-	3,709	193	773	1,190	552	29,307
Other loans	46,301	-	46,929	8,319	3,462	191	38,790	26,562	23,730	7,376	73,156	68,959	343,775
Off-balance sheet items:													
Financial guarantees	1,058	-	1,443	1,577	4	1,012	-	1,055	12	73	339	320	6,893
Undrawn loan commitments	-	-	2,017	-	5,345	5,000	-	225	-	-	-	5	12,592
Undrawn overdraft	9,797	-	4,343	1,083	203	1,363	-	1,993	72	1,096	513	986	21,449
Credit card commitments	19,392	-	1,521	272	5	48	10	352	81	380	68	73	22,202
<b>Total maximum credit exposure</b>	<b>258,843</b>	<b>110,267</b>	<b>73,743</b>	<b>17,711</b>	<b>9,070</b>	<b>57,719</b>	<b>38,808</b>	<b>37,666</b>	<b>25,777</b>	<b>11,193</b>	<b>77,230</b>	<b>72,208</b>	<b>790,235</b>

## 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 taken 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 collateral including accounts receivables, inventory, vehicles and equipment. Loans to government entities and to municipalities are more often than not unsecured. Derivative exposures are generally made under ISDA master agreements with Credit Support Annex or corresponding terms with 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 represent a reduction in maximum exposure to credit risk. 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 from the Iceland Property Registry or expert opinion of the Issuer's employees, depending on availability. In the case of fishing vessels the associated fishing quota is included in the valuation. Collateral is allocated according to claim value of loans, not carrying amount, and is measured without including the effect of overcollateralization. This means that if some loans have collateral values in excess of their claim value, then the excess is removed in order to reflect the Issuer's actual maximum exposure to credit risk.

**An estimate of the collateral held by the Issuer against credit exposure is shown below:**

	Real estate	Fishing vessels	Cash & securities	Vehicles & equipment	Other collateral	Total collateral
<b>At 30 September 2012</b>						
Derivatives .....	-	-	620	-	-	620
Loans and commitments to customers:	312,374	58,439	10,864	19,172	14,828	415,677
Individuals .....	189,086	87	698	8,306	-	198,177
Commerce and services .....	21,876	-	193	9,655	4,045	35,769
Construction .....	7,823	-	166	304	3,504	11,797
Energy .....	2,583	-	5	3	123	2,714
Financial services .....	69	-	-	15	-	84
Government secured customer loan .....	-	-	-	-	-	-
Industrial and transportation .....	12,645	-	179	684	5,597	19,105
Investment companies .....	4,020	-	9,061	17	395	13,493
Public sector and non-profit organisations .....	3,980	-	9	66	221	4,276
Real estate .....	65,101	143	307	73	-	65,624
Seafood .....	5,191	58,209	246	49	943	64,638
<b>Total</b>	<b>312,374</b>	<b>58,439</b>	<b>11,484</b>	<b>19,172</b>	<b>14,828</b>	<b>416,297</b>

<b>At 31 December 2011</b>	Real estate	Fishing vessels	Cash & securities	Other collateral	Total collateral
Loans and commitments to credit institutions .....	-	-	-	-	-
Loans and commitments to customers:	268,925	62,382	51,530	19,021	401,858
Individuals .....	170,491	71	1,148	3	171,713
Commerce and Services .....	15,728	-	725	10,504	26,957
Construction .....	7,757	-	457	1,270	9,484
Energy .....	2,517	-	83	149	2,749
Financial services .....	44	-	47	-	91
Government secured customer loan .....	-	-	38,799	-	38,799
Industrial and transportation .....	7,362	-	294	5,703	13,359
Investment companies .....	2,933	-	8,901	389	12,223
Public sector and non-profit organisations .....	3,455	-	9	200	3,664
Real estate .....	54,679	154	675	-	55,508
Seafood .....	3,959	62,157	392	803	67,311
Bonds and debt instruments .....	-	-	-	-	-
Derivatives .....	-	-	600	-	600
<b>Total</b>	<b>268,925</b>	<b>62,382</b>	<b>52,130</b>	<b>19,021</b>	<b>402,458</b>

The Issuer is still in the process of finalising the registration of necessary collateral information for this disclosure, in particular for loans recently acquired from Byr. During the reporting period, the Issuer obtained a third party collateral valuation for a part of the leasing portfolio explaining the increase seen for vehicles and equipment in the table above.

#### **CREDIT QUALITY OF FINANCIAL ASSETS**

Loans are classified as impaired loans if contractual cash payments are not expected to be fulfilled and if financial restructuring of the obligor is expected to lead to a loss on that particular loan. In most cases, loss is avoided because of the difference between the claim value and the carrying amount resulting from the deep discount of the acquired loan portfolio.

Loans are also classified as impaired if the Issuer has made impairments to offset currency movements. This impairment does not signal a loss from the deep discount.

