Interim Consolidated Financial Statements

1 January - 30 September 2014

Unaudited

Arion Bank
Borgartún 19
105 Reykjavík
Iceland

Reg. no. 581008 - 0150

CONTENTS

ENDORSEMENT AND STATEMENT BY THE BOARD OF DIRECTORS AND THE CEO

The Interim Consolidated Financial Statements of Arion Bank for the period ended 30 September 2014 include the Interim Consolidated Financial Statements of Arion Bank ("the Bank") and its subsidiaries, together referred to as "the Group".

Operations during the period

Net earnings amounted to ISK 22,633 million for the period ended 30 September 2014. The Group’s equity amounted to ISK 159,765 million at the end of the period. The capital adequacy ratio of the Group, calculated according to the Financial Undertakings Act, was 24.6% and official CET 1 ratio was 20.3%. Both ratios comfortably meet the requirements set by law and the Financial Supervisory Authority ("FME"). The liquidity position was strong at the end of the period and well above the regulatory minimum.

The Group performed well during the period. Net interest income is stable despite the strengthening of the Icelandic krona and lower inflation. Fee and commission income increased substantially, with an increase recorded in all business segments between years. Net impairment of loans and other assets is positive by ISK 2.9 billion, reflecting a successful closure of loan restructuring during the period. The Bank levy is several times higher than the same period in the previous year, but is expected to be similar to last year on a full year basis.

The sale and listing of shares in HB Grandi hf. had a significant influence on the Group's performance in the second quarter. In April the Bank sold an 18.8% share in HB Grandi hf. in connection with the listing of the company on NASDAQ OMX Iceland. Prior to the sale the Bank held a 31% share in HB Grandi hf. and classified the shareholding as Non-current assets and disposal groups held for sale. The realized gain from the sale, amounting to ISK 6,290 million, is recognized as Net gain from discontinued operations but the unrealized gain is included in the Net financial income. The remaining shareholding in HB Grandi hf. is classified as Financial instruments.

The Financial position of the Group at the end of September has changed slightly from the position at year end. The changes in Balances with Central Bank, Loans to credit institutions and Financial instruments are the results of the Bank's liquidity management. In June the Bank sold its subsidiary Landfestar ehf. to Eik fasteignafélag hf. and in return the Bank received a 44% shareholding in Eik fasteignafélag hf. In July the Bank sold a 20% shareholding in Eik fasteignafélag hf. and holds as a result 24% at the end of September. The main effects of the sale of Landfestar ehf. on the financial position of the Group is a decrease in Investment property and an increase in Investment in associates. In May Arion Bank paid ISK 7,811 million dividend to its shareholders.

The Group had 1,135 full-time equivalent positions at the end of the period, compared with 1,145 at the end of 2013, and 899 of these positions were at the parent company Arion Bank hf., compared with 911 at the end of 2013.

Outlook

Arion Bank is a leading universal bank on the Icelandic market and enjoys a strong position in all its business segments. Over the last few years the Bank has reduced the risk in its loan portfolio by increasing the share of retail mortgage loans, mainly through the acquisition of mortgage portfolios. The loan portfolio now comprises loans to individuals and companies in equal measure. Asset quality has continued to improve and problem loans as a percentage of equity are now starting to resemble those of other Nordic banks. The Bank has taken a leading position in the Icelandic market as regards lending to new export revenue generating industries both in the health care sector and in power intensive industries. The Bank's objective is to further strengthen this position. The Bank has furthermore increased its international loan portfolio by lending to the fishing- and marine industries in the neighbouring countries, thus achieving targets for diversification and growth.

Arion Bank has improved the quality of its funding. The Bank has focused on extending the maturities of its deposit base as demonstrated by its very strong LCR. In October Standard & Poor's confirmed the rating of BB+ and changed the outlook from stable to positive. Bank's credit rating still remains one notch below the rating of the Republic of Iceland. The Bank aims to issue a benchmark bond in the near future and the positive ratings outlook is expected to further enhance investor demand for Arion Bank's bonds.

The core of the Bank’s business is traditional banking activities. The focus in the near future will be to further improve operations and to take advantage of the foundations already in place to continue to build a strong diversified bank with healthy returns. In June a new main branch was opened in Borgartún 18, where user-friendly technology is introduced to the customer to a greater extent than before. This is in line with the Bank's aims to continue reducing operating expenses, mainly through automation and further optimization in both back office functions as well as the branch network. The Bank’s solid position will enable it to support its customers in their operations and investment activities domestically as well as in their current operation and expansion internationally.

ENDORSEMENT AND STATEMENT BY THE BOARD OF DIRECTORS AND THE CEO

Group business and ownership

Arion Bank is a group of financial undertakings which provide financial services to companies, institutions and private customers. These services include corporate banking, retail banking, investment banking and asset management. The Group includes subsidiaries in the real estate sector, card services and insurance.

Kaupskil ehf., a company owned by Kaupthing hf., holds 87% of the shares in Arion Bank. The remaining shareholding of 13% is held by the Icelandic State Financial Investments on behalf of the Icelandic government.

Endorsement of the Board of Directors and the Chief Executive Officer

The Interim Consolidated Financial Statements for the period ended 30 September 2014 have been prepared in accordance with International Financial Reporting Standards (IAS 34 Interim Financial Reporting) as endorsed by the European Union.

It is our opinion that the Interim Consolidated Financial Statements give a true and fair view of the financial performance and cash flows of the Group for the period ended 30 September 2014 and its financial position as at 30 September 2014.

Further, in our opinion the Consolidated Financial Statements and the Endorsement of the Board of Directors and the CEO give a fair view of the development and performance of the Group's operations and its position and describes the principal risks and uncertainties faced by the Group.

The Board of Directors and the CEO have today discussed the Interim Consolidated Financial Statements of Arion Bank for the period ended 30 September 2014 and confirm them by means of their signatures.

Reykjavík, 18 November 2014

Board of Directors

Monica Caneman
Chairman

Benedikt Olgeirsson

Guðrún Johnsen

Måns Höglund

Kirstín Þ. Flygenring

Þóra Hallgrímsdóttir

Ólafur Örn Svansson

Chief Executive Officer

Höskuldur H. Ólafsson

INTERIM CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR THE PERIOD FROM 1 JANUARY TO 30 SEPTEMBER 2014

	Notes	2014 1.1.-30.9.	2013 1.1.-30.9.	2014 1.7.-30.9.	2013 1.7.-30.9.
Interest income		40,036	43,363	13,155	13,314
Interest expense		(21,727)	(25,050)	(6,812)	(7,668)
Net interest income	6	18,309	18,313	6,343	5,646
Fee and commission income		13,679	11,881	4,762	4,141
Fee and commission expense		(3,560)	(3,597)	(1,236)	(1,155)
Net fee and commission income	7	10,119	8,284	3,526	2,986
Net financial income	8	5,861	954	1,994	658
Other operating income	9	3,963	4,035	689	1,610
Operating income		38,252	31,586	12,552	10,900
Salaries and related expense	10	(10,026)	(9,439)	(2,862)	(2,760)
Other operating expense	11	(8,598)	(8,744)	(2,787)	(2,516)
Net impairment	12	2,877	(119)	876	(253)
Earnings before tax		22,505	13,284	7,779	5,371
Income tax expense	13	(4,456)	(2,851)	(1,989)	(1,102)
Bank levy	14	(2,008)	(300)	(633)	(112)
Net earnings from continuing operations		16,041	10,133	5,157	4,157
Net gain (loss) from discontinued operations, net of tax	15	6,592	(3)	67	62
Net earnings		22,633	10,130	5,224	4,219
Attributable to					
Shareholders of Arion Bank		22,369	10,230	5,106	4,093
Non-controlling interest		264	(100)	118	126
Net earnings		22,633	10,130	5,224	4,219
Other comprehensive income					
Exchange difference on translating foreign subsidiaries	31	(4)	(2)	(2)	(1)
Total comprehensive income for the period		22,629	10,128	5,222	4,218
Earnings per share from continuing operations					
Basic and diluted earnings per share attributable to the shareholders of Arion Bank (ISK)	16	7.89	5.12	2.52	2.05

The notes on pages 10 to 54 are an integral part of these Interim Consolidated Financial Statements.

Arion Bank Interim Consolidated Financial Statements 30 September 2014 5 Amounts are in ISK millions

INTERIM CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 30 SEPTEMBER 2014

Assets	Notes	30.09.2014	31.12.2013	30.09.2013
Cash and balances with Central Bank	17	33,335	37,999	20,116
Loans to credit institutions	18	108,621	102,307	113,202
Loans to customers	19	652,598	635,774	576,204
Financial instruments	20-22	99,223	86,541	154,387
Investment property	22	2,901	28,523	29,382
Investments in associates	24	22,025	17,929	14,856
Intangible assets		5,337	5,383	5,348
Tax assets	25	660	818	702
Other assets	26	17,471	23,576	22,747
Total Assets		942,171	938,850	936,944
Liabilities				
Due to credit institutions and Central Bank	21	21,131	28,000	28,548
Deposits	21	482,518	471,866	471,768
Financial liabilities at fair value	21	6,038	8,960	9,834
Tax liabilities	25	6,103	4,924	4,815
Other liabilities	27	43,464	43,667	42,218
Borrowings	21.28	191,947	204,568	206,065
Subordinated liabilities	21.29	31,205	31,918	32,809
Total Liabilities		782,406	793,903	796,057
Equity				
Share capital and share premium	31	75,861	75,861	75,861
Other reserves	31	1,633	1,637	1,637
Retained earnings		77,149	62,591	59,802
Total Shareholders' Equity		154,643	140,089	137,300
Non-controlling interest		5,122	4,858	3,587
Total Equity		159,765	144,947	140,887
Total Liabilities and Equity		942,171	938,850	936,944

The notes on pages 10 to 54 are an integral part of these Interim Consolidated Financial Statements.

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INTERIM CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE PERIOD FROM 1 JANUARY TO 30 SEPTEMBER 2014

	Share capital and share premium	Other reserves	Retained earnings	**Total Share-holders' equity**	Non-controlling interest	**Total equity**
Changes in equity from 1 January to 30 September 2014						
Equity 1 January 2014	75,861	1,637	62,591	140,089	4,858	144,947
Total comprehensive income for the period		(4)	22,369	22,365	264	22,629
Dividend paid			(7,811)	(7,811)		(7,811)
Equity 30 September 2014	75,861	1,633	77,149	154,643	5,122	159,765
Changes in equity from 1 January to 30 September 2013						
Equity 1 January 2013	75,861	1,639	49,572	127,072	3,806	130,878
Total comprehensive income for the period		(2)	10,230	10,228	(100)	10,128
Decrease due to dividend paid to non-controlling interest					(119)	(119)
Equity 30 September 2013	75,861	1,637	59,802	137,300	3,587	140,887

The notes on pages 10 to 54 are an integral part of these Interim Consolidated Financial Statements.

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INTERIM CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE PERIOD FROM 1 JANUARY TO 30 SEPTEMBER 2014

	2014	2013
	1.1.-30.9.	1.1.-30.9.
Operating activities		
Net earnings	22,633	10,130
Non-cash items included in net earnings and other adjustments	(26,604)	(14,666)
Changes in operating assets and liabilities	(14,333)	(20,832)
Interest received	29,891	25,715
Interest paid*	(10,919)	(7,530)
Dividend received	874	46
Income tax and Bank levy paid	(1,999)	(1,512)
Net cash used in operating activities	(457)	(8,648)
Investing activities		
Net investment in associated companies	3,283	(25)
Net investment in property and equipment and intangible assets	(698)	(2,275)
Net cash from (used in) investing activities	2,585	(2,300)
Financing activities		
Dividend paid to shareholders of Arion Bank	(7,811)	-
Dividend paid to non-controlling interest	-	(119)
Net cash used in financing activities	(7,811)	(119)
Net decrease in cash and cash equivalents	(5,683)	(11,067)
Cash and cash equivalents at beginning of the period	99,683	105,173
Effect of exchange rate changes on cash and cash equivalents	(291)	(4,923)
Cash and cash equivalents at the end of the period	93,709	89,183
Non-cash investing and financing transactions		
Assets acquired through foreclosure on collateral from customers with view to resale	898	9,127
Settlement of loans through foreclosure on collateral from customers with view to resale	(898)	(9,127)
Changes due to the sale of Landfestar:		
Changes in Investment property	(23,131)	-
Changes in investment in asscociates	7,242	-
Changes in borrowings	14,769	-
Changes in tax liabilities	1,120	-

* Interest paid includes interest credited to deposit accounts at the end of the period.

The notes on pages 10 to 54 are an integral part of these Interim Consolidated Financial Statements.

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NOTES TO THE INTERIM CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE PERIOD FROM 1 JANUARY TO 30 SEPTEMBER 2014

	2014 1.1.-30.9.	2013 1.1.-30.9.
Non-cash items included in net earnings and other adjustments		
Net interest income	(18,309)	(18,313)
Net impairment	(2,877)	119
Income tax expense	4,456	2,851
Bank levy	2,008	300
Net foreign exchange (gain) loss	(564)	1,036
Net gain on financial instruments	(4,423)	(484)
Depreciation and amortisation	1,045	849
Share of loss (gain) of associates and fair value change	27	(430)
Investment property, fair value change	(935)	(475)
Net (gain) loss on disposal of property and equipment	(296)	18
Net gain on disposal of investment property	(144)	(140)
Net (gain) loss from discontinued operations, net of tax	(6,592)	3
Non-cash items included in net earnings and other adjustments	(26,604)	(14,666)

Changes in operating assets and liabilities		
Mandatory reserve with Central Bank	(177)	(250)
Loans to credit institutions	(7,351)	(18,271)
Loans to customers	(7,718)	(12,211)
Financial instruments	(7,556)	(14,571)
Investment property	3,570	298
Other assets	11,506	2,780
Due to credit institutions and Central Bank	(6,931)	(4,442)
Deposits	4,139	13,796
Borrowings	(1,973)	11,170
Other liabilities	(1,842)	869
Changes in operating assets and liabilities	(14,333)	(20,832)

Cash and cash equivalents comprises		
Cash in hand and demand deposits	33,335	20,116
Due from credit institutions	69,538	78,054
Mandatory reserve with Central Bank	(9,164)	(8,987)
Cash and cash equivalents at the end of the period	93,709	89,183

The notes on pages 10 to 54 are an integral part of these Interim Consolidated Financial Statements.