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

	Neither past due nor impaired	Past due but not impaired	Classified as impaired	Total carrying amount
<b>At 30 September 2012</b>				
Cash and balances with Central Bank.....	87,059	-	-	87,059
Derivatives .....	1,637	-	-	1,637
Bonds and debt instruments .....	52,127	-	-	52,127
Loans to credit institutions .....	60,942	-	-	60,942
Loans to customers:	437,960	56,608	53,878	548,446
Individuals .....	196,339	35,470	7,724	239,533
Commerce and services .....	49,435	7,116	8,350	64,901
Construction .....	12,824	2,474	2,712	18,010
Energy .....	2,851	-	-	2,851
Financial services .....	111	29	35	175
Government secured customer loan .....	-	-	-	-
Industrial and transportation.....	36,883	2,313	3,883	43,079
Investment companies .....	11,048	2,405	3,848	17,301
Public sector and non-profit organisations .....	8,819	540	278	9,637
Real estate .....	51,982	4,919	23,758	80,659
Seafood .....	67,668	1,342	3,290	72,300
<b>Total</b>	<b>639,725</b>	<b>56,608</b>	<b>53,878</b>	<b>750,211</b>

	Neither past due nor impaired	Past due but not impaired	Classified as impaired loans	Total carrying amount
<b>At 31 December 2011</b>				
Cash and balances with Central Bank.....	57,992	-	-	57,992
Derivatives .....	1,481	-	-	1,481
Bonds and debt instruments .....	58,662	-	-	58,662
Loans to credit institutions .....	43,655	-	-	43,655
Loans to customers:	413,849	66,491	84,969	565,309
Individuals .....	180,399	37,860	10,327	228,586
Commerce and services .....	44,234	6,397	13,435	64,066
Construction .....	6,110	4,255	4,360	14,725
Energy .....	2,927	28	556	3,511
Financial services .....	168	176	1,059	1,403
Government secured customer loan .....	38,798	-	-	38,798
Industrial and transportation .....	25,378	2,148	6,502	34,028
Investment companies .....	8,545	3,381	12,508	24,434
Public sector and non-profit organisations .....	5,799	307	3,449	9,555
Real estate .....	36,612	9,097	29,751	75,460
Seafood .....	64,879	2,842	3,022	70,743
<b>Total</b>	<b>575,639</b>	<b>66,491</b>	<b>84,969</b>	<b>727,099</b>

#### PAST DUE BUT NOT IMPAIRED LOANS

Past due but not impaired loans are loans where contractual interest or principal payments have passed due date without the obligor making full payment but specific impairment is not appropriate. These loans are expected to be restructured without any loss to the Issuer. In some cases, loss is avoided because of the difference between the claim value and the carrying amount resulting from the deep discount of the acquired loan portfolio. In other cases there is sufficient collateral or the assessment is that contractual payments will be fulfilled.

Amounts reported as past due refer to the total loan exposure and not only the payment or sum of payments that are past due. Payments three days in arrears or less are not considered to be past due and the corresponding loans are therefore omitted here. Past due but not impaired loans are as follows:

	Past due 4-30 days	Past due 31-60 days	Past due 61-90 days	Past due more than 90 days	Total past due loans
<b>At 30 September 2012</b>					
Loans to credit institutions .....	-	-	-	-	-
Loans to customers:					
Individuals .....	5,098	1,910	1,178	27,284	35,470
Commerce and services .....	1,980	236	126	4,774	7,116
Construction .....	288	49	28	2,109	2,474
Energy .....	-	-	-	-	-
Financial services .....	6	-	-	23	29
Government secured customer loan .....	-	-	-	-	-
Industrial and transportation .....	291	115	85	1,822	2,313
Investment companies .....	207	104	319	1,775	2,405
Public sector and non-profit organisations .....	138	16	-	386	540
Real estate .....	279	127	167	4,346	4,919
Seafood .....	124	38	115	1,065	1,342
<b>Total</b>	<b>8,411</b>	<b>2,595</b>	<b>2,018</b>	<b>43,584</b>	<b>56,608</b>

	Past due 4-30 days	Past due 31-60 days	Past due 61-90 days	Past due more than 90 days	Total past due loans
<b>At 31 December 2011</b>					
Loans to credit institutions .....	-	-	-	-	-
Loans to customers:					
Individuals .....	10,578	4,198	2,011	21,073	37,860
Commerce and services .....	1,311	394	435	4,257	6,397
Construction .....	1,337	290	287	2,341	4,255
Energy .....	14	-	-	14	28
Financial services .....	54	-	-	122	176
Government secured customer loan .....	-	-	-	-	-
Industrial and transportation .....	44	377	110	1,617	2,148
Investment companies .....	330	41	5	3,005	3,381
Public sector and non-profit organisations .....	174	24	11	98	307
Real estate .....	760	247	335	7,755	9,097
Seafood .....	92	29	66	2,655	2,842
<b>Total</b>	<b>14,694</b>	<b>5,600</b>	<b>3,260</b>	<b>42,937</b>	<b>66,491</b>

#### LARGE EXPOSURE DISCLOSURE

When the Issuer's total exposure to a group of connected clients exceeds 10% of the Issuer's capital base it is considered a large exposure. The exposure is evaluated net of credit risk mitigating effects eligible according to the FME's rules on large exposure incurred by financial undertakings No. 216/2007. When assessing the exposure, both on-balance sheet and off-balance sheet items from all types of financial instruments are included as defined by the FME rules. The Issuer has internal criteria that define connections between clients. These criteria reflect the Issuer's interpretation of Article (1)(a) in Law no. 161/2002 on Financial Undertakings, where groups of connected clients are defined. In line with the law, the capital base from the last reviewed financial statements at 30 June 2012 is used to define large exposures.

The Issuer has one large exposure to a group of connected clients that amounts to 16% of the Issuer's capital base which is below the aggregated 400% limit set by the law. No large exposure exceeds the maximum 25% set by the law.