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NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

GENERAL INFORMATION

Arion banki hf., the Parent Company, was established 18 October 2008 and is incorporated and domiciled in Iceland. The registered office of Arion banki hf. is located at Borgartún 19, Reykjavík. The Interim Consolidated Financial Statements for the period ended 30 September 2014 comprise the Parent Company and its subsidiaries (together referred to as "the Group").

1. Basis of preparation

Statement of compliance

The Interim Financial Statements are consolidated and have been prepared in accordance with International Financial Reporting Standard IAS 34, Interim Financial Reporting as endorsed by the European Union. The Interim Consolidated Financial Statements do not include all the information and disclosures required in the annual financial statements, and should be read in conjunction with Arion Bank´s annual Financial Statements for the year 2013. The statements are available at Arion Bank's website www.arionbanki.is.

The Interim Consolidated Financial Statements were approved and authorised for issue by the Board of Directors of Arion Bank on 18 November 2014.

Basis of measurement

The Interim Consolidated Financial Statements are prepared on the historical cost basis except for the following:

- Financial assets and financial liabilities held for trading are measured at fair value;
- financial assets and financial liabilities at fair value are measured at fair value;
- investment properties are measured at fair value; and
- non-current assets and disposal groups classified as held for sale are stated at the lower of their carrying amount and fair value less costs to sell.

Functional and presentation currency

The Interim Consolidated Financial Statements are presented in Icelandic Krona (ISK), which is the Parent Company's functional currency, rounded to the nearest million unless otherwise stated. At the end of the period the exchange rate of the ISK against the USD was 121.01 and 152.72 for the EUR (31.12.2013: USD 115.09 and EUR 158.49).

2. Significant accounting estimates and judgements in applying accounting policies

The preparation of the Interim Consolidated Financial Statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an on going basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

The key sources of estimation uncertainty are within:

- impairment losses and reversal of impairment losses on loans;
- the foreign currency loan portfolio caused by legal dispute and court judgements;
- investment property;
- assets classified as held for sale; and
- investments in associates.

3. The Group

Shares in main subsidiaries in which Arion Bank held a direct interest at the end of the period

			Equity interest		
	Country	Currency	30.9.2014	31.12.2013	30.9.2013
AFL - sparisjóður, Aðalgata 34, Siglufjörður	Iceland	ISK	99.3%	99.3%	99.3%
Arion Bank Mortgages Institutional Investor Fund, Borgartún 19, Reykjavík	Iceland	ISK	100.0%	100.0%	100.0%
BG 12 slhf., Borgartún 19 Reykjavík	Iceland	ISK	62.0%	62.0%	-
EAB 1 ehf., Borgartún 19, Reykjavík	Iceland	ISK	100.0%	100.0%	100.0%
Eignabjarg ehf., Borgartún 19, Reykjavík	Iceland	ISK	100.0%	100.0%	100.0%
Eignarhaldsfélagið Landey ehf., Hátún 2b, Reykjavík	Iceland	ISK	100.0%	100.0%	100.0%
Landfestar ehf., Álfheimar 74, Reykjavík	Iceland	ISK	-	100.0%	100.0%
Okkar líftryggingar hf., Sóltún 26, Reykjavík	Iceland	ISK	100.0%	100.0%	100.0%
Stefnir hf., Borgartún 19, Reykjavík	Iceland	ISK	100.0%	100.0%	100.0%
Valitor Holding hf., Dalshraun 3, Hafnarfjörður	Iceland	ISK	60.8%	60.8%	60.8%

At the end of June 2014 the Bank sold its subsidiary Landfestar ehf. to Eik fasteignafélag hf. The main effects on the Interim Consolidated Statement of Financial Position is a decrease in Investment property by ISK 23.1 billion. The total effects of Landfestar ehf. on the Interim Consolidated Statement of Comprehensive Income is approximately ISK 850 million net income in the first half of 2014.

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OPERATING SEGMENT REPORTING

Segment information is presented in respect of the Group's operating segments based on the Group's management and internal reporting structure. Segment performance is evaluated based on earnings before tax.

Inter segment pricing is determined on an arm's length basis. Business segments pay and receive interest to and from Treasury on an arm's length basis to reflect the allocation of capital and funding cost.

Operating segments

The Group comprises six main operating segments:

Corporate Banking provides services to the Bank’s larger corporate customers. Its role is to provide comprehensive financial services and tailored services to meet the needs of each company.

Retail Banking, including Arion Bank Mortgages Institutional Investor Fund and AFL - sparisjóður, provide a comprehensive range of services. That includes among other advice on deposits and loans, savings, payment cards, pension savings, insurance, securities and funds. To maximize operational efficiency the branch network is divided into six clusters, with the smaller branches capitalizing on the strength of larger units within each cluster. Customers of Retail Banking's 26 branches all around Iceland are over 100,000.

The Asset Management division comprises Institutional Asset Management, Private Banking and Investment Services. Asset Management manages financial assets on behalf of its customers according to a pre-determined investment strategy. In addition the division is the main distributor of funds managed by Stefnir hf. to individuals, companies and institutional investors as well as distributing funds managed by international fund management companies. Stefnir hf. is an independently operating financial company owned by Arion Bank. Stefnir manages a broad range of mutual funds, investment funds and institutional investor funds.

Investment Banking is divided into Corporate Advisory, Capital Markets and Research. Corporate Advisory advises customers on securities offerings and the admission of securities for trading on regulated securities markets and also provides M&A advisory services. Capital Markets handles securities brokerage and foreign exchange trading for the Bank’s customers. Research publishes regular analyses of listed securities, the major business sectors, markets and the Icelandic economy and also produces economic forecasts. Investment Banking’s customers are private individuals, companies and institutions.

Treasury is responsible for the Bank’s liquidity management as well as currency and interest rate management. The other main functions of Treasury are the internal pricing of interest rates and currency and liaison with other financial institutions.

Other divisions and Subsidiaries include market making in domestic securities and currencies. The subsidiaries are Eignabjarg ehf., Eignarhaldsfélagið Landey ehf., Landfestar ehf. (sold in June 2014), Okkar líftryggingar hf., Valitor holding hf. and other smaller entities of the Group.

Headquarters: Overhead, Risk Management, Accounting, Legal, Operations and Corporate Development.

4. The Group's business segments

1.1.-30.9.2014	Corporate Banking	Retail Banking	Asset Management and Stefnir	Investment Banking	Treasury	Other divisions and Subsidiaries	Headquarters and Elimination	Total
Net interest income	5,479	9,339	380	218	3,643	(728)	(22)	18,309
Other income	965	1,917	2,753	6,658	(772)	6,917	1,505	19,943
Operating income	6,444	11,256	3,133	6,876	2,871	6,189	1,483	38,252
Operating expense	(446)	(4,183)	(1,030)	(536)	(195)	(3,613)	(8,621)	(18,624)
Net impairment	2,841	(223)	-	(398)	683	(55)	29	2,877
Earnings before tax	8,839	6,850	2,103	5,942	3,359	2,521	(7,109)	22,505
Net seg. rev. from ext. customers	13,068	18,850	1,523	7,159	(11,087)	7,302	1,437	38,252
Net seg. rev. from other segments	(6,624)	(7,594)	1,610	(283)	13,958	(1,113)	46	-
Operating income	6,444	11,256	3,133	6,876	2,871	6,189	1,483	38,252
Depreciation and amortisation	-	226	-	-	-	245	574	1,045
Total assets	240,775	411,823	4,996	31,504	175,998	56,803	20,272	942,171
Total liabilities	202,251	367,403	2,452	26,463	138,631	27,686	17,520	782,406
Allocated equity	38,524	44,420	2,544	5,041	37,367	29,117	2,752	159,765

1.1.-30.9.2013	Corporate Banking	Retail Banking	Asset Management and Stefnir	Investment Banking	Treasury	Other divisions and Subsidiaries	Headquarters and Elimination	Total
Net interest income	6,648	8,942	393	80	3,213	(1,129)	166	18,313
Other income	496	1,818	2,316	2,178	(510)	6,366	609	13,273
Operating income	7,144	10,760	2,709	2,258	2,703	5,237	775	31,586
Operating expense	(462)	(4,073)	(920)	(439)	(174)	(3,865)	(8,250)	(18,183)
Net impairment	798	(2,841)	(3)	1,772	204	(42)	(7)	(119)
Earnings before tax	7,480	3,846	1,786	3,591	2,733	1,330	(7,482)	13,284
Net seg. rev. from ext. customers	13,080	16,960	995	2,082	(8,625)	7,324	(230)	31,586
Net seg. rev. from other segments	(5,936)	(6,200)	1,714	176	11,328	(2,087)	1,005	-
Operating income	7,144	10,760	2,709	2,258	2,703	5,237	775	31,586
Depreciation and amortisation	-	131	-	-	-	161	557	849
Total assets	243,267	338,882	4,357	32,876	234,838	73,518	9,206	936,944
Total liabilities	204,344	307,221	2,050	27,616	200,600	45,970	8,256	796,057
Allocated equity	38,923	31,661	2,307	5,260	34,238	27,548	950	140,887

The vast majority of the revenues from external customers is attributable to customers in Iceland.

Discontinued operations are excluded from the profit and loss segment information.

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NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

QUARTERLY STATEMENTS

5. Operations by quarters

2014	Q3	Q2	Q1	Total
Net interest income	6,343	6,483	5,483	18,309
Net fee and commission income	3,526	3,445	3,148	10,119
Net financial income (expense)	1,994	4,439	(572)	5,861
Other operating income	689	2,356	918	3,963
Operating income	12,552	16,723	8,977	38,252
Salaries and related expense	(2,862)	(3,714)	(3,450)	(10,026)
Other operating expense	(2,787)	(3,064)	(2,747)	(8,598)
Net impairment	876	34	1,967	2,877
Earnings before tax	7,779	9,979	4,747	22,505
Tax expense	(2,622)	(1,867)	(1,975)	(6,464)
Net earnings from continuing operations	5,157	8,112	2,772	16,041
Net gain from discontinued operations, net of tax	67	6,433	92	6,592
Net earnings	5,224	14,545	2,864	22,633

2013				
Net interest income	5,646	6,379	6,288	18,313
Net fee and commission income	2,986	2,849	2,449	8,284
Net financial income (expense)	658	1,123	(827)	954
Other operating income	1,610	1,249	1,176	4,035
Operating income	10,900	11,600	9,086	31,586
Salaries and related expense	(2,760)	(3,357)	(3,322)	(9,439)
Other expense	(2,516)	(2,951)	(3,277)	(8,744)
Net impairment	(253)	456	(322)	(119)
Earnings before tax	5,371	5,748	2,165	13,284
Tax expense	(1,214)	(1,260)	(677)	(3,151)
Net earnings from continuing operations	4,157	4,488	1,488	10,133
Net gain (loss) from discontinued operations, net of tax	62	14	(79)	(3)
Net earnings	4,219	4,502	1,409	10,130

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NOTES TO THE INTERIM CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

6. Net interest income

	2014 1.1.-30.9.	2013 1.1.-30.9.	2014 1.7.-30.9.	2013 1.7.-30.9.
Cash and balances with Central Bank	501	621	169	157
Loans	36,227	35,663	11,953	10,946
Securities	2,824	6,579	845	2,095
Other	484	500	188	116
Interest income	40,036	43,363	13,155	13,314
Deposits	(12,808)	(14,417)	(4,024)	(4,511)
Borrowings	(7,876)	(9,555)	(2,413)	(2,783)
Subordinated liabilities	(974)	(996)	(324)	(334)
Other	(69)	(82)	(51)	(40)
Interest expense	(21,727)	(25,050)	(6,812)	(7,668)
Net interest income	18,309	18,313	6,343	5,646
Net interest income from assets and liabilities at fair value	2,824	6,578	845	2,094
Interest income from assets not at fair value	37,212	36,785	12,311	11,220
Interest expense from liabilities not at fair value	(21,727)	(25,050)	(6,813)	(7,668)
Net interest income	18,309	18,313	6,343	5,646

7. Net fee and commission income

Fee and commission income				
Asset management	2,918	2,532	938	812
Cards	6,657	5,580	2,505	2,024
Collection and payment services	942	848	343	296
Investment banking	1,692	904	640	273
Interbank clearing	123	529	1	177
Lending and guarantees	896	685	281	297
Other fee and commission income	451	803	54	262
Fee and commission income	13,679	11,881	4,762	4,141
Fee and commission expense				
Asset management	(151)	(143)	(61)	(47)
Cards	(2,776)	(2,523)	(1,051)	(803)
Collection and payment services	(63)	(13)	(21)	(4)
Investment banking	(30)	(30)	(6)	(8)
Interbank clearing	(122)	(527)	-	(175)
Other fee and commission expense	(418)	(361)	(97)	(118)
Fee and commission expense	(3,560)	(3,597)	(1,236)	(1,155)
Net fee and commission income	10,119	8,284	3,526	2,986

Asset management fees are earned by the Group on trust and fiduciary activities where the Group holds or invests assets on behalf of the customers.

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8. Net financial income

	2014 1.1.-30.9.	2013 1.1.-30.9.	2014 1.7.-30.9.	2013 1.7.-30.9.
Dividend income	874	46	216	-
Net gain (loss) on financial assets and financial liabilities classified as held for trading	(394)	484	(21)	287
Net gain (loss) on financial assets and financial liabilities designated at fair value through profit or loss	4,817	1,459	1,387	158
Net foreign exchange gain (loss)	564	(1,035)	412	213
Net financial income	5,861	954	1,994	658

Net gain (loss) on financial assets and financial liabilities classified as held for trading

Net gain (loss) on equity instruments and related derivatives	(54)	477	27	148
Net gain (loss) on interest rate instruments and related derivatives	(124)	58	6	74
Net gain (loss) on other derivatives	(216)	(51)	(54)	65
Net gain (loss) on financial assets and financial liabilities classified as held for trading	(394)	484	(21)	287

Net gain (loss) on financial assets and financial liabilities designated at fair value through profit or loss

Net gain (loss) on equity instruments designated at fair value	5,500	542	1,442	5
Net gain (loss) on interest rate instruments designated at fair value	(683)	917	(55)	153
Net gain (loss) on financial assets and financial liabilities designated at fair value through profit or loss	4,817	1,459	1,387	158

9. Other operating income

Share of (loss) profit of associates	(27)	430	53	442
Rental income from investment property	1,226	1,673	55	560
Fair value changes on investment property	935	475	3	168
Realised gain on investment property	144	140	138	32
Earned premiums, net of reinsurance	739	796	247	263
Net gain on disposals of assets other than held for sale	488	5	39	-
Other income	458	516	154	145
Other operating income	3,963	4,035	689	1,610

10. Personnel and salaries

Number of employees

Average number of full time equivalent positions during the period	1,130	1,164	1,119	1,139
Full time equivalent positions at the end of the period	1,135	1,139	1,135	1,139

The Bank's number of employees

Average number of full time equivalent positions during the period	898	927	887	902
Full time equivalent positions at the end of the period	899	906	899	906

Salaries and related expense

Salaries	7,791	7,189	2,270	2,094
Defined contribution pension plans	1,097	937	320	273
Salary related expense	1,138	1,313	272	393
Salaries and related expense	10,026	9,439	2,862	2,760

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10. Personnel and salaries, continued

	2014 1.1.-30.9.	2013 1.1.-30.9.	2014 1.7.-30.9.	2013 1.7.-30.9.
Salaries and related expense for the Bank				
Salaries	6,082	5,662	1,759	1,619
Defined contribution pension plans	880	738	290	211
Salary related expense	971	1,025	248	290
Salaries and related expense	7,933	7,425	2,297	2,120

During the first nine months of 2014 the Group made a provision of ISK 239 million (9M 2013: nil) for performance plan payments, including salary related expense. During the first nine months the Bank made a provision of ISK 193 million (9M 2013: nil). Forty percent of the payment is deferred for three years in accordance with FME rules on remuneration policy for financial undertakings. At the end of the period the Group had made a provision amounting to ISK 534 million (31.12.2013: ISK 494 million and 30.9.2013: nil). The Bank had made a provision of ISK 449 million at the end of the period (31.12.2013: ISK 452 million and 30.9.2013: nil).

11. Other operating expense

	2014 1.1.-30.9.	2013 1.1.-30.9.	2014 1.7.-30.9.	2013 1.7.-30.9.
Administration expense	6,354	6,686	2,083	1,817
Depositors' and investors' guarantee fund	623	565	208	186
Depreciation of property and equipment	743	677	273	236
Amortisation of intangible assets	302	172	103	63
Direct operating expense derived from rental-earning investment properties	315	382	35	126
Claims incurred, net of reinsurance	254	236	81	65
Other expense	7	26	4	23
Other operating expense	8,598	8,744	2,787	2,516

12. Net impairment

Increase in book value of loans to corporates	2,245	7,087	591	382
Increase in book value of loans to individuals	1,276	545	966	452
Increase in book value of other assets	683	-	-	-
Reversal of impairment (impairment) of loans to corporates	17	(5,373)	(210)	(70)
Reversal of impairment of loans to credit institutions	-	23	-	-
Impairment of loans to individuals	(1,469)	(2,415)	(534)	(699)
Collective reversal of impairment (impairment)	125	14	63	(318)
Net impairment	2,877	(119)	876	(253)

13. Income tax expense

Current tax expense	4,042	3,356	1,968	1,247
Deferred tax expense	414	(505)	21	(145)
Income tax expense	4,456	2,851	1,989	1,102

Reconciliation of effective tax rate	1.1.-30.9.2014		1.1.-30.9.2013	
Earnings before tax		22,505		13,284
Income tax using the Icelandic corporation tax rate	20.0%	4,501	20.0%	2,657
Additional 6% tax on financial institutions	3.9%	869	5.5%	733
Non-deductible expenses	0.1%	23	0.9%	115
Tax exempt revenue	(3.8%)	(865)	(3.3%)	(439)
Tax incentives not recognised in the Statement of Comprehensive Income	0.0%	-	(1.3%)	(172)
Other changes	(0.3%)	(72)	(0.3%)	(43)
Effective tax rate	19.8%	4,456	21.5%	2,851

Financial institutions pay 6% additional tax on taxable profit exceeding ISK 1.0 billion.

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14. Bank levy

The Bank levy is 0.376% on total debt excluding tax liabilities, in excess of ISK 50 billions. Non-financial subsidiaries are exempt from this tax. The tax is assessed on financial institutions to meet the funding of a special index and interest relief provided to individual tax payers. The tax rate for Bank levy increased at the end of 2013. Prior to the increase the tax rate was 0.041%.

15. Net gain from discontinued operations, net of tax

	2014 1.1.-30.9.	2013 1.1.-30.9.	2014 1.7.-30.9.	2013 1.7.-30.9.
Net gain from legal entities	-	11	-	-
Net gain from associated companies	6,290	-	-	-
Net gain (loss) from real estate	299	(14)	66	62
Net gain from other assets	3	-	1	-
Net gain (loss) from discontinued operations, net of tax	6,592	(3)	67	62

Net gain from associated companies comprises the realised gain from sale of the Bank's 18.8% share in HB Grandi hf. in connection with the listing of the company on NASDAQ OMX Iceland.

16. Earnings per share

	Discontinued operations			
	Excluded		Included	
	2014 1.1.-30.9.	2013 1.1.-30.9.	2014 1.1.-30.9.	2013 1.1.-30.9.
Net earnings attributable to the shareholders of Arion Bank	15,777	10,233	22,369	10,230
Weighted average number of outstanding shares for the year, million	2,000	2,000	2,000	2,000
Basic earnings per share	7.89	5.12	11.18	5.12

There were no instruments at the end of the period that could potentially dilute basic earnings per share (2013: none).

Arion Bank Interim Consolidated Financial Statements 30 September 2014 19 Amounts are in ISK millions

NOTES TO THE INTERIM CONSOLIDATED STATEMENT OF FINANCIAL POSITION

17. Cash and balances with Central Bank

	30.9.2014	31.12.2013	30.9.2013
Cash on hand	3,791	4,099	3,251
Cash with Central Bank	20,380	24,912	7,878
Mandatory reserve deposit with Central Bank	9,164	8,987	8,987
Cash and balances with Central Bank	33,335	37,999	20,116

The mandatory reserve deposit with Central Bank is not available for the Group to use in its daily operations.

18. Loans to credit institutions

Loans to credit institutions

	30.9.2014	31.12.2013	30.9.2013
Bank accounts	69,538	70,671	78,054
Money market loans	33,515	26,197	29,394
Other loans	5,568	5,439	6,060
Provision on loans	-	-	(306)
Loans to credit institutions	108,621	102,307	113,202

Changes in the provision for losses on loans to credit institutions

	30.9.2014	31.12.2013	30.9.2013
Balance at the beginning of the period	-	804	804
Provision for losses (reversal)	-	-	(23)
Write-offs	-	(804)	(475)
Provision for losses on loans to credit institutions at the end of the period	-	-	306

19. Loans to customers

30.9.2014	Individuals	Corporates	Total
Overdrafts	18,525	23,453	41,978
Credit cards	10,228	939	11,167
Mortgage loans	257,122	8,940	266,062
Subordinated loans	-	419	419
Other loans	47,218	312,867	360,085
Provision on loans	(12,616)	(14,497)	(27,113)
Loans to customers	320,477	332,121	652,598

31.12.2013	Individuals	Corporates	Total
Overdrafts	18,205	19,669	37,874
Credit cards	11,296	878	12,174
Mortgage loans	258,065	8,103	266,168
Subordinated loans	-	531	531
Other loans	36,133	312,120	348,253
Provision on loans	(13,208)	(16,018)	(29,226)
Loans to customers	310,491	325,283	635,774

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19. Loans to customers, continued

30.9.2013	Individuals	Corporates	Total
Overdrafts	18,263	19,010	37,273
Credit cards	9,890	874	10,764
Mortgage loans	205,295	6,719	212,014
Subordinated loans	-	550	550
Other loans	37,584	320,137	357,721
Provision on loans	(14,406)	(27,712)	(42,118)
Loans to customers	256,626	319,578	576,204

The total book value of pledged loans that were pledged against amounts borrowed was ISK 190 billion at the end of the period (31.12.2013: ISK 173 billion and 30.9.2013: ISK 172 billion). Pledged loans comprised mortgage loans to individuals, loans to municipals and loans to state related entities.

Further analysis of loans is provided in Risk Management Disclosures.

Changes in the provision for losses on loans to customers

1.1.-30.9.2014	Specific	FX rulings	Collective	Total
Balance at the beginning of the period	24,224	902	4,100	29,226
Provision for losses	91	805	(252)	644
Write-offs	(2,360)	(1,158)	(68)	(3,586)
Payment of loans previously written off	829	-	-	829
Balance at the end of the period	22,784	549	3,780	27,113

1.1.-31.12.2013				
Balance at the beginning of the year	41,498	14,942	3,341	59,781
Provision for losses	6,041	1,952	947	8,940
Write-offs	(24,228)	(12,008)	(188)	(36,424)
Transferred to liabilities	-	(3,984)	-	(3,984)
Payment of loans previously written off	913	-	-	913
Balance at the end of the year	24,224	902	4,100	29,226

1.1.-30.9.2013				
Balance at the beginning of the period	41,499	14,942	3,341	59,782
Provision for losses	3,601	4,168	(18)	7,751
Write-offs	(11,780)	(11,099)	(20)	(22,899)
Transferred to liabilities	-	(2,979)	-	(2,979)
Payment of loans previously written off	464	-	-	464
Balance at the end of the period	33,783	5,032	3,303	42,118

20. Financial instruments

	30.9.2014	31.12.2013	30.9.2013
Bonds and debt instruments	65,698	62,171	131,511
Shares and equity instruments with variable income	25,277	17,449	17,748
Derivatives	1,306	1,070	1,080
Securities used for hedging	6,942	5,851	4,048
Financial instruments	99,223	86,541	154,387

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21. Financial assets and financial liabilities

30.9.2014	Amortised cost	Trading	Designated at fair value	Total
Loans				
Cash and balances with Central Bank	33,335	-	-	33,335
Loans to credit institutions	108,621	-	-	108,621
Loans to customers	652,598	-	-	652,598
Loans	794,554	-	-	794,554
Bonds and debt instruments				
Listed	-	5,537	58,379	63,916
Unlisted	-	34	1,748	1,782
Bonds and debt instruments	-	5,571	60,127	65,698
Shares and equity instruments with variable income				
Listed	-	1,849	8,639	10,488
Unlisted	-	1,487	11,285	12,772
Bond funds with variable income	-	725	1,292	2,017
Shares and equity instruments with variable income	-	4,061	21,216	25,277
Derivatives				
OTC derivatives	-	1,306	-	1,306
Derivatives	-	1,306	-	1,306
Securities used for hedging				
Bonds and debt instruments	-	2,108	-	2,108
Shares and equity instruments with variable income	-	4,834	-	4,834
Securities used for hedging	-	6,942	-	6,942
Other financial assets	5,208	-	-	5,208
Financial assets	799,762	17,880	81,343	898,985
Liabilities at amortised cost				
Due to credit institutions and Central Bank	21,131	-	-	21,131
Deposits	482,518	-	-	482,518
Borrowings	191,947	-	-	191,947
Subordinated liabilities	31,205	-	-	31,205
Liabilities at amortised cost	726,801	-	-	726,801
Financial liabilities at fair value				
Short position in bonds	-	5,374	-	5,374
Short position in equity	-	59		59
Derivatives	-	605	-	605
Financial liabilities at fair value	-	6,038	-	6,038
Other financial liabilities	36,377	-	-	36,377
Financial liabilities	763,178	6,038	-	769,216

Arion Bank Interim Consolidated Financial Statements 30 September 2014 22 Amounts are in ISK millions

21. Financial assets and financial liabilities, continued

31.12.2013	Amortised cost	Trading	Designated at fair value	Total
Loans				
Cash and balances with Central Bank	37,999	-	-	37,999
Loans to credit institutions	102,307	-	-	102,307
Loans to customers	635,774	-	-	635,774
Loans	776,080	-	-	776,080
Bonds and debt instruments				
Listed	-	4,708	55,625	60,333
Unlisted	-	49	1,789	1,838
Bonds and debt instruments	-	4,757	57,414	62,171
Shares and equity instruments with variable income				
Listed	-	1,420	2,858	4,278
Unlisted	-	1,387	9,553	10,940
Bond funds with variable income	-	906	1,325	2,231
Shares and equity instruments with variable income	-	3,713	13,736	17,449
Derivatives				
OTC derivatives	-	1,070	-	1,070
Derivatives	-	1,070	-	1,070
Securities used for hedging				
Bonds and debt instruments	-	490	-	490
Shares and equity instruments with variable income	-	5,361	-	5,361
Securities used for hedging	-	5,851	-	5,851
Other financial assets	5,746	-	-	5,746
Financial assets	781,826	15,391	71,150	868,367
Liabilities at amortised cost				
Due to credit institutions and Central Bank	28,000	-	-	28,000
Deposits	471,866	-	-	471,866
Borrowings	204,568	-	-	204,568
Subordinated liabilities	31,918	-	-	31,918
Liabilities at amortised cost	736,352	-	-	736,352
Financial liabilities at fair value				
Short position in bonds	-	8,199	-	8,199
Derivatives	-	761	-	761
Financial liabilities at fair value	-	8,960	-	8,960
Other financial liabilities	36,747	-	-	36,747
Financial liabilities	773,099	8,960	-	782,059

Arion Bank Interim Consolidated Financial Statements 30 September 2014 23 Amounts are in ISK millions

21. Financial assets and financial liabilities, continued

30.9.2013	Amortised		Designated at fair	
Loans	cost	Trading	value	Total
Cash and balances with Central Bank	20,116	-	-	20,116
Loans to credit institutions	113,202	-	-	113,202
Loans to customers	576,204	-	-	576,204
Loans	709,522	-	-	709,522
Bonds and debt instruments				
Listed	-	4,264	41,303	45,567
Unlisted	-	50	85,894	85,944
Bonds and debt instruments	-	4,314	127,197	131,511
Shares and equity instruments with variable income				
Listed	-	1,665	2,711	4,376
Unlisted	-	1,297	8,458	9,755
Bond funds with variable income	-	2,043	1,574	3,617
Shares and equity instruments with variable income	-	5,005	12,743	17,748
Derivatives				
OTC derivatives	-	1,080	-	1,080
Derivatives	-	1,080	-	1,080
Securities used for hedging				
Bonds and debt instruments	-	755	-	755
Shares and equity instruments with variable income	-	3,293	-	3,293
Securities used for hedging	-	4,048	-	4,048
Other financial assets	4,037	-	-	4,037
Financial assets	713,559	14,447	139,940	867,946
Liabilities at amortised cost				
Due to credit institutions and Central Bank	28,548	-	-	28,548
Deposits	471,768	-	-	471,768
Borrowings	206,065	-	-	206,065
Subordinated liabilities	32,809	-	-	32,809
Liabilities at amortised cost	739,190	-	-	739,190
Financial liabilities at fair value				
Short position in bonds	-	8,860	-	8,860
Derivatives	-	974	-	974
Financial liabilities at fair value	-	9,834	-	9,834
Other financial liabilities	35,954	-	-	35,954
Financial liabilities	775,144	9,834	-	784,978

Included in unlisted Bonds and debt instruments designated at fair value at 30 September 2013 is the Drómi bond, which the Group received when acquiring deposits from SPRON hf. in March 2009 and was closed by contract at year end 2013.