The following tables show the Issuer's large exposures as a percentage of the Issuer's capital base, gross and net of eligible credit risk mitigating effects. Note that group references might change between reporting periods, i.e. Group 1 might not be the same group in the two tables.

	30.9.2012	
<b>Client groups</b>	Gross	Net
Group 1 .....	70%	0%
Group 2 .....	16%	16%

	31.12.2011	
<b>Client groups</b>	Gross	Net
Group 1 .....	56%	0%
Group 2 .....	27%	0%
Group 3 .....	15%	15%

## 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 the Issuer's funding and long-term liquidity management. The Interbank desk is responsible for day-to-day liquidity management.

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

The tables below show the contractual payments of principal and interest for the Issuer's financial liabilities. Thus, the total figures for each liability class are higher than the respective balance sheet amount. Cash flows for payments of unknown nature, such as for floating rate, CPI linked or foreign currency denominated instruments, 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.

### Maturity analysis 30 September 2012

<b>Financial liabilities</b>	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Short positions .....	-	10,493	-	-	-	-	10,493
Deposits from Central Bank .....	13	-	-	-	-	-	13
Deposits from credit institutions .....	33,342	3,005	5,630	-	-	-	41,977
Deposits from customers .....	354,595	47,678	37,379	44,769	22,387	-	506,808
Debt issued and other borrowed funds .....	143	2,828	7,589	44,606	18,555	2,724	76,445
Subordinated loans .....	-	-	757	5,978	27,332	-	34,067
Other financial liabilities .....	37,030	1,935	599	-	294	214	40,072
<b>Total financial liabilities</b>	<b>425,123</b>	<b>65,939</b>	<b>51,954</b>	<b>95,353</b>	<b>68,568</b>	<b>2,938</b>	<b>709,875</b>

Off-balance sheet liabilities show the amount of contractual obligations that the Issuer has taken towards customers, either by committing to lend out money in the future or as third party guarantees. The amounts shown reflect the maximum amount, not taking 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.

Off balance sheet liabilities, 30 September 2012:

	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
<b>Off balance sheet liabilities</b>							
Financial guarantees .....	9,095	-	-	-	-	-	9,095
Undrawn loan commitments .....	13,346	-	-	-	-	-	13,346
Undrawn overdrafts .....	20,187	-	-	-	-	-	20,187
Credit card commitments .....	28,863	-	-	-	-	-	28,863
<b>Total</b>	<b>71,491</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>71,491</b>

Total non-derivative financial liabilities and off balance sheet liabilities .....	496,614	65,939	51,954	95,353	68,568	2,938	781,366
--	---------	--------	--------	--------	--------	-------	---------

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, the cash flow for both legs of the derivative is shown, since netting cannot be applied upon settlement.

#### Derivative financial liabilities, 30 September 2012.

	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
<b>Derivative financial liabilities</b>							
<b>Gross settled derivatives</b>							
Inflow .....	-	7,407	5,520	96,966	-	-	109,893
Outflow .....	-	(6,897)	(5,530)	(113,584)	-	-	(126,011)
Total	-	510	(10)	(16,618)	-	-	(16,118)
Net settled derivatives .....	-	(77)	-	-	-	-	(77)
<b>Total</b>	<b>-</b>	<b>433</b>	<b>(10)</b>	<b>(16,618)</b>	<b>-</b>	<b>-</b>	<b>(16,195)</b>

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

#### Financial assets and derivative financial assets, 30 September 2012

	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
<b>Financial assets</b>							
Cash and balances with Central Bank .....	19,827	67,232	-	-	-	-	87,059
Bonds and debt instruments .....	1,876	15,515	-	-	31,082	3,654	52,127
Shares and equity instruments .....	-	-	335	42	-	9,501	9,878
Loans to credit institutions .....	41,902	18,928	108	-	4	-	60,942
Loans to customers .....	74	56,194	46,578	144,163	299,896	-	546,905
Other financial assets .....	4,529	583	306	6,238	-	2,167	13,823
<b>Total financial assets</b>	<b>68,208</b>	<b>158,452</b>	<b>47,327</b>	<b>150,443</b>	<b>330,982</b>	<b>15,322</b>	<b>770,734</b>

#### Derivative financial assets

<b>Gross settled derivatives</b>							
Inflow .....	-	5,605	518	8,815	-	-	14,938
Outflow .....	-	(5,415)	(430)	(9,095)	-	-	(14,940)
Total	-	190	88	(280)	-	-	(2)
Net settled derivatives	-	65	-	-	-	-	65
<b>Total</b>	<b>-</b>	<b>255</b>	<b>88</b>	<b>(280)</b>	<b>-</b>	<b>-</b>	<b>63</b>



The tables below show the comparative amounts for financial assets and liabilities at the end of 2011.

**Maturity analysis 31 December 2011**

	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
<b>Financial Liabilities</b>							
Short positions .....	9,346	-	-	-	-	-	9,346
Deposits from Central Bank .....	73	-	-	-	-	-	73
Deposits from credit institutions .....	49,527	12,209	1,077	-	-	-	62,813
Deposits from customers .....	351,478	53,730	28,670	25,411	12,907	-	472,196
Debt issued and other borrowed funds .....	333	2,226	7,108	43,423	27,381	2,145	82,616
Subordinated loans .....	-	298	559	6,124	38,288	-	45,269
Other financial liabilities .....	22,379	13,188	3,156	570	392	148	39,833
<b>Total financial liabilities</b>	<b>433,136</b>	<b>81,651</b>	<b>40,570</b>	<b>75,528</b>	<b>78,968</b>	<b>2,293</b>	<b>712,146</b>
	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
<b>Off balance sheet liabilities</b>							
Financial guarantees .....	6,893	-	-	-	-	-	6,893
Undrawn loan commitments .....	12,592	-	-	-	-	-	12,592
Undrawn overdrafts .....	21,449	-	-	-	-	-	21,449
Credit card commitments .....	22,202	-	-	-	-	-	22,202
<b>Total</b>	<b>63,136</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>63,136</b>
Total non-derivative financial liabilities and off balance sheet liabilities .....	496,272	81,651	40,570	75,528	78,968	2,293	775,282
	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
<b>Derivative financial liabilities</b>							
<b>Gross settled derivatives</b>							
Inflow .....	-	6,258	2,498	78,562	25,000	-	112,318
Outflow .....	-	(6,131)	(2,979)	(94,688)	(25,074)	-	(128,872)
Total	-	127	(481)	(16,126)	(74)	-	(16,554)
Net settled derivatives	-	(38)	-	-	-	-	(38)
<b>Total</b>	<b>-</b>	<b>89</b>	<b>(481)</b>	<b>(16,126)</b>	<b>(74)</b>	<b>-</b>	<b>(16,592)</b>
	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
<b>Financial assets</b>							
Cash and balances with Central bank .....	22,937	35,055	-	-	-	-	57,992
Bonds and debt instruments .....	6,617	16,494	82	152	31,361	3,956	58,662
Shares and equity instruments .....	-	-	525	48	-	10,534	11,107
Loans to credit institutions .....	22,027	21,556	-	-	72	-	43,655
Loans to customers .....	-	50,523	46,877	169,833	297,161	-	564,394
Other financial assets .....	-	2,567	237	2	-	380	3,186
<b>Total financial assets</b>	<b>51,581</b>	<b>126,195</b>	<b>47,721</b>	<b>170,035</b>	<b>328,594</b>	<b>14,870</b>	<b>738,996</b>
	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
<b>Derivative financial assets</b>							
<b>Gross settled derivatives</b>							
Inflow .....	-	8,069	773	33,058	-	-	41,900
Outflow .....	-	(7,976)	(692)	(32,860)	-	-	(41,528)
Total	-	93	81	198	-	-	372
Net settled derivatives	-	21	-	-	-	-	21
<b>Total</b>	<b>-</b>	<b>114</b>	<b>81</b>	<b>198</b>	<b>-</b>	<b>-</b>	<b>393</b>

As a part of managing liquidity risk, the Issuer holds a portfolio of liquid assets to meet unexpected outflow of funds or a temporary shortage 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 liquidity back-up at the end of 2011 and end of Q3 2012. The liquidity facility line with the

Government expired at end of September and is therefore no longer included in the Bank's liquid assets at end of Q3 2012.

<b>Composition and amount of liquidity back-up</b>	30.9.2012	31.12.2011
Cash and balances with Central Bank .....	87,059	57,992
Domestic bonds eligible as collateral against borrowing at the Central Bank .....	15,177	55,024
Foreign government bonds .....	15,516	16,323
Short-term placements with credit institutions .....	55,485	36,695
Government liquidity facility .....	-	25,000
<b>Composition and amount of liquidity back-up</b>	<b>173,237</b>	<b>191,034</b>

## MARKET RISK

The Issuer defines market risk as the current or prospective risk to 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 and foreign exchange rates.

## MARKET RISK MANAGEMENT

The Issuer's market risk appetite is determined by the Board of Directors. The Asset and Liability Committee (ALCO) decides on limits for portfolios and products in accordance with the market risk policy approved by the Board. Risk management is responsible for monitoring and reporting on the Issuer's overall market risk positions and compliance to 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 into trading 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 originated from mismatches in assets and liabilities with respect to currencies, interest reset dates and inflation indexation and from shares and equity instruments acquired through restructuring. These mismatches are reported to management and are subject to regulatory and internal limits.

## INTEREST RATE RISK

Interest rate risk is the risk that the Issuer will experience deterioration in its financial position as interest rates change over time.

The Issuer uses sensitivity measures like Basis Point Value (BPV) to measure and manage risk arising from its fixed income exposures. The BPV measures the effect of a 0.01% upward parallel shift in the yield curve on the fair value of the bonds.

## INTEREST RATE RISK IN THE TRADING PORTFOLIO

The fixed income trading unit invests mainly in government bonds and bonds issued by the Housing Financing Fund (HFF), which are guaranteed by the Icelandic government. These positions can include short positions. The Issuer holds a significant amount of highly liquid foreign government bills in its liquidity portfolio. The bills are held for cash management purposes and can be liquidated with a short notice.