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21. Financial assets and financial liabilities, continued

Bonds and debt instruments designated at fair value specified by issuer	30.9.2014	31.12.2013	30.9.2013
Financial and insurance activities	1,294	1,363	70,479
Public administration, human health and social activities	57,782	55,007	55,678
Corporates	1,051	1,044	1,040
Bonds and debt instruments designated at fair value	60,127	57,414	127,197

The total amount of pledged bonds at the end of the period was ISK 14.5 billion (31.12.2013: ISK 18.4 billion and 30.9.2013: ISK 20.8 billion). Pledged bonds comprised Icelandic Government Bonds that were pledged against funding received and included in Due to credit institutions and Central Bank as well as short positions included in Financial liabilities at fair value.

Settlement of Drómi Bond

At the end of 2013 the Bank reached an agreement with Eignasafn Seðlabanka Íslands ehf. (ESÍ) on the settlement of a bond issued by Drómi hf. in 2009, when deposits from SPRON were transferred to Arion Bank. The bond was secured with all Drómi's assets and also with a hold harmless statement from the Ministry of Finance and Economic Affairs. The bond was due in June 2014 with a possible extension to 2015. The agreement stated that the Bank would acquire loans to individuals held by Drómi hf., Frjálsi hf. (subsidiary of Drómi hf.) and Hilda hf. (entity held by ESÍ). The bond was fully settled in April 2014 through this agreement.

22. Fair value hierarchy

The Group uses the following hierarchy for determining and disclosing the fair value of assets and liabilities by valuation technique:

Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities;
Level 2: valuation techniques for which all significant inputs are market observable, either directly or indirectly; and
Level 3: valuation techniques which include significant inputs that are not based on observable market data.

For assets and liabilities that are recognised at fair value on a recurring basis, the Group determines whether transfers have occurred between Levels in the hierarchy by re-assessing categorisation (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting year.

Assets and liabilities recorded at fair value by level of the fair value hierarchy

30.9.2014

Assets at fair value	Level 1	Level 2	Level 3	Total
Bonds and debt instruments	25,989	38,551	1,158	65,698
Shares and equity instruments with variable income	10,000	15,083	194	25,277
Derivatives	-	1,306	-	1,306
Securities used for hedging	5,549	1,393	-	6,942
Investment property	-	-	2,901	2,901
Assets at fair value	41,538	56,333	4,253	102,124
Liabilities at fair value				
Short position in bonds	5,374	-	-	5,374
Short position in equity	59	-	-	59
Derivatives	-	605	-	605
Liabilities at fair value	5,433	605	-	6,038

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22. Fair value hierarchy, continued

31.12.2013

Assets at fair value	Level 1	Level 2	Level 3	Total
Bonds and debt instruments	21,411	39,531	1,229	62,171
Shares and equity instruments with variable income	3,570	13,441	438	17,449
Derivatives	-	1,070	-	1,070
Securities used for hedging	4,495	1,356	-	5,851
Investment property	-	-	28,523	28,523
Assets at fair value	29,476	55,397	30,190	115,063
Liabilities at fair value				
Short position in bonds	8,199	-	-	8,199
Derivatives	-	761	-	761
Liabilities at fair value	8,199	761	-	8,960

30.9.2013

Assets at fair value	Level 1	Level 2	Level 3	Total
Bonds and debt instruments	6,367	123,985	1,159	131,511
Shares and equity instruments with variable income	3,619	13,768	361	17,748
Derivatives	-	1,080	-	1,080
Securities used for hedging	2,418	1,630	-	4,048
Investment property	-	-	29,382	29,382
Assets at fair value	12,404	140,463	30,902	183,769
Liabilities at fair value				
Short position in bonds	8,860	-	-	8,860
Derivatives	-	974	-	974
Liabilities at fair value	8,860	974	-	9,834

There have been no transfers between Level 1 and Level 2 during the period (2013: none).

The level of the fair value hierarchy of assets is determined at the end of each reporting period.

Movements in Level 3 assets measured at fair value	Investment property		Financial assets		Total	
	30.9.2014	31.12.2013	30.9.2014	31.12.2013	30.9.2014	31.12.2013
Balance at the beginning of the period	28,523	28,919	1,667	1,935	30,190	30,854
Effects recognised in Statement of Comprehensive Income	935	1,219	(320)	231	615	1,450
Additions	178	1,804	5	-	183	1,804
Disposal	(26,735)	(3,419)	-	(407)	(26,735)	(3,826)
Transfers out of Level 3	-	-	-	(92)	-	(92)
Balance at the end of the period	2,901	28,523	1,352	1,667	4,253	30,190

On 30 June the Bank sold its subsidiary Landfestar ehf. resulting in a total decrease in investment property by ISK 23.1 billion.

The effects of Level 3 assets recognised in the Interim Consolidated Statement of Comprehensive Income are included in the following line items:

	2014	2013
	1.1.-30.9.	1.1.-31.12.
Net interest income	54	82
Net financial income	(374)	149
Other operating income	935	1,219
Effects through the Consolidated Statement of Comprehensive Income	615	1,450

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22. Fair value hierarchy, continued

Carrying values and fair values of financial assets and financial liabilities that are not carried at fair value in the Interim Consolidated Financial Statements. The table does not include the fair values of non-financial assets and non-financial liabilities.

30.9.2014	Carrying value	Fair value	Unrealised gain (loss)
Financial assets not carried at fair value			
Cash and balances with Central bank	33,335	33,335	-
Loans to credit institutions	108,621	108,621	-
Loans to customers	652,598	659,992	7,394
Other financial assets	5,208	5,208	-
Financial assets not carried at fair value	799,762	807,156	7,394
Financial liabilities not carried at fair value			
Due to credit institutions and Central bank	21,131	21,131	-
Deposits	482,518	482,675	(157)
Borrowings	191,947	181,065	10,882
Subordinated loans	31,205	31,205	-
Other financial liabilities	36,377	36,377	-
Financial liabilities not carried at fair value	763,178	752,453	10,725
31.12.2013			
Financial assets not carried at fair value			
Cash and balances with Central bank	37,999	37,999	-
Loans to credit institutions	102,307	102,307	-
Loans to customers	635,774	643,994	8,220
Other financial assets	5,746	5,746	-
Financial assets not carried at fair value	781,826	790,046	8,220
Financial liabilities not carried at fair value			
Due to credit institutions and Central bank	28,000	28,000	-
Deposits	471,866	472,063	(197)
Borrowings	204,568	196,981	7,587
Subordinated loans	31,918	31,918	-
Other financial liabilities	36,747	36,747	-
Financial liabilities not carried at fair value	773,099	765,709	7,390

Financial assets and financial liabilities predominantly bear interest at floating rates. For assets and liabilities not at floating rates fair value is determined by Level 2 methods for which the valuation input is market observable interest rates.

Retail mortgages are estimated by using the discount cash flow method with the interest rates offered on new loans, taking into account mortgaging. Defaulted loans are estimated at book value as no future cash flow is expected on them. Instead they are written down according to their estimated potential recovery value. Other loans, including corporate loans, are estimated at book value as they are generally of a shorter duration than retail mortgages and the interest rate risk on them is therefore limited.

The estimate of the fair value of loans has changed from last year, as the Bank now uses improved methodology. When the methodology was updated it took into account recent transactions with the ESÍ loan portfolio.

Comparative figures year end 2013 have been changed. Figures for 30 September 2013 are not available.

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22. Fair value hierarchy, continued

Derivatives	Fair value	
30.9.2014	Assets	Liabilities
Forward exchange rate agreements, unlisted	185	78
Interest rate and exchange rate agreements, unlisted	267	169
Bond swap agreements, unlisted	20	29
Share swap agreements, unlisted	401	313
Options - purchased agreements, unlisted	433	16
Derivatives	1,306	605

31.12.2013		
Forward exchange rate agreements, unlisted	68	20
Interest rate and exchange rate agreements, unlisted	518	42
Bond swap agreements, unlisted	4	54
Share swap agreements, unlisted	33	632
Options - purchased agreements, unlisted	447	13
Derivatives	1,070	761

30.9.2013		
Forward exchange rate agreements, unlisted	48	24
Interest rate and exchange rate agreements, unlisted	217	74
Bond swap agreements, unlisted	9	839
Share swap agreements, unlisted	346	33
Options - purchased agreements, unlisted	460	4
Derivatives	1,080	974

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23. Offsetting financial assets and financial liabilities

Financial assets subject to enforceable master netting arrangements and similar arrangements

Reverse repurchase agreements have been made for assets amounting to ISK 6,564 millions (31.12.2013: ISK 10,381 millions) to meet short positions on derivative contracts amounting to ISK 5,374 millions (31.12.2013: ISK 8,199 millions). Derivatives are lower compared to year end nettings. Due to the settlement of Drómi bond there is no netting of Deposits against Other assets at the end of

Accounting policies for offsetting are provided in Note 53 in the Annual Financial Statements for 2013.

24. Investments in associates

The Group's interest in its principal associates	30.9.2014	31.12.2013	30.9.2013
Auðkenni hf., Borgartún 31, 105 Reykjavík, Iceland	20.0%	20.0%	20.0%
Bakkavör Group Ltd., West Marsh Road, Spalding, Lincolnshire, United Kingdom	45.8%	45.8%	30.1%
Eik fasteignafélag hf., Álfheimum 74, 104 Reykjavík, Iceland	23.9%	-	-
Farice ehf., Smáratorg 3, 201 Kópavogur, Iceland	39.3%	39.3%	43.5%
GO fjárfesting ehf., Undirheimar, 845 Flúðir, Iceland	-	30.0%	30.0%
Klakki ehf., Ármúli 1, 108 Reykjavík, Iceland	31.8%	31.8%	31.8%
Reiknistofa bankanna hf., Katrínartúni 2, 150 Reykjavík, Iceland	21.7%	21.7%	21.7%
Reitir fasteignafélag hf., Kringlan 4-12, 103 Reykjavík, Iceland	42.7%	42.7%	42.7%
Sementsverksmiðjan ehf., Mánabraut 20, 300 Akranes, Iceland	-	23.6%	23.6%
Skipti hf., Ármúla 25, 108 Reykjavík, Iceland	38.3%	38.3%	38.2%
SMI ehf., Smáratorg 3, 200 Kópavogur, Iceland	-	-	39.1%

Investments in associates			
Carrying amount at the beginning of the period	17,929	7,050	7,050
Additions	3,975	8,903	7,386
Dividend	(16)	(10)	(10)
Exchange difference	164	-	-
Share of profit (loss) of associates and changes in impairment	(27)	1,986	430
Investment in associates	22,025	17,929	14,856

At the end of June the Bank sold all shares in the subsidiary Landfestar ehf. to Eik fasteignafélag hf. and in return the Bank received 44% share in Eik fasteignafélag hf. In July the Bank sold 20% shareholding in Eik fasteignafélag hf. The sale had no effects on the Interim Consolidated Statement of Comprehensive Income.

On 27 June the Bank sold its shareholding in GO fjárfesting ehf. The sale had no effects on the Interim Consolidated Statement of Comprehensive Income.

On 27 March the shareholders of Sementsverksmiðjan ehf. agreed on a write down of all of issued shares of Sementsverksmiðjan ehf. After the write down the Bank's shareholding is nil.

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NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

25. Tax assets and tax liabilities

	30.9.2014		31.12.2013		30.9.2013	
	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities
Current tax	-	5,741	-	3,698	-	3,726
Deferred tax	660	362	818	1,226	702	1,089
Tax assets and tax liabilities	660	6,103	818	4,924	702	4,815

26. Other assets

	30.9.2014	31.12.2013	30.9.2013
Non-current assets and disposal groups held for sale	4,210	10,046	9,931
Property and equipment	6,938	6,943	7,165
Accounts receivable	3,651	4,610	2,296
Prepaid expenses	926	690	1,402
Accrued income	733	619	623
Unsettled securities trading	505	255	724
Sundry assets	508	413	606
Other assets	17,471	23,576	22,747

Non-current assets and disposal groups held for sale			
Legal entities	-	300	302
Associates	-	5,457	5,820
Real estates	4,174	4,150	3,610
Other assets	36	139	199
Non-current assets and disposal groups held for sale	4,210	10,046	9,931

The legal entities and associates were acquired exclusively with view to resale and are classified as disposal groups held for sale in accordance with IFRS 5.

In April 2014 the Bank sold 18.8% share in HB Grandi hf. in connection with the listing of the company on NASDAQ OMX Iceland. Prior to the sale the Bank held 31% share in HB Grandi. The financial effects from the sale is recognised in the Interim Consolidated Statement of Comprehensive Income. The shareholding in HB Grandi hf. as at 30 September is classified as listed shares designated at fair value among Financial instruments.

Real estates and other assets classified as non-current assets are generally the result of foreclosures on companies and individuals.

	30.9.2014	31.12.2013	30.9.2013
Liabilities associated with the legal entities held for sale	190	567	591

27. Other liabilities

Accounts payable	18,829	19,264	18,448
Provision for settled FX loans	2,842	4,524	6,817
Unsettled securities trading	528	144	213
Depositors' and investors' guarantee fund	2,872	2,886	2,869
Insurance claim	2,341	2,266	2,248
Withholding tax	490	1,552	387
Non-current liabilities and disposal groups held for sale	190	567	591
Bank levy	4,887	2,835	685
Sundry liabilities	10,485	9,629	9,960
Other liabilities	43,464	43,667	42,218

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28. Borrowings

	Issued	Maturity	Maturity type	Terms of interest	30.9.2014	31.12.2013	30.9.2013
Covered bond in ISK	2013	2019	At maturity	Fixed, CPI linked, 2.50%	4,501	4,453	2,978
Covered bond in ISK	2012	2015	At maturity	Fixed, 6.50%	14,754	4,378	4,449
Covered bond in ISK	2012	2034	Amortizing	Fixed, CPI linked, 3.60%	2,531	2,603	2,561
Covered bond in ISK	2008	2045	Amortizing	Fixed, CPI linked, 4.00%	6,222	21,361	21,293
Covered bond in ISK	2008	2031	Amortizing	Fixed, CPI linked, 4.00%	-	4,934	4,948
Covered bond in ISK	2006	2048	Amortizing	Fixed, CPI linked, 3.75%	78,230	77,894	77,614
Covered bond in ISK	2005	2033	Amortizing	Fixed, CPI linked, 3.75%	17,675	17,873	17,898
Covered bonds					123,913	133,496	131,741
Senior unsecured bond in NOK	2013	2016	At maturity	Floating, NIBOR + 5.00%	9,343	9,356	9,856
Senior unsecured bond in ISK	2010	2018	Amortizing	Floating, REIBOR + 1.00%	2,445	2,662	2,990
Senior unsecured bond in EUR	2009	2018	Amortizing	Floating, EURIBOR +1.00%	1,924	2,202	2,501
Secured bond, Landfestar in ISK	2010	2044	Amortizing	Fixed, CPI linked, 4.70%	-	2,932	2,965
Bonds issued					13,712	17,152	18,312
Central Bank, secured, various curr.	2010	2022	At maturity	Floating, LIBOR + 3.00%	53,991	52,998	55,478
Other					331	922	534
Other loans					54,322	53,920	56,012
Borrowings					191,947	204,568	206,065

Book value of listed bonds was ISK 31,129 million (31.12.2013: ISK 23,770 million and 30.9.2013: ISK 19,894 million) at the end of the period. Market value of those bonds was ISK 31,286 million (31.12.2013: ISK 24,472 million and 30.9.2013: ISK 20,383 million).

The Group repurchased own covered bond of ISK 20,000 million (2013: nil) and issued new covered bond amounting to ISK 10,000 million during the period.

At the end of June 2014 the Bank sold its subsidiary Landfestar ehf. as described in Note 3.

29. Subordinated liabilities

	Issued	Maturity	Maturity type	Terms of interest	30.9.2014	31.12.2013	30.9.2013
Tier II capital in various currencies	2010	2020	At maturity	Floating, LIBOR + 4.00%*	31,205	31,918	32,809
Subordinated liabilities					31,205	31,918	32,809

* In 2015 and thereafter 3 month EURIBOR/LIBOR +500 basis points.

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30. Pledged assets

Pledged assets against liabilities	30.9.2014	31.12.2013	30.9.2013
Assets, pledged as collateral against borrowings	227,581	258,762	262,389
Assets, pledged as collateral against loans from credit institutions and short positions	14,496	18,440	20,801
Pledged assets against liabilities	242,077	277,202	283,190

The Group has pledged assets against borrowings, both issued covered bonds and other issued bonds and loan agreements. The total value of those pledged assets was ISK 228 billion at the end of the period (31.12.2013: ISK 259 billion and 30.9.2013: ISK 262 billion). Those assets were mainly pool of mortgage loans to individuals, loans to municipals and loans to state related entities. The book value of those borrowings was ISK 178 billion at the end of the period (31.12.2013: ISK 190 billion and 30.9.2013: ISK 187 billion).

Assets are primarily pledged against borrowings associated with the acquisition of the pledged assets. Two major events are most significant. Assets were acquired from the Central Bank of Iceland in conjunction with the recapitalization of Arion Bank on 8 January 2010 and a portfolio of mortgages was acquired from Kaupthing hf. and is pledged against a structured covered bond that Arion Bank took over as issuer of from Kaupthing hf. at the end of 2011.

The Group has pledged bonds against short term lending from the Central Bank of Iceland and against short positions, related to swap agreements, to hedge market risk of those assets.

31. Equity

Share capital and share premium

According to the Bank's Articles of Association, total share capital amounts to ISK 2,000 million, with par value of ISK 1 per share. The holders of ordinary shares are entitled to receive dividends as approved by the general meeting and are entitled to one vote per share at Shareholders' meetings.

	Number (million)	30.9.2014	Number (million)	31.12.2013	Number (million)	30.9.2013
Issued share capital	2,000	75,861	2,000	75,861	2,000	75,861

Share premium represents excess of payment above nominal value that Shareholders have paid for shares issued by Arion banki hf.

Other reserves	30.9.2014	31.12.2013	30.9.2013
Statutory reserve	1,637	1,637	1,637
Foreign currency translation reserve	(4)	-	-
Other reserves	1,633	1,637	1,637

OFF BALANCE SHEET INFORMATION

32. Obligations

Guarantees, unused overdraft and loan commitments the Group has granted its customers	30.9.2014	31.12.2013	30.9.2013
Guarantees	10,534	9,922	9,966
Unused overdrafts	38,283	37,371	36,713
Loan commitments	90,897	48,585	69,725

Depositors' and Investors' Guarantee fund

The Icelandic parliament has discussed a bill on a new Depositors' and Investors' Guarantee Fund, without conclusion of the matter. Due to uncertainty of the shape of future legislation the liability brought forward from previous years is not changed from the balance of ISK 2,669 million. The Group has granted the Fund a guarantee for obligations amounting to ISK 3,210 million.

33. Assets under management and under custody

	30.9.2014	31.12.2013	30.9.2013
Assets under management	908,262	895,457	900,214
Assets under custody	1,367,718	1,490,888	1,414,477

34. Legal matters

The Group has formal controls and policies for managing legal claims. Once professional advice has been obtained and the amount of loss reasonably estimated, the Group makes adjustments, if appropriate, to account for any adverse effects which the claims may have on its financial standing. At the end of the period, the Group had several unresolved legal claims.

i) Contingent liabilities

Investigation and legal proceedings regarding alleged breaches of competition law

The Icelandic Competition Authority (ICA) has opened a formal investigation into practices of all card issuers in Iceland, including the Bank, and by two card payment acquirers, including Valitor. The investigation was initiated by a complaint by Kortaþjónustan hf., a card payment acquirer, in 2009. The case concerns alleged concerted practices through associations of undertakings connected to decisions on multilateral interchange fees and alleged anti-competitive practices towards competitors in the field of acquiring.

The ICA has also opened a formal investigation into the alleged abuse of an alleged collective dominant position by the three largest retail banks in Iceland, including the Bank. The investigation was initiated by separate complaints from BYR hf. and MP banki hf. made in 2010. The complaints from BYR hf. and MP banki hf. concern the terms of the Banks' mortgage arrangements, which, according to the complaint, deter individuals from moving their business to other banks and thereby restrict competition.

The extent of the investigations and outcome of the cases before the ICA is still uncertain as well as any effect on the Group. However, if the Bank or Valitor will be deemed to have violated the Competition Act, it could result in a fine or restrictions by the ICA.

In April 2013 the ICA imposed a ISK 500 million fine on Valitor for abusing its dominant position on the payment card market and violating conditions set in an earlier decision of the Authority. Valitor appealed the decision to the Competition Appeals Committee. In October 2013 the Committee confirmed the decision of the Competition Authority. Valitor has referred the decision to the courts of law for annulment.

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34. Legal matters, continued

In 2012 Kortaþjónustan hf. filed a suit against Valitor claiming damages for the alleged loss suffered by Kortaþjónustan hf. due to alleged breaches of competition law based on a settlement made by Valitor with the ICA, published in ICA decision No 4/2008. The case is still being contested before the District Court of Reykjavík. In July 2013 Kortaþjónustan hf. filed another suit, now against the Bank and Valitor, as well as Landsbanki, Íslandsbanki and Borgun hf., claiming damages for the alleged loss suffered by Kortaþjónustan hf. in relation to the alleged breaches of competition law based on the complaint to the ICA in 2009, stated above. The case is being contested before the District Court of Reykjavík.

Legal proceedings regarding the Bank's variable interest rate

Two borrowers have issued summons against the Group where they claim that a clause in their mortgage loan (in foreign currency), where it is stated that the bond shall bear a variable interest rate, which the Bank was authorised to change, is illegal and unbinding. The borrowers make e.g. the claim that it will be recognised by the court that said clause on interest rates is illegal. With a judgment of the District Court of Reykjavík on 20 December 2013 the Group was acquitted. The judgment was appealed to the Supreme Court of Iceland and the Bank was acquitted with a judgement on 6 November 2014.

Legal proceedings regarding damages

The former chairman of the Board of BM Vallá hf., together with Lindarflöt ehf., have filed two cases against the Bank claiming damages which they believe they suffered because of the conduct of the Bank's employees in connection with the bankruptcy of BM Vallá and its subsidiary, Fasteignafélagið Ártún ehf. In the two cases the plaintiffs claim in total damages in the amount of over four billion ISK plus further specified interests. The plaintiffs claim that the Bank caused them, as shareholders of BM Vallá and Fasteignafélagið Ártún, damage by not granting the companies financial restructuring and thereby forcing the companies into bankruptcy. The Bank believes more than less likely that it will be acquitted of the plaintiff's claims in both cases and has therefore made no provision.

ii) Other legal matters

Legal proceedings regarding CPI loans

In 2013 the Supreme Court of Iceland requested an Advisory Opinion from the EFTA Court in two separate cases regarding the interpretation of certain provisions of EC directives, in cases where the disagreement is whether the CPI-indexation of a consumer loan and its presentation is in accordance with certain provisions of Icelandic law on contracts and consumer loans. An Advisory Opinion in one of those cases was published 28 August 2014 where it was stated that the EC directive does not in general prohibit the indexation of consumer loans and that it was up to the domestic courts to assess whether the terms of such loans were fair. This case is now pending the ruling of a district court in Iceland. The other case was presented to the EFTA Court 11 June 2014 and the Advisory Opinion will be published 24 November 2014. It is difficult to predict the likely outcome in these cases. If successful in a court case, one possible outcome is that a debtor would receive a part or all of the CPI-indexation of his loan annulled. The Group considers the possibility of this happening unlikely and has therefore made no provision due to this.

Act no 35/2014 on "adjustment" of CPI-indexed mortgage loans

In May 2014 the Icelandic Parliament passed a bill on adjustment of CPI-indexed mortgage loans, Act no 35/2014. The Act entails that all individuals who had indexed mortgage loans in 2008-2009 can apply to have their loans reduced by the amount corresponding to the difference between real inflation compensation and adjusted inflation compensation. The adjusted figure can be a maximum of ISK 4 million for each household and if borrowers have already had some of their mortgage written down, that amount will be subtracted from the figure being adjusted. When the amount has been adjusted, the current loans of the borrower in question will be reduced by that amount and moved into a special "adjusted loan". The Treasury estimates to finish paying the adjusted part of the loan in the beginning of the year 2016, provided that funding is obtained from the Parliament. The applications period is to 1st of September 2014 and the extent of the adjustment will be clearer after that date. In Article 2 of the Act it is expected that the Treasury will reach an agreement with the Bank on the execution and settlement of the adjustment and that the aim should be not to create any profit or loss to the Bank. Negotiation between the concerned parties has not been concluded.

35. The uncertainty regarding the book value of foreign currency loans

As summarized in Note 37 to the Annual Financial Statements 2013, the book value of foreign currency loans has been subject to uncertainty arising from various court cases and changes in law since the Group's formation in 2008. This uncertainty continues in 2014 and the Group constantly monitors judgments in court cases it is party to as well as other relevant court cases to refine its provisions on foreign currency loans.

After consideration of such judgments, the Group has provisioned a total amount of ISK 22.3 billion of which ISK 18.9 billion have been written-off since 2011.

Although there is more clarity in the matters of foreign currency loans, due to the judgments pronounced by the Supreme Court of Iceland in 2013, there still remains uncertainty regarding those loans, e.g. what interest rate foreign currency-linked loans should bear from the date they are recalculated and until their final maturity. Nevertheless, the Group considers its portfolio of foreign currency-linked loans fully provisioned for the most likely outcome.

36. Events after Balance Sheet date

In October the Bank finished offering of 6 months bills. Total offers amounted to ISK 3,690 million and the Bank accepted offers amounting to ISK 2,120 million at 6.00% interest. The bills have been admitted for trading on NASDAQ OMX Iceland.

In November the Bank finished offering of 6 months bills. Total offers amounted to ISK 480 million and the Bank accepted all the offers at 5.80% interest. The aim is to list the bonds at NASDAQ OMX Iceland by the end of November.

RELATED PARTY

37. Related party

The Group has a related party relationship with Kaupskil ehf., being the ultimate controlling party with 87% stake in Arion Bank, the Board of Directors of Kaupskil ehf. and Kaupthing hf., being the parent company of Kaupskil ehf.