Trading bonds and debt instruments, long position	30.9.2012			31.12.2011		
	MV	Duration	BPV	MV	Duration	BPV
Indexed .....	312	9.11	(0.28)	379	9.22	(0.35)
Non-indexed .....	16,450	0.46	(0.76)	17,231	0.32	(0.55)
<b>Total</b>	<b>16,762</b>	<b>0.62</b>	<b>(1.04)</b>	<b>17,610</b>	<b>0.51</b>	<b>(0.90)</b>

Trading bonds and debt instruments, short position	30.9.2012			31.12.2011		
	MV	Duration	BPV	MV	Duration	BPV
Indexed .....	591	7.77	0.46	962	7.89	0.76
Non-indexed .....	46	9.35	0.04	364	8.17	0.30
<b>Total</b>	<b>637</b>	<b>7.88</b>	<b>0.50</b>	<b>1,326</b>	<b>7.97</b>	<b>1.06</b>

Net position of trading bonds and debt instruments	16,125	0.34	(0.54)	16,284	(0.09)	0.16
--	--------	------	--------	--------	--------	------

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

For sensitivity analysis in the trading portfolio the Issuer applies a 100 bps shift in ISK, non-indexed and indexed interest rates. Shifts in rates in other currencies are scaled down in accordance with lower volatility. The following table demonstrates the sensitivity of the Issuer's equity and income statement to a reasonable change in interest rates, all other risk factors held constant.

Sensitivity analysis for trading bonds and debt instruments	Parallel shift in yield curve (basis points)	31.12.2011		31.12.2010	
		Downward shift	Upward shift	Downward shift	Upward shift
<b>Currency (ISK million)</b>					
ISK, indexed .....	100	(41)	41	138	(138)
ISK, non-indexed .....	100	(7)	7	125	(125)
CHF .....	40	0	0	0	0
EUR .....	20	1	(1)	4	(4)
GBP .....	40	0	0	1	(1)
JPY .....	20	0	0	0	0
USD .....	40	5	(5)	13	(13)
Other total .....	40	6	(6)	3	(3)
<b>Total</b>		<b>(36)</b>	<b>36</b>	<b>284</b>	<b>(284)</b>

#### INTEREST RATE RISK IN THE BANKING BOOK

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 Issuer's assets and liabilities are of different maturities and are priced relative to different interest rates.

The Issuer holds a government bond designated at fair value amounting to ISK 30.8 billion at 30 September 2012 (2011: ISK 30.8 billion). The bond pays floating rates and carries relatively low interest rate risk.

Risk management is responsible for measuring, monitoring and reporting on the Issuer's interest rate risk in the non-trading portfolio. The Treasury unit is responsible for managing the Issuer's interest rate risk within limits set by ALCO. The Issuer uses traditional measures for assessing the sensitivity of the Issuer's financial assets, financial liabilities and earnings to changes in the underlying interest rates. Standard scenarios include an adverse 100 basis point parallel shift in all yield curves.

	0-3 months	3-12 months	1-2 years	2-5 years	5-10 years	Over 10 years	Total
<b>Assets</b>							
Cash and balances w ith Central Bank .....	84,902	-	-	-	-	-	84,902
Bonds and debt instruments .....	32,347	1,959	430	456	571	60	35,823
Loans to credit institutions .....	60,834	108	-	-	-	-	60,942
Loans to customers .....	388,782	35,228	32,703	74,084	1,328	14,780	546,905
<b>Total assets</b>	<b>566,865</b>	<b>37,295</b>	<b>33,133</b>	<b>74,540</b>	<b>1,899</b>	<b>14,840</b>	<b>728,572</b>
Off balance sheet items.....	56,910	7,301	10,901	1,505	113	-	76,730
<b>Liabilities</b>							
Short positions .....	-	3,208	1,314	880	-	-	5,402
Deposits from Central Bank .....	13	-	-	-	-	-	13
Deposits from credit institutions .....	36,338	5,570	-	-	-	-	41,908
Deposits from customers .....	476,098	1,559	1,563	1,573	1,751	-	482,544
Debt issued and other borrow ed funds .....	8,802	-	-	4,683	48,374	2,634	64,493
Subordinated loans .....	22,093	-	-	-	-	-	22,093
<b>Total liabilities</b>	<b>543,344</b>	<b>10,337</b>	<b>2,877</b>	<b>7,136</b>	<b>50,125</b>	<b>2,634</b>	<b>616,453</b>
Off balance sheet items .....	60,614	7,463	11,108	1,538	-	-	80,723
<b>Net interest gap on 30 September 2012</b>	<b>19,817</b>	<b>26,796</b>	<b>30,049</b>	<b>67,371</b>	<b>( 48,113)</b>	<b>12,206</b>	<b>108,126</b>

Banking book interest rate adjustment periods 31 December 2011

	0-3 months	3-12 months	1-2 years	2-5 years	5-10 years	Over 10 years	Total
<b>Assets</b>							
Cash and balances w ith Central Bank .....	56,016	-	-	-	-	-	56,016
Bonds and debt instruments .....	32,218	1,153	1,069	370	1,398	4,458	40,666
Loans to credit institutions .....	43,551	104	-	-	-	-	43,655
Loans to customers .....	420,171	27,158	35,739	63,895	1,914	15,517	564,394
<b>Total assets</b>	<b>551,956</b>	<b>28,415</b>	<b>36,808</b>	<b>64,265</b>	<b>3,312</b>	<b>19,975</b>	<b>704,731</b>
Off balance sheet items .....	59,201	-	10,007	3,115	113	-	72,436
<b>Liabilities</b>							
Short positions .....	-	3,567	1,815	477	-	-	5,859
Deposits from Central Bank .....	73	-	-	-	-	-	73
Deposits from credit institutions .....	61,711	1,061	-	-	-	-	62,772
Deposits from customers .....	456,329	3,383	759	807	1,665	-	462,943
Debt issued and other borrow ed funds .....	7,221	-	-	6,679	49,133	188	63,221
Subordinated loans .....	21,937	-	-	-	-	-	21,937
<b>Total liabilities</b>	<b>547,271</b>	<b>8,011</b>	<b>2,574</b>	<b>7,963</b>	<b>50,798</b>	<b>188</b>	<b>616,805</b>
Off balance sheet items .....	62,484	-	9,862	3,070	-	-	75,416
<b>Net interest gap on 31 December 2011</b>	<b>1,402</b>	<b>20,404</b>	<b>34,379</b>	<b>56,347</b>	<b>( 47,373)</b>	<b>19,787</b>	<b>84,946</b>