Icelandic State Financial Investments (ISFI, a separate state institution under the Ministry of Finance) manages a 13% stake in Arion Bank and thus has influence over the Group. ISFI and related entities are defined as related parties.

The Board of Directors of Arion Bank, key Management personnel of the Bank and the Group's associates are defined as related parties, as well as close family members of individuals referred to above and legal entities controlled by them.

No unusual transactions took place with related parties during the period. Transactions with related parties have been conducted on an arm's length basis. There have been no further guarantees provided or received for related party receivables or payables.

Balances with related parties			Net
30.9.2014	Assets	Liabilities	balance
Shareholders with control over the Group	556	(68,010)	(67,454)
Board of Directors and key Management personnel	254	(66)	188
Associates and other related parties	49,662	(19,693)	29,969
Balances with related parties	50,472	(87,769)	(37,297)
31.12.2013			
Shareholders with control over the Group	554	(63,949)	(63,395)
Shareholders with influence over the Group	19	(2,003)	(1,984)
Board of Directors and key Management personnel	228	(68)	160
Associates and other related parties	36,546	(19,015)	17,531
Balances with related parties	37,347	(85,035)	(47,688)
30.9.2013			
Shareholders with control over the Group	567	(63,309)	(62,742)
Shareholders with influence over the Group	-	(3,951)	(3,951)
Board of Directors and key Management personnel	192	(91)	101
Associates and other related parties	48,830	(21,099)	27,731
Balances with related parties	49,589	(88,450)	(38,861)

Through the ownership of ISFI the Group has a related party relationship with Landsbanki Íslands hf. Landsbanki Íslands hf. provides banking services to the Bank's subsidiary Valitor hf. The Group holds assets amounting to ISK 11,666 million (31.12.2013: ISK 12,185 million and 30.9.2013: ISK 10,719 million) by Landsbanki Íslands hf. and liabilities amounting to ISK 5,744 million (31.12.2013: ISK 7,234 million and 30.9.2013: ISK 6,878 million). Those amounts are not included in the table above.

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RISK MANAGEMENT DISCLOSURES

The Group faces various risks arising from its day to day operations. Managing risk is therefore a core activity within the Group. The key to effective risk management is a process of on-going identification of significant risk, quantification of risk exposure, actions to limit risk and constant monitoring of risk. This process of risk management and the ability to evaluate, manage and correctly price the risk encountered is critical to the Group's continuing profitability as well as to be able to ensure that the Group's exposure to risk remains within acceptable levels.

Further information regarding risk management is available in the Annual Consolidated Financial Statements for 2013 and in the Pillar 3 Risk Disclosures for 2013, published on the Bank's website, www.arionbanki.is. The Pillar 3 Risk Disclosures are not audited.

38. Credit risk

Credit risk is the risk that the Group will incur a loss because its customers or counterparties fail to discharge their contractual obligations.

Credit risk arises anytime the Group commits its funds, resulting in capital or earnings being dependent on counterparty, issuer or borrower performance. Loans to customers and credit institutions are the largest source of credit risk. Credit risk is also inherent in other types of assets, such as bonds and debt instruments, and off balance sheet items such as commitments and guarantees.

Maximum exposure to credit risk

The following table shows the maximum exposure to credit risk for the components of the Interim Consolidated Statement of Financial Position, at the end of the reporting period before the effect of mitigation due to collateral agreements or other credit enhancements.

Maximum exposure to credit risk related to on-balance sheet items	30.9.2014	31.12.2013	30.9.2013
Cash and balances with Central Bank	33,335	37,999	20,116
Loans to credit institutions	108,621	102,307	113,202
Loans to customers	652,598	635,774	576,204
Financial instruments	69,112	63,731	133,346
Other assets with credit risk	5,208	5,746	4,037
Total on-balance sheet maximum exposure to credit risk	868,874	845,557	846,905
Maximum exposure to credit risk related to off-balance sheet items			
Financial guarantees	10,534	9,922	9,966
Unused overdrafts	38,283	37,371	36,713
Loan commitments	90,897	48,585	69,725
Total off-balance sheet maximum exposure to credit risk	139,714	95,878	116,404
Maximum exposure to credit risk	1,008,588	941,435	963,309

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38. Credit risk, continued

Loans to customers specified by sectors	30.9.2014	31.12.2013	30.9.2013
Individuals	49.1%	48.8%	44.5%
Real estate activities and construction	15.0%	13.1%	13.5%
Fishing industry	10.7%	9.6%	10.4%
Information and communication technology	3.6%	3.8%	4.3%
Wholesale and retail trade	8.0%	8.7%	8.2%
Financial and insurance activities	4.5%	4.3%	5.9%
Industry, energy and manufacturing	3.8%	3.5%	4.0%
Transportation	0.9%	3.0%	3.4%
Services	2.7%	3.1%	3.5%
Public administration, human health and social activities	0.9%	1.4%	1.5%
Agriculture and forestry	0.8%	0.7%	0.8%
	100.0%	100.0%	100.0%

Collateral and other credit enhancements

The amount and type of collateral required depends on an assessment of the credit risk of the counterparty and the exposure type. The main types of collateral obtained are as follows:

- Retail loans to individuals: Mortgages in residential properties.
- Corporate loans: Charges over real estate properties, fishing vessels and other fixed and current assets, inventory and trade receivables, cash and securities.
- Derivative exposures: Cash, treasury notes and bills, asset backed bonds, listed equity and funds that consist of eligible securities.

Collateral value is monitored and additional collateral requested in accordance with the underlying agreement. Collateral value is reviewed in line with the adequacy of the allowance for impairment losses.

Collateral held by the Bank against different types of financial assets

30.9.2014	Cash and securities	Real estates	Fishing vessels	Other collateral	Total collateral
Cash and balances with Central Bank	-	-	-	-	-
Loans to credit institutions	-	-	-	-	-
Loans to customers					
Individuals	543	278,205	47	837	279,632
Real estate activities and construction	1,260	67,861	12	2,229	71,362
Fishing industry	91	2,281	53,591	3,220	59,183
Information and communication technology	31	1,840	-	19,889	21,760
Wholesale and retail trade	380	14,328	4	31,726	46,438
Financial and insurance activities	11,434	997	-	8,026	20,457
Industry, energy and manufacturing	1,002	9,055	49	9,213	19,319
Transportation	91	589	63	3,415	4,158
Services	584	2,708	95	8,808	12,195
Public administration, human health and social activities	59	3,674	-	179	3,912
Agriculture and forestry	6	2,408	-	132	2,546
Financial instruments	2,672	-	-	-	2,672
Collateral held against different types of financial assets	18,153	383,946	53,861	87,674	543,634

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38. Credit risk, continued

31.12.2013	Cash and securities	Real estates	Fishing vessels	Other collateral	Total collateral
Cash and balances with Central Bank	-	-	-	-	-
Loans to credit institutions	-	-	-	-	-
Loans to customers					
Individuals	659	269,700	49	362	270,770
Real estate activities and construction	3,887	55,427	12	1,053	60,379
Fishing industry	89	3,039	52,878	2,361	58,367
Information and communication technology	26	1,842	-	20,452	22,320
Wholesale and retail trade	6,664	10,095	5	28,447	45,211
Financial and insurance activities	12,416	441	-	9,116	21,973
Industry, energy and manufacturing	180	8,645	46	10,719	19,590
Transportation	69	563	51	2,310	2,993
Services	285	3,314	98	2,994	6,691
Public administration, human health and social activities	22	3,190	-	170	3,382
Agriculture and forestry	5	2,331	-	136	2,472
Financial instruments	2,867	-	-	-	2,867
Collateral held against different types of financial assets	27,169	358,587	53,139	78,120	517,015

30.9.2013	Cash and securities	Real estates	Fishing vessels	Other collateral	Total collateral
Cash and balances with Central Bank	-	-	-	-	-
Loans to credit institutions	-	-	-	-	-
Loans to customers					
Individuals	486	216,636	53	1,356	218,531
Real estate activities and construction	1,513	52,492	5	632	54,642
Fishing industry	1,860	2,490	51,696	2,058	58,104
Information and communication technology	24	818	-	22,032	22,874
Wholesale and retail trade	1,640	9,872	5	23,790	35,308
Financial and insurance activities	17,352	1,709	-	3,840	22,902
Industry, energy and manufacturing	168	7,907	1	11,505	19,580
Transportation	65	514	46	4,048	4,673
Services	279	3,307	71	2,718	6,375
Public administration, human health and social activities	33	3,580	-	123	3,736
Agriculture and forestry	5	2,278	-	177	2,460
Financial instruments	1,661	-	-	68,987	70,648
Collateral held against different types of financial assets	25,086	301,603	51,878	141,266	519,833

Information on collateral held at subsidiaries is not available.

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38. Credit risk, continued

Credit quality by class of financial assets	Neither past due nor impaired	Past due but not impaired	Individually impaired*	Total
30.9.2014				
Cash and balances with Central Bank	33,335	-	-	33,335
Loans to credit institutions	108,621	-	-	108,621
Loans to customers				
Loans to corporates	311,702	13,141	7,278	332,121
Loans to individuals	282,283	28,342	9,852	320,477
Financial instruments	69,112	-	-	69,112
Other assets with credit risk	5,208	-	-	5,208
Credit quality of loans	810,261	41,483	17,130	868,874
31.12.2013				
Cash and balances with Central Bank	37,999	-	-	37,999
Loans to credit institutions	102,307	-	-	102,307
Loans to customers				
Loans to corporates	304,880	9,789	10,614	325,283
Loans to individuals	268,485	34,607	7,399	310,491
Financial instruments	63,731	-	-	63,731
Other assets with credit risk	5,746	-	-	5,746
Credit quality of loans	783,148	44,396	18,013	845,557
30.9.2013				
Cash and balances with Central Bank	20,116	-	-	20,116
Loans to credit institutions	113,202	-	-	113,202
Loans to customers				
Loans to corporates	278,435	22,445	18,698	319,578
Loans to individuals	223,228	24,230	9,168	256,626
Financial instruments	133,346	-	-	133,346
Other assets with credit risk	4,037	-	-	4,037
Credit quality of loans	772,364	46,675	27,866	846,905

* The figures for individually impaired reflects both impairment due to legal uncertainty related to foreign currency loans as well as impairment due to a deterioration in the borrower's credit quality.

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38. Credit risk, continued

Neither past due nor impaired loans

The Bank uses internal credit rating models to monitor the development of credit risk and to estimate customers' probability of default (PD). The Bank rates customers with one of three models. For large corporates the Bank uses quantitative information based on financial statements as well as qualitative data. Credit ratings of individuals and SMEs are based on statistical models using historical information which has been found to be predictive.

The table below shows loans to customers which are neither past due nor impaired, broken down by the Bank's classification scale, where 5 denotes the highest risk. Comparative figures are not available for 30 September 2013.

	Risk classification						
30.9.2014	1	2	3	4	5	Not rated	Total
Individuals	48,905	136,141	57,315	23,964	8,316	7,642	282,283
Real estate activities and construction	850	30,957	41,214	8,367	2,102	9,240	92,730
Fishing industry	9,520	20,153	12,684	1,947	1,854	18,742	64,900
Information and communication technology	249	19,167	3,308	358	2	-	23,084
Wholesale and retail trade	7,510	15,183	20,280	2,074	1,924	3,524	50,495
Financial and insurance activities	287	730	12,241	362	8	10,183	23,811
Industry, energy and manufacturing	3,038	7,528	10,660	970	367	869	23,432
Transportation	772	3,504	860	508	3	263	5,910
Services	327	8,612	3,604	1,353	21	2,777	16,694
Public sector	151	3,222	927	383	36	1,090	5,809
Agriculture and forestry	141	717	1,323	974	494	1,188	4,837
Neither past due nor impaired loans	71,750	245,914	164,416	41,260	15,127	55,518	593,985
31.12.2013							
Individuals	12,201	68,291	120,751	53,841	9,978	3,422	268,484
Real estate activities and construction	1,889	4,924	37,703	6,848	708	27,612	79,684
Fishing industry	26,962	6,070	7,193	10,865	3,162	3,707	57,959
Information and communication technology	19,242	2,802	1,065	294	2	1,011	24,416
Wholesale and retail trade	12,130	9,550	18,057	3,384	1,644	6,395	51,160
Financial and insurance activities	102	9,178	1,429	211	-	12,721	23,641
Industry, energy and manufacturing	4,610	12,193	2,979	580	550	758	21,670
Transportation	197	17,404	573	458	87	244	18,963
Services	117	10,198	3,288	914	110	442	15,069
Public sector	85	3,335	917	178	38	4,052	8,605
Agriculture and forestry	162	480	1,636	769	11	656	3,714
Neither past due nor impaired loans	77,697	144,425	195,591	78,342	16,290	61,020	573,365

Exposures that are "Not rated" are primarily due to newly formed entities and entities for which the Bank's rating models are deemed unreliable. The credit rating for large corporates is based on annual statements and is valid for a maximum of 18 months after the financial date of those statements. Many ratings therefore lapse during Q3 and are not in all cases renewed in time for Q3 Financial Statements which can lead to a temporary increase in exposures that are classified as "Not rated".

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38. Credit risk, continued

Past due but not impaired loans by class of loans	Up to 30 days	31 to 60 days	61 to 90 days	More than 90 days	Total
30.9.2014					
Loans to corporates	8,782	2,469	223	1,667	13,141
Loans to individuals	12,001	4,039	1,028	11,274	28,342
Past due but not impaired loans	20,783	6,508	1,251	12,941	41,483
31.12.2013					
Loans to corporates	6,100	923	111	2,655	9,789
Loans to individuals	11,224	3,751	543	19,089	34,607
Past due but not impaired loans	17,324	4,674	654	21,744	44,396
30.9.2013					
Loans to corporates	9,135	2,867	741	9,703	22,445
Loans to individuals	9,495	4,650	428	9,657	24,230
Past due but not impaired loans	18,630	7,517	1,168	19,360	46,675

The majority of the past due but not impaired loans have been acquired at discount. These loans are not considered to be impaired unless the specific allowance exceeds the discount received.

Collateral repossessed

During the period, the Group took possession of real estates with the carrying value of ISK 892 million and other assets with the value of ISK 6 million, all which the Group is in the process of selling, see Note 26.

Impaired loans to customers specified by sector

	Loans impaired due to borrower credit quality		Loans impaired due to FX-loan court rulings			
30.9.2014	Impair-ment amount	Loan carrying amount	Impair-ment amount	Loan carrying amount	Total im-pairment amount	Total loan carrying amount
Individuals	10,542	20,299	60	155	10,602	20,454
Real estate activities and construction	1,727	3,712	-	-	1,727	3,712
Fishing industry	415	665	458	1,547	873	2,212
Information and communication technology	235	235	-	-	235	235
Wholesale and retail trade	1,036	1,185	-	-	1,036	1,185
Financial and insurance activities	7,974	11,180	-	-	7,974	11,180
Industry, energy and manufacturing	354	470	-	-	354	470
Transportation	17	18	-	-	17	18
Services	363	585	21	21	384	606
Public administration, human health and social activities	27	35	-	-	27	35
Agriculture and forestry	94	346	10	10	104	356
	22,784	38,730	549	1,733	23,333	40,463

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38. Credit risk, continued

31.12.2013	Loans impaired due to borrower credit quality: Impairment amount	Loans impaired due to borrower credit quality: Loan carrying amount	Loans impaired due to FX-loan court rulings: Impairment amount	Loans impaired due to FX-loan court rulings: Loan carrying amount	Total impairment amount	Total loan carrying amount
Individuals	11,538	18,496	173	614	11,711	19,110
Real estate activities and construction	1,726	3,755	37	113	1,763	3,868
Fishing industry	617	1,899	612	1,870	1,229	3,769
Information and communication technology	164	190	-	-	164	190
Wholesale and retail trade	4,020	5,941	14	44	4,034	5,985
Financial and insurance activities	4,513	6,080	-	-	4,513	6,080
Industry, energy and manufacturing	446	996	17	33	463	1,029
Transportation	65	356	6	9	71	365
Services	775	1,865	43	53	818	1,918
Public administration, human health and social activities	8	35	-	-	8	35
Agriculture and forestry	352	790	-	-	352	790
	24,224	40,403	902	2,736	25,126	43,139

30.9.2013	Loans impaired due to borrower credit quality: Impairment amount	Loans impaired due to borrower credit quality: Loan carrying amount	Loans impaired due to FX-loan court rulings: Impairment amount	Loans impaired due to FX-loan court rulings: Loan carrying amount	Total impairment amount	Total loan carrying amount
Individuals	12,119	19,617	967	2,637	13,086	22,254
Real estate activities and construction	4,532	8,098	854	1,745	5,386	9,843
Fishing industry	1,578	2,481	989	3,230	2,567	5,711
Information and communication technology	190	227	47	56	237	283
Wholesale and retail trade	5,564	8,623	499	1,549	6,063	10,172
Financial and insurance activities	7,003	9,865	1,008	1,394	8,011	11,259
Industry, energy and manufacturing	739	1,424	77	224	816	1,648
Transportation	24	25	334	2,244	358	2,269
Services	1,196	1,510	137	331	1,333	1,841
Public administration, human health and social activities	27	36	101	132	128	168
Agriculture and forestry	812	1,110	18	123	830	1,233
	33,784	53,016	5,031	13,665	38,815	66,681

This note separates impairments that are due to the uncertainty related to foreign currency loans from impairments that are due to borrower credit quality. At year end 2013, a provision for losses due to court rulings for illegal FX loans was ISK 902 million, in addition to liability to customers of ISK 4,524 million. The provision is reduced to ISK 549 million and the liability to customers is ISK 2,842 million at 30 September 2014. Recalculation during the period resulted in an additional ISK 805 million impairment and ISK 1,158 million write-off or repayments.

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38. Credit risk, continued

Large exposure

A large exposure is defined as an exposure to a group of financially related borrowers which exceeds 10% of the Group's capital base net of eligible collateral according to FME rules No 625/2013.

The legal maximum for individual large exposures is 25% of the capital base and the sum of all large exposures cannot exceed 400% of the capital base.

The largest exposure to a group of connected clients at the end of the period was ISK 25 billion (31.12.2013: ISK 29 billion and 30.9.2013: ISK 29 billion) before taking account of eligible collateral. The Group has three large exposures at the end of the period (31.12.2013: three exposures and 30.09.2013: four exposures) net of eligible collateral.

	30.9.2014		31.12.2013		30.9.2013	
no.	Gross	Net	Gross	Net	Gross	Net
Drómi*	-	-	-	-	42%	0%
1	14%	14%	16%	16%	17%	17%
2	11%	11%	17%	17%	18%	18%
3	11%	11%	-	-	-	-
<10%	<10%	<10%	12%	12%	13%	13%
<10%	<5%	<5%	10%	<10%	<10%	<10%
<10%	<2%	<2%	10%	<10%	11%	11%
Sum of large exposure gross and net > 10%	36%	36%	65%	45%	101%	59%

* The Drómi bond, which the Group received when acquiring deposits from SPRON hf. in March 2009, was closed by contract at year end 2013.

No large exposure exceeds the legal limit of 25% of the Group's capital base at the end of the period.

The sum of exposures exceeding 10% of capital base is 36% of the Group's capital base before collateral mitigation or 36% net of eligible collateral, which is well below the 400% legal maximum.

39. Market risk

Market risk is the current or prospective risk where changes in financial market prices and rates will cause fluctuations in the value and cash flows of financial instruments.

Interest rate risk in the non-trading book

The following table shows the sensitivity of the Group's net present value of interest bearing assets and liabilities to changes in interest rates by currencies and interest fixing periods. Risk is quantified as the net change in value of interest bearing assets and liabilities when assuming a simultaneous parallel shift upwards of all yield curves by 100 basis points. The sensitivity does not relate to variation of annual net interest income.

30.9.2014	0-1Y	1-5Y	5-10Y	10-20Y	>20Y
ISK, CPI Indexed linked	(110)	(887)	(120)	(595)	(3,157)
ISK, Non Indexed linked	(13)	(856)	(30)	(22)	(14)
EUR	38	(207)	-	-	-
Other	(9)	(168)	(102)	-	-

31.12.2013					
ISK, CPI Indexed linked	(44)	(823)	32	(557)	(1,129)
ISK, Non Indexed linked	(103)	(480)	(28)	(29)	(17)
EUR	63	(1)	-	-	-
Other	(36)	-	-	-	-

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39. Market risk, continued

30.9.2013	0-1Y	1-5Y	5-10Y	10-20Y	>20Y
ISK, CPI Indexed linked	(37)	(827)	(7)	(357)	295
ISK, Non Indexed linked	(121)	(616)	(25)	(27)	(15)
EUR	65	(2)	-	-	-
Other	39	(3)	-	-	-

Interest rate risk in the trading book

Interest rate risk in the trading book is quantified in the same way as that of the non-trading book.

30.9.2014	0-1Y	1-5Y	5-10Y	10-20Y	>20Y
ISK, CPI Indexed linked	3	(3)	(43)	(1)	61
ISK, Non Indexed linked	43	(44)	(33)	(60)	-
EUR	(3)	-	-	-	-
Other	6	-	-	-	-
31.12.2013					
ISK, CPI Indexed linked	(11)	2	(0)	(34)	(92)
ISK, Non Indexed linked	(1)	(8)	(61)	(92)	-
EUR	1	-	-	-	-
Other	1	-	-	-	-
30.9.2013					
ISK, CPI Indexed linked	(15)	7	(80)	(21)	(215)
ISK, Non Indexed linked	(31)	8	(32)	5	-
EUR	(0)	-	-	-	-
Other	(2)	-	-	-	-

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39. Market risk, continued

Group's assets and liabilities at carrying amount by residual maturity

30.9.2014 Assets	Carrying amount	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	With no maturity
Cash and balances with Central Bank	33,335	24,463	-	8,872	-	-	-
Loans to credit institutions	108,621	45,263	63,358	-	-	-	-
Loans to customers	652,598	4,497	53,605	108,466	218,684	267,346	-
Financial instruments	99,223	8,813	5,133	1,802	48,956	4,407	30,112
Derivatives - assets leg	*33,764*	-	*21,693*	*5,834*	*6,237*	-	-
Derivatives - liabilities leg	*(32,458)*	-	*(20,823)*	*(5,568)*	*(6,067)*	-	-
Investment property	2,901	-	-	-	-	-	2,901
Investments in associates	22,025	-	-	-	-	-	22,025
Intangible assets	5,337	-	-	-	-	-	5,337
Tax assets	660	-	-	-	660	-	-
Other assets	17,471	852	3,190	28	1,126	13	12,262
Assets	942,171	83,888	125,286	119,168	269,426	271,766	72,637
Liabilities							
Due to credit institutions and Central Bank	21,131	15,151	185	5,744	51	-	-
Deposits	482,518	267,189	147,592	44,620	19,707	3,410	-
Financial liabilities at fair value	6,038	-	5,841	42	155	-	-
Derivatives - assets leg	*(13,587)*	-	*(11,292)*	*(1,547)*	*(748)*	-	-
Derivatives - liabilities leg	*14,192*	-	*11,700*	*1,589*	*903*	-	-
Short position bonds and derivatives	*2,488*	-	*2,488*	-	-	-	-
Short position bonds used for hedging	*2,945*	-	*2,945*	-	-	-	-
Tax liabilities	6,103	-	1,435	4,306	362	-	-
Other liabilities	43,464	99	30,810	628	4,732	107	7,088
Borrowings	191,947	-	1,690	16,693	26,201	147,363	-
Subordinated liabilities	31,205	-	-	-	-	31,205	-
Liabilities	782,406	282,439	187,553	72,033	51,208	182,085	7,088
Off-balance sheet items							
Guarantees	10,534	3,356	1,448	2,351	1,544	1,835	-
Unused overdraft	38,283	723	7,117	18,951	11,433	59	-
Loan commitments	90,897	1,442	24,188	19,662	45,605	-	-
Off-balance sheet items	139,714	5,521	32,753	40,964	58,582	1,894	-
Net interest sensitivity gap	20,051	(204,072)	(95,020)	6,171	159,636	87,787	65,549

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39. Market risk, continued

31.12.2013 Assets	Carrying amount	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	With no maturity
Cash and balances with Central Bank	37,999	28,666	-	9,333	-	-	-
Loans to credit institutions	102,307	47,197	55,110	-	-	-	-
Loans to customers	635,774	2,151	56,696	85,340	221,979	269,608	-
Financial instruments	86,541	6,889	1,240	13,349	38,569	3,684	22,810
Derivatives - assets leg	*23,567*	*447*	*8,008*	*4,094*	*11,018*	-	-
Derivatives - liabilities leg	*(22,497)*	-	*(7,918)*	*(3,893)*	*(10,686)*	-	-
Investment property	28,523	-	-	-	-	-	28,523
Investments in associates	17,929	-	-	-	-	-	17,929
Intangible assets	5,383	-	-	-	-	-	5,383
Tax assets	818	-	-	-	-	818	-
Other assets	23,576	53	4,014	693	973	13	17,830
Assets	938,850	84,956	117,060	108,715	261,521	274,123	92,475
Liabilities							
Due to credit institutions and Central Bank	28,000	17,692	3,622	6,636	50	-	-
Deposits	471,866	246,160	126,784	74,426	21,693	2,803	-
Financial liabilities at fair value	8,960	-	8,757	161	42	-	-
Derivatives - assets leg	*(18,830)*	-	*(16,322)*	*(911)*	*(1,597)*	-	-
Derivatives - liabilities leg	*19,592*	-	*16,881*	*1,072*	*1,639*	-	-
Short position bonds and derivatives	*2,837*	-	*2,837*	-	-	-	-
Short position bonds used for hedging	*5,362*	-	*5,362*	-	-	-	-
Tax liabilities	4,924	-	924	2,774	1,226	-	-
Other liabilities	43,667	371	28,344	5,098	2,671	263	6,919
Borrowings	204,568	-	1,868	2,319	27,779	172,602	-
Subordinated liabilities	31,918	-	-	-	-	31,918	-
Liabilities	793,903	264,223	170,299	91,414	53,461	207,586	6,919
Off-balance sheet items							
Guarantees	9,922	2,216	2,698	2,650	1,106	1,252	-
Unused overdraft	37,371	949	8,909	16,108	11,345	60	-
Loan commitments	48,585	3,301	25,011	14,198	6,075	-	-
Off-balance sheet items	95,878	6,466	36,618	32,956	18,526	1,312	-
Net interest sensitivity gap	49,069	(185,733)	(89,857)	(15,655)	189,534	65,225	85,556

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39. Market risk, continued

30.9.2013	Carrying amount	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	With no maturity
Assets							
Cash and balances with Central Bank	20,116	10,926	-	9,190	-	-	-
Loans to credit institutions	113,202	77,868	35,092	-	242	-	-
Loans to customers	576,204	3,811	51,829	85,844	206,035	228,685	-
Financial instruments	154,387	6,661	410	69,360	15,447	41,469	21,040
Derivatives - assets leg	*27,022*	*460*	*11,718*	*3,619*	*11,225*	-	-
Derivatives - liabilities leg	*(25,941)*	-	*(11,315)*	*(3,502)*	*(11,124)*	-	-
Investment property	29,382	-	-	-	-	-	29,382
Investments in associates	14,856	-	-	-	-	-	14,856
Intangible assets	5,348	-	-	-	-	-	5,348
Tax assets	702	-	-	-	702	-	-
Other assets	22,747	62	2,293	714	952	16	18,710
Assets	936,944	99,328	89,624	165,108	223,378	270,170	89,336
Liabilities							
Due to credit institutions and Central Bank	25,727	15,323	7,025	6,124	49	27	-
Deposits	466,834	252,058	147,056	43,928	26,233	2,493	-
Financial liabilities at fair value	10,005	-	9,759	16	59	-	-
Derivatives - assets leg	*(25,763)*	-	*(12,056)*	*(167)*	*(1,607)*	-	-
Derivatives - liabilities leg	*26,618*	-	*12,954*	*183*	*1,666*	-	-
Short position bonds and derivatives	*4,174*	-	*4,520*	-	-	-	-
Short position bonds used for hedging	*4,976*	-	*4,341*	-	-	-	-
Tax liabilities	4,049	-	932	2,794	1,089	-	-
Other liabilities	50,024	869	31,047	621	3,198	219	6,264
Borrowings	206,065	-	2,091	2,450	29,138	172,386	-
Subordinated liabilities	32,809	-	-	-	-	32,809	-
Liabilities	796,057	268,250	197,910	55,933	59,766	207,934	6,264
Off-balance sheet items							
Guarantees	9,966	1,831	1,847	3,628	1,411	1,249	-
Unused overdraft	36,713	816	6,215	18,246	11,341	95	-
Loan commitments	69,725	1,459	46,486	10,419	11,361	-	-
Off-balance sheet items	116,404	4,106	54,548	32,293	24,113	1,344	-
Net interest sensitivity gap	24,483	(173,028)	(162,834)	76,882	139,499	60,892	83,072

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39. Market risk, continued

Inflation risk

The Group is exposed to inflation risk when there is a mismatch between inflation linked assets and liabilities. The total amount of indexed assets amount to ISK 297.5 billion (31.12.2013: ISK 291.6 billion and 30.9.2013: ISK 263.0 billion) and the total amount of indexed liabilities amount to ISK 199.0 billion (31.12.2013: ISK 223.7 billion and 30.9.2013: ISK 219.9 billion).