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

For sensitivity analysis in the non-trading portfolio a 100 bps shift is applied for non-indexed ISK interest rates. Shifts in other currencies are chosen using the same scaling factors as in the trading portfolio. CPI linked ISK rate shifts are also scaled down to reflect significantly stronger mean reversion than for non-indexed rates. The table shows how applied shifts would affect the fair value of the Issuer's banking book.

Currency (ISK million)	Parallel shift in yield curve (basis points)	Profit or loss			
		Downward shift	Upward shift	Downward shift	Profit or loss
ISK, indexed .....	40	935	(935)	684	(684)
ISK, non-indexed .....	100	487	(487)	(62)	62
CHF .....	40	(5)	5	5	(5)
EUR .....	20	(3)	3	(3)	3
GBP .....	40	1	(1)	0	0
JPY .....	20	3	(3)	2	(2)
USD .....	40	8	(8)	(1)	1
Other .....	40	(1)	1	(1)	1
<b>Total</b>		<b>1.425</b>	<b>(1.425)</b>	<b>624</b>	<b>(624)</b>

### CURRENCY RISK

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

The analysis of the Issuer's foreign currency exposure presented 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. Most of the net non-adjusted currency imbalance is due to loans with a non-ISK contractual currency to customers with ISK income. As a part of the transfer of assets from Glitnir, the Issuer determined that these loans have a recovery value that is limited in ISK terms. To reflect the ISK based recovery value of these loans the Issuer has impaired fully the foreign exchange gains on these assets since the date of transfer. Should there be an appreciation of the ISK there will be a corresponding reversal of the impairment charge. This is in accordance with IFRS accounting standards. The Issuer's regulators allow for an adjustment of the contractual currency imbalance to reflect the recovery of foreign currency denominated loans to customers with ISK income. The tables below summarise the Issuer's exposure to currency risk at 30 September 2012 and 31 December 2011, based on contractual currencies, off-balance sheet items along with the currency adjustment, but excluding assets categorised as held-for-sale.

### Currency analysis 30 September 2012

<b>Assets</b>	EUR	USD	GBP	CHF	JPY	Other	Total
Cash and balances w with Central Bank.....	395	161	67	31	21	255	930
Bonds and debt instruments.....	6,791	8,421	73	1	-	1,079	16,365
Shares and equity instruments.....	454	228	22	-	-	-	704
Loans to credit institutions.....	23,479	19,515	3,303	677	2,363	6,974	56,311
Loans to customers.....	60,338	15,847	4,116	15,912	17,395	2,491	116,099
Investments in associates.....	20	551	-	-	-	367	938
Other assets.....	159	1,409	126	-	2	37	1,733
<b>Total assets</b>	<b>91,636</b>	<b>46,132</b>	<b>7,707</b>	<b>16,621</b>	<b>19,781</b>	<b>11,203</b>	<b>193,080</b>
<b>Liabilities</b>							
Deposits from credit institutions .....	163	152	-	-	-	-	315
Deposits from customers .....	31,239	25,861	4,883	753	837	5,472	69,045
Debt issued and other borrowed funds .....	-	-	-	-	-	78	78
Subordinated loans .....	22,093	-	-	-	-	-	22,093
Other liabilities.....	1,166	3,293	608	1	15	221	5,304
<b>Total liabilities</b>	<b>54,661</b>	<b>29,306</b>	<b>5,491</b>	<b>754</b>	<b>852</b>	<b>5,771</b>	<b>96,835</b>
Non-adjusted foreign exchange							
on balance sheet imbalance .....	36,975	16,826	2,216	15,867	18,929	5,432	96,245
Adjustment of currency							
imbalance for FX/ISK loans .....	7,317	981	143	7,301	6,983	228	22,953
<b>Adjusted imbalance</b>	<b>29,658</b>	<b>15,845</b>	<b>2,073</b>	<b>8,566</b>	<b>11,946</b>	<b>5,204</b>	<b>73,292</b>
<b>Off balance sheet items</b>							
Off balance sheet assets .....	2,312	12,426	-	40	1,802	1,379	17,959
Off balance sheet liabilities .....	19,133	24,344	641	8,993	14,113	1,403	68,627
<b>Net off balance sheet items</b>	<b>( 16,821)</b>	<b>( 11,918)</b>	<b>( 641)</b>	<b>( 8,953)</b>	<b>( 12,311)</b>	<b>( 24)</b>	<b>( 50,668)</b>
Net currency imbalance							
on 30 September 2012.....	12,837	3,927	1,432	( 387)	( 365)	5,180	22,624