The following table shows the transaction maturity profile of indexed assets and liabilities. In previous statements, the profile was based on residual maturity. The 30 September 2013 figures have therefore been updated to cash flow basis for accurate comparison. Financial instruments held for proprietary trading or for liquidity purposes are assumed to be on demand.

30.9.2014 Assets, CPI indexed linked	Up to 1 year	1 to 5 years	Over 5 years	Total
Loans to customers	24,900	71,895	196,693	293,488
Financial instruments	1,254	-	-	1,254
Off-balance sheet position	347	2,373	-	2,720
Assets, CPI indexed linked	26,501	74,268	196,693	297,462
Liabilities, CPI indexed linked				
Deposits	67,567	19,558	2,335	89,460
Borrowings	2,010	13,655	93,915	109,580
Liabilities, CPI indexed linked	69,577	33,213	96,250	199,040
Net on-balance sheet position	(43,423)	38,682	100,443	95,702
Net off-balance sheet position	347	2,373	-	2,720
CPI Balance 30.9.2014	(43,076)	41,055	100,443	98,422
CPI Balance 31.12.2013	(51,197)	46,693	72,380	67,876
CPI Balance 30.9.2013	(47,144)	53,422	36,757	43,035

Currency risk

Currency risk is the risk of loss due to adverse movements in foreign exchange rates. The Group is exposed to currency risk through a currency mismatch between assets and liabilities. ISK denominated deposits are a primary source of funding for the Group whereas a substantial part of the Group's assets consist of foreign currency denominated loans to customers. Net exposures per currency are monitored centrally in the Bank.

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39. Market risk, continued

Breakdown of assets and liabilities by currency at the end of the period

30.9.2014

Assets	ISK	EUR	USD	CHF	GBP	JPY	Other	Total
Cash and balances with Central Bank	30,966	597	1,090	311	85	48	238	33,335
Loans to credit institutions	23,620	17,582	13,653	2,046	15,551	9,476	26,693	108,621
Loans to customers	545,412	44,660	27,564	5,677	6,402	3,743	19,140	652,598
Financial instruments	73,968	15,958	7,278	18	1,966	2	33	99,223
Investment property	2,901	-	-	-	-	-	-	2,901
Investments in associates	16,185	-	-	-	5,840	-	-	22,025
Intangible assets	5,337	-	-	-	-	-	-	5,337
Tax assets	660	-	-	-	-	-	-	660
Other assets	16,720	518	130	-	63	-	40	17,471
Assets 30.9.2014	715,769	79,315	49,715	8,052	29,907	13,269	46,144	942,171

Liabilities and equity	ISK	EUR	USD	CHF	GBP	JPY	Other	Total
Due to credit inst. and Central Bank ..	15,378	1,952	685	1,140	5	1,971	-	21,131
Deposits	398,006	27,483	17,295	140	11,538	604	27,452	482,518
Financial liabilities at fair value	5,960	4	74	-	-	-	-	6,038
Tax liabilities	6,103	-	-	-	-	-	-	6,103
Other liabilities	36,075	1,540	2,625	79	633	394	2,118	43,464
Borrowings	126,689	1,924	21,336	14,537	8,702	9,416	9,343	191,947
Subordinated liabilities	-	24,878	2,421	-	3,906	-	-	31,205
Equity	159,765	-	-	-	-	-	-	159,765
Liabilities and equity 30.9.2014	747,976	57,781	44,436	15,896	24,784	12,385	38,913	942,171

	ISK	EUR	USD	CHF	GBP	JPY	Other
Net on-balance sheet position	(32,207)	21,534	5,279	(7,844)	5,123	884	7,231
Net off-balance sheet position	15,586	(14,032)	(2,208)	7,941	-	-	(7,287)
Net position 30.9.2014	(16,621)	7,502	3,071	97	5,123	884	(56)

31.12.2013

	ISK	EUR	USD	CHF	GBP	JPY	Other
Net on-balance sheet position	(45,886)	28,979	5,378	(2,327)	6,955	706	6,195
Net off-balance sheet position	14,256	(17,076)	924	3,569	1,069	792	(3,534)
Net position 31.12.2013	(31,630)	11,903	6,302	1,242	8,024	1,498	2,661

30.9.2013

	ISK	EUR	USD	CHF	GBP	JPY	Other
Net on-balance sheet position	(38,146)	28,473	4,021	(3,548)	3,747	740	4,713
Net off-balance sheet position	11,822	(17,742)	2,347	2,931	259	579	(196)
Net position 30.9.2013	(26,324)	10,731	6,368	(617)	4,006	1,319	4,517

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40. Liquidity risk

Liquidity risk is defined as the risk that the Group, though solvent, either does not have sufficient financial resources available to meet its liabilities when they fall due, or can secure them only at excessive cost. Liquidity risk arises from the inability to manage unplanned decreases or changes in funding sources.

Liquidity coverage ratio

On 1 December 2013 new liquidity rules issued by the Central Bank of Iceland took effect, overriding rules on liquidity and cash ratios that have previously been reported by the Group. The new rules are based on liquidity standards introduced in the Basel III Accord which are to be implemented in 2015 on a global level. The standard defines the Liquidity Coverage Ratio (LCR), which is the balance between highly liquid assets and the expected net cash outflow of the Group in the next 30 days under stressed conditions.

The criteria for liquid assets used to meet unexpected outflow is stricter for the new liquidity measure. The assets must be non-pledged, liquid and easily priced on the market, repoable at the Central Bank and not issued by the Group or related entities.

The Central Bank has set a guideline for minimum Liquidity Coverage Ratio. As at 1 January 2014, the LCR requirement is 100% in foreign currency and 70% in total (ISK and foreign currency). The latter benchmark increases by 10% every year until a 100% requirement is implemented in 2017.

Liquidity coverage ratio	30.9.2014	31.12.2013
FX	196%	274%
Total	137%	123%

No comparison is available for 30 September 2013 figures as the new LCR rules took effect 1 December 2013.

LCR deposit categorization

As per the LCR methodology, the Group's deposit base is split into different categories depending on customer type. A second categorization is used where term deposits refer to deposits with a residual maturity greater than 30 days. Deposits that can be withdrawn within 30 days are marked stable if the customer has a business relationship with the Group and the amount is covered by the Deposit Insurance Scheme. Other deposit funds are considered less stable. A weight is attributed to each category, representing the expected outflow under stressed conditions, i.e. the level of stickiness.

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40. Liquidity risk, continued

The table below shows the breakdown of the Group's deposit base according to the LCR categorization, with the associated expected stressed outflow weights. Some similar categories are grouped together.

LCR categorization - amounts and LCR outflow weights

30.9.2014	Deposits maturing within 30 days				Term	Total
	Less Stable	Weight (%)	Stable	Weight (%)	deposits*	deposits
Retail	79,288	10%	33,614	5%	55,681	168,583
SME	36,396	10%	3,952	5%	6,179	46,527
Operational relationship	1,310	25%	-	5%	8	1,318
Corporations	34,819	40%	831	20%	9,577	45,227
Sovereigns, central-banks and PSE	25,258	40%	-	-	2,832	28,090
Financial entities being wound up	22,010	100%	-	-	66,000	88,010
Pension funds	52,998	100%	-	-	18,824	71,822
Domestic financial entities	23,072	100%	-	-	17,437	40,509
Foreign financial entities	4,124	100%	-	-	516	4,640
Other foreign parties	1,660	100%	879	25%	640	3,179
Total	280,935		39,276		177,694	497,905

31.12.2013**	Deposits maturing within 30 days				Term	Total
	Less Stable	Weight (%)	Stable	Weight (%)	deposits*	deposits
Retail	79,688	10%	33,971	5%	50,732	164,391
SME	32,496	10%	3,723	5%	6,675	42,894
Operational relationship	847	25%	-	5%	530	1,377
Corporations	49,841	40%	742	20%	12,977	63,560
Sovereigns, central-banks and PSE	19,104	40%	-	-	7,206	26,310
Financial entities being wound up	17,616	100%	-	-	59,675	77,291
Pension funds	46,463	100%	-	-	20,430	66,893
Domestic financial entities	26,652	100%	-	-	13,636	40,288
Foreign financial entities	2,135	100%	-	-	495	2,630
Other foreign parties	3,830	100%	626	25%	250	4,706
Total	278,672		39,062		172,606	490,340

* Here term deposits refer to deposits with maturities greater than 30 days.

** Changes in LCR rules in Q2 resulted in deposit pension funds being re-classified as retail deposits. Here, 31.12.2013 figures have been revised accordingly to show comparable data. The official LCR figures for 31.12.2013 of 274% (FX) and 123% (Total) have not been adjusted accordingly.

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41. Capital management

The capital base at 30 September 2014 amounts to ISK 184,728 million. The capital adequacy ratio, calculated in accordance with Article 84 of the Act on Financial Undertakings was 24.6%, exceeding the minimum legal requirement of 8%.

The Group uses the standardised approach to calculate the capital requirements for credit risk and market risk and basic indicator approach for operational risk.

The Bank carries out an on-going process, the Internal Capital Adequacy Assessment Process (ICAAP), with the aim to ensure that the Bank has in place sufficient risk management processes and systems to identify, manage and measure the Bank's total risk exposure. The ICAAP is aimed at identifying and measuring the Group's risk across all risk types and ensure that the Group has sufficient capital in accordance to its risk profile. FME supervises the Group, receives the Group's internal estimation on the capital adequacy and sets capital requirements for the Group as a whole.

The Group is subject to capital requirements which are specified by the FME following the Supervisory Review and Evaluation Process (SREP). The Group's capital base exceeds the FME's SREP requirements.

Group's RWA calculations

Capital Base	30.9.2014	31.12.2013	30.9.2013
Share capital and share premium	75,861	75,861	75,861
Other reserves	1,633	1,637	1,637
Retained earnings	77,149	62,591	59,802
Non-controlling interests	5,122	4,858	3,587
Total Equity	159,765	144,947	140,887
Intangible assets	(5,337)	(5,383)	(5,348)
Tax assets	(660)	(818)	(702)
Other statutory deductions	(125)	(119)	(158)
Total Tier 1 capital	153,643	138,627	134,679
Subordinated liabilities	31,205	31,918	32,809
Other statutory deductions	(120)	(106)	(146)
Total Capital base	184,728	170,439	167,342

Risk weighted assets			
Credit risk	630,866	608,029	584,912
Market risk FX	18,399	31,703	27,421
Market risk other	4,251	4,993	6,293
Operational risk	76,097	76,097	72,329
Total risk weighted assets	729,613	720,822	690,955
CET 1 ratio	21.1%	19.2%	19.5%
Capital adequacy ratio	25.3%	23.6%	24.2%
Official CET 1 ratio*	20.3%	19.2%	18.9%
Official Capital adequacy ratio*	24.6%	23.6%	23.6%

* Official capital ratio is based on reviewed retained earnings at 30 June 2014.

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NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

SIGNIFICANT ACCOUNTING POLICIES

The accounting policies adopted in the preparation of these Interim Consolidated Financial Statements are consistent with those followed in the preparation of the Group's annual Consolidated Financial Statements for the year ended 31 December 2013.

IFRS 10 Consolidated Financial Statements . IFRS 10 replaces the portion of IAS 27 Consolidated and Separate Financial Statements that addresses the accounting for consolidated financial statements. IFRS 10 establishes a single control model that applies to all entities including special purpose entities. The changes introduced by IFRS 10 requires management to exercise significant judgement to determine which entities are controlled, and therefore, are required to be consolidated by a parent, compared with the requirements that were in IAS 27. This standard has been endorsed by the EU and became effective for annual periods beginning on or after 1 January 2014. Adoption of the standard did not have impacts on the financial position or performance of the Group during the period.

IFRS 12 Disclosure of Interests in Other Entities . IFRS 12 includes all of the disclosures that were previously in IAS 27 related to consolidated financial statements, as well as all of the disclosures that were previously included in IAS 31 and IAS 28. These disclosures relate to an entity’s interests in subsidiaries, joint arrangements, associates and structured entities. A number of new disclosures are also required. This standard has been endorsed by the EU and became effective for annual periods beginning on or after 1 January 2014. The standard has no impacts on the financial position or performance of the Group during the period.

42. Going concern assumption

The Group's management has made an assessment of the ability to continue as a going concern and is satisfied that the Group has the resources to continue. In making this assessment, management has taken into consideration the risk exposures facing the Group which are further described in the Risk Management Disclosures. The Financial Statements are prepared on a going concern basis.