### Currency analysis 31 December 2011

<b>Assets</b>	EUR	USD	GBP	CHF	JPY	Other	Total
Cash and balances w with Central Bank .....	491	124	63	36	10	226	950
Bonds and debt instruments .....	5,919	5,890	-	-	-	5,238	17,047
Shares and equity instruments .....	630	122	213	-	-	-	965
Loans to credit institutions .....	18,866	10,355	1,492	1,236	382	5,220	37,551
Loans to customers .....	60,941	18,176	4,813	22,681	25,082	2,473	134,166
Investments in associates .....	20	433	-	-	-	-	453
Other assets .....	-	-	-	-	-	-	-
<b>Total assets</b>	<b>86,867</b>	<b>35,100</b>	<b>6,581</b>	<b>23,953</b>	<b>25,474</b>	<b>13,157</b>	<b>191,132</b>
<b>Liabilities</b>							
Deposits from credit institutions .....	2,511	380	135	11	2	95	3,134
Deposits from customers .....	21,307	19,451	4,557	725	536	8,547	55,123
Debt issued and other borrowed funds .....	-	-	-	-	-	14	14
Subordinated loans .....	21,937	-	-	-	-	-	21,937
Other liabilities .....	-	-	-	-	-	-	-
<b>Total liabilities</b>	<b>45,755</b>	<b>19,831</b>	<b>4,692</b>	<b>736</b>	<b>538</b>	<b>8,656</b>	<b>80,208</b>
Non-adjusted foreign exchange							
on balance sheet imbalance .....	41,112	15,269	1,889	23,217	24,936	4,501	110,924
Adjustment of currency							
imbalance for FX/ISK loans .....	16,007	3,075	806	12,638	13,210	912	46,648
Adjusted imbalance	25,105	12,194	1,083	10,579	11,726	3,589	64,276
<b>Off balance sheet items</b>							
Off balance sheet assets .....	4,265	17,238	38	239	2,459	76	24,315
Off balance sheet liabilities .....	21,176	25,427	294	11,106	15,011	1,891	74,905
Net off balance sheet items	( 16,911)	( 8,189)	( 256)	( 10,867)	( 12,552)	( 1,815)	( 50,590)
Net currency imbalance							
on 31 December 2011.....	8,194	4,005	827	( 288)	( 826)	1,774	13,686

## SENSITIVITY ANALYSIS TOWARDS CURRENCY RISK

The table below shows how the adjusted imbalance is affected by either depreciation or appreciation of each currency assuming other risk factors are held constant. The shift number is the 99% 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 income statement would be affected by the shifts.

### Sensitivity to currency risk:

#### Sensitivity to currency risk 31 December 2011

Currency (shift)	Shift Effect
EUR (2%) .....	(164)
USD (3%) .....	(120)
CHF (9%) .....	(26)
GBP (2%) .....	(17)
JPY (5%) .....	(41)
Other (4%) .....	(71)
<b>Total</b>	<b>(439)</b>

#### Sensitivity to currency risk 31 December 2010

Currency (shift)	Shift Effect
EUR (4%) .....	(163)
USD (4%) .....	(214)
CHF (4%) .....	(362)
GBP (4%) .....	0
JPY (4%) .....	(19)
Other (5%) .....	(32)
<b>Total</b>	<b>(790)</b>

## 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

The following table demonstrates how reasonable shifts in the prices of trading and non-trading portfolio would affect the equity and net financial income. Shifts applied for the trading and banking book are 20% and 40% respectively.

### Sensitivity analysis for equity:

Portfolio (ISK million)	Change in equity prices	Profit or loss			
		31.12.2011		31.12.2010	
		Downward shift	Upward shift	Downward shift	Upward shift
Trading .....	20%	( 79)	79	( 85)	85
Banking book .....	40%	( 5,117)	5,117	( 1,045)	1,045
<b>Total</b>		<b>( 5,195)</b>	<b>5,195</b>	<b>( 1,130)</b>	<b>1,130</b>

## DERIVATIVES

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

## INFLATION RISK

The Issuer is exposed to inflation risk since the value of CPI-indexed assets exceeds the value of CPI-indexed liabilities. The value of these assets and liabilities changes according to changes in the CPI at any given time and



all changes in the CPI index affect profit and loss. On 30 September 2012 the CPI gap amounted to ISK 17.0bn (31 December 2011: ISK 22,2bn). Thus, a 1% increase in the index would have a positive impact on the profit and loss account to the amount of ISK 170 million in profit and a 1% decrease would result in a corresponding loss, other risk factors held constant.

## **CAPITAL MANAGEMENT**

### **RISK EXPOSURE AND CAPITAL BASE**

Under Icelandic law the minimum capital requirement is 8.0% of risk weighted assets in accordance to the EU capital requirements directives (CRD).

As part of the conditions for granting the Issuer an operating license as a financial undertaking, the FME required the Issuer to maintain a minimum Core Tier 1 ratio of 12% of risk weighted assets and a total capital ratio, allowing for subordinated Tier 2 debt, of 16% for the first three years of operations.

Capital requirements in excess of the legal minimum of 8% of risk weighted assets are now discretionary based on the outcome of the results from the Issuer's Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP) conducted by the FME.

Current capital ratios are well in excess of both internal and regulatory requirements.

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. Market risk exposure for currency risk is based on the adjusted currency imbalance described in note 48 in the Consolidated Interim Financial Statements ended 30 September 2012.

The table below shows the capital base, risk weighted assets and capital ratios of the Issuer at 30 September 2012 and 31 December 2011. In addition, the table shows the official capital ratios based on reviewed retained earnings at 30 June 2012.

	30.9.2012	31.12.2011
<b>Tier 1 capital</b>		
Ordinary share capital .....	10,000	10,000
Share premium .....	55,000	55,000
Other reserves .....	2,731	2,661
Retained earnings .....	71,235	55,133
Non-controlling interests .....	1,079	909
Tax assets .....	( 1,533)	( 2,629)
Intangible assets .....	( 602)	( 544)
Other regulatory adjustments .....	( 436)	-
<b>Total Tier 1 capital</b>	<b>137,474</b>	<b>120,530</b>
<b>Tier 2 capital</b>		
Other regulatory adjustments .....	( 436)	-
Qualifying subordinated liabilities .....	22,093	21,937
<b>Total capital base</b>	<b>159,131</b>	<b>142,467</b>
<b>Risk weighted assets</b>		
- due to credit risk .....	550,724	532,301
- due to market risk: .....	25,060	16,695
Market risk, trading book .....	1,685	1,895
Currency risk foreign exchange .....	23,375	14,800
- due to operational risk .....	80,423	80,423
<b>Total risk weighted assets</b>	<b>656,207</b>	<b>629,419</b>
<b>Capital ratios</b>		
Tier 1 ratio .....	20.9%	19.1%
Total capital ratio .....	24.3%	22.6%
Official Tier 1 ratio.....	20.2%	19.1%
Official capital ratio.....	23.5%	22.6%

Article 86 of the act on Financial Undertakings (161/2002) details the measures taken in the case of insufficient own 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 Financial Supervisory Authority, Iceland (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 for expires, the operating licence of the financial undertaking shall be revoked.

#### OPERATIONAL RISK

The Issuer defines operational risk as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. This risk includes reputational risk, as well legal and compliance risk. Legal and compliance risk are covered within the compliance structure. Major sources of operational risk include operational process reliability, IT security, fraud, human error and regulatory compliance.

The Issuer has implemented an operational risk management framework within the parent company which satisfies the requirements for the Standardised Approach under the Basel II Accord. Under this framework, the Issuer collects all operational risk losses and ensures it is registered with relevant information into the Issuer's loss event database. All loss event data (LED) entered into the database are categorised according to the Basel II risk event categories. Potential operational risks are identified at least annually and assessed by the business units based on the Issuer's Risk and Control Self Assessment (RCSA) process. All unacceptable risks that are identified through the LED collection or RCSA must be mitigated with specific action plans.

The Issuer uses the Basic Indicator Approach of the Capital Requirements Directive (CRD) to calculate the capital requirements for operational risks.

## **TAXATION**

### **ICELANDIC TAXATION**

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

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

There are no taxes or other governmental charges payable under the laws of Iceland or any authority of, or in, Iceland in respect of the principal on the Bonds by a holder who is not a tax resident of Iceland. On the other hand, non-Icelandic tax residents receiving interest payments from Iceland are as a general principle considered to have limited tax liability in Iceland according to Article 3(8) of the Income Tax Act No. 90/2003. The Issuer is therefore required by the current laws of Iceland to withhold a 10 per cent. tax on any payment of interest due under the Bonds. However, a non-Icelandic tax resident may be exempt from such taxation of interest, by virtue of a Double Taxation Treaty that the Government of Iceland has concluded with the Government of the home State of the non-Icelandic tax resident, which provides for a double taxation relief. In such circumstances, the taxable person (the recipient of the interest payments) must apply for such exemption to the Tax Authorities by filing an application (being Form RSK 5.42) to gain an exemption from such withholding. If an application is not made prior to such withholding, a tax refund for the withholding tax can be claimed through the same channels (being Form RSK 5.43).

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

### **ICELANDIC TAX RESIDENTS**

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

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

### **EU SAVINGS DIRECTIVE**

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

## DOCUMENTS ON DISPLAY

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

- i. The Base Prospectus, dated 7 February 2013
- ii. All issued Final Terms.
- iii. The Issuer's Articles of Association.
- iv. The Consolidated Financial Statements of the Issuer for the years 2009, 2010 and 2011 and the Condensed Consolidated Interim Financial Statements for the period 1 January to 30 September 2011 and 2012.
- v. Independent Auditors' Reports for the years 2009-2011

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

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

**DOCUMENTS INCORPORATED BY REFERENCE**

The Consolidated Financial Statements of the Issuer for years 2009-2011, the Independent Auditors' Reports for the years 2009-2011 and the Condensed Consolidated Interim Financial Statements for the period 1 January to 30 September 2011 and 2012 are hereby incorporated into this Base Prospectus, by reference. The Financial Statements and the Independent Auditors' Reports are available for viewing at the Issuer premises at Kirkjusandur 2, 155 Reykjavík, Iceland and at the Issuer's website <http://www.islandsbanki.is/english/investor-relations/financials/>.

**ISSUER**  
**Íslandsbanki hf.**  
Kirkjusandi  
155 Reykjavík  
Iceland

**ARRANGER**  
**Íslandsbanki hf.**  
Kirkjusandi  
155 Reykjavík  
Iceland

**AUDITORS**  
*To the Issuer*  
**Deloitte hf.**  
Smáratorg 3  
201 Kópavogi  
Iceland