Íslandsbanki

CONSOLIDATED FINANCIAL STATEMENTS

2014

Íslandsbanki hf. | Kirkjusandur | 105 Reykjavík | Reg. no. 491008-0160

Contents

Endorsement and Statement by the Board of Directors and the CEO

The consolidated financial statements of Íslandsbanki hf. for the period ended 31 December 2014 comprise the financial statements of Íslandsbanki hf. and its subsidiaries, together referred to as "the Bank".

Operations and ownership

Íslandsbanki (the "Bank"), is a universal bank offering comprehensive financial services to households, corporations and professional investors in Iceland and overseas. The Bank is one of Iceland's largest banking and financial services groups with strong market share across all domestic franchise areas.

The Bank, which traces its roots back to 1884, builds on a solid heritage of lending to industry in Iceland. The Bank has developed specific expertise in lending to selected industry sectors i.e. tourism, seafood, municipalities and energy. With its focused approach in these fields, Íslandsbanki offers valuable services to industry players and investors.

The Bank is divided into six business segments: Retail Banking, Corporate Banking, Markets, Wealth Management, Treasury and Subsidiaries & Equity Investments. The Bank operates a diverse and efficient branch network with 18 branches strategically located in the Reykjavík metropolitan area and larger towns across the country. At the reporting date there were 1,206 full-time employees at the Bank, thereof 945 were employees of the parent company.

The Bank has two shareholders, ISB Holding ehf., which holds 95% of the Bank's share capital and the Icelandic State Treasury which holds 5% through the Icelandic State Financial Investments (ISFI – Bankasýsla ríkisins). At a shareholders' meeting on 24 September 2014 it was decided to reduce the number of members of the Board of Directors from nine to seven. One board member is appointed by ISFI and the remaining six are appointed by ISB Holding ehf. The Bank conforms to a legislation stipulating that corporate entities with more than 50 employees must ensure that the proportion of each gender on their Board of Directors is not lower than 40%.

Risk Management

The Bank is exposed to various risks. The management of these risks is an integral part of the Bank's operations. The ultimate responsibility for ensuring an adequate risk management framework lies with the Board of Directors. The Board defines and communicates the acceptable level of risk through the Bank's risk management policies. The Bank's risk management framework and policies are discussed under Notes 59-84.

The reporting period

Íslandsbanki reports good results for the year 2014, with increase in asset values having significant impact on the earnings. The majority of the reported net profit derives from the Bank's core operations with two thirds of the Bank's regular income coming from net interest income. The Bank continued to realise cost synergies and improve cross-selling throughout the year as a result of strategic acquisitions. In line with the Bank's strategy of simplifying processes, the Bank is participating in the implementation of a new deposit and settlement system update. The main benefits of this new software are expected to be operational security, optimisation, increased flexibility and shorter time-to-market.

The customer loan portfolio grew by ISK 80 billion both through domestic and international lending at the same time as the Bank continued to reduce its non-performing loans. Market research conducted during the reporting period shows positive results for the Bank in all areas of financial services, particularly with regards to large and small corporates, and the Bank continues to be a leader in asset financing. The Bank's annual work survey returned positive results with increased work enjoyment, corporate pride and good knowledge of corporate strategy.

Close to 5,000 of the Bank's customers are entitled to a debt relief programme for CPI linked mortgages implemented by the Icelandic government in 2014. The programme is funded through a special bank tax which in 2014 took ISK 2.4 billion out of Íslandsbanki's profits. It is important that temporary increased taxation does not remain in place for longer than is absolutely necessary, as it harms Icelandic banks in the long term by handing foreign banks a competitive advantage in lending to Icelandic corporates.

In 2014, Íslandsbanki issued a SEK 300 million tap of its inaugural SEK 500 million December 2017 Floating Rate Note. The Bank followed that transaction with a EUR 100 million fixed rate bond, the first Euro bond issued by an Icelandic bank since 2008. The bonds are issued under the Bank's Global Medium Term Note (GMTN) Programme. The Bank issued covered bonds for ISK 8.8 billion in 2014 and at year-end the Bank had ISK 4.4 billion in short-term unsecured bonds outstanding.

Standard & Poor's assigned Íslandsbanki ratings of BB+/B with a stable outlook in April, and revised its outlook to positive from stable in October. The rating is one notch under the rating assigned to the Icelandic Sovereign.

The financial magazine Euromoney awarded Íslandsbanki, for the second year in a row, the Award for Excellence as the best bank in Iceland. The Bank was also selected as the Bank of the Year 2014 in Iceland by the Banker magazine, which is published by the Financial Times, and received an award for marketing by the Icelandic Marketing Association ÍMARK.

Endorsement and Statement by the Board of Directors and the CEO

The Bank is focused on clear goal setting and strategy planning with the participation of its employees. The current strategy is to promote and develop customer service, to simplify operations for the benefit of customers, to pursue responsible banking opportunities based on sound business practices, and ensuring continuous improvement in the Bank's infrastructure and processes.

Corporate social responsibility

The Bank has issued a Global Compact Report that summarises key areas from the Bank's Corporate Social Responsibility ("CSR") policy which are business, human capital, community and environment. The United Nation's Global Compact strategic policy initiative provides the parameters within the Bank's policy. New CSR objectives were set for the year 2014 with a new policy implemented at year-end. The aim of the Bank is to be a forward looking and reliable bank, responsible in all its actions and playing a proactive role in the enhancement of the community and the environment in which it operates.

Outlook

The economic environment in Iceland continues to improve. The single biggest challenge currently facing the economy is the capital controls which were put in place in 2008 resulting in a substantial block of foreign capital being tied up in Icelandic krona (ISK). The controls provided stability in the foreign exchange market at a critical time, but will most likely slow growth in the long-term. Although the authorities have not issued a clear timeline for lifting the capital controls, they have indicated their willingness to do so in the near future. The authorities have, however, still to declare the nature of the exchange rate policy that might take effect after controls are lifted.

The Bank's solid funding, strong capital ratios and considerable liquidity buffer makes it well prepared for the eventual relaxation of the capital controls. The change in outlook by Standard & Poor's (now at BB+ with positive outlook) and their view that the Bank's leverage ratio is exceptional in a global comparison, will further ease the Bank's access to international capital markets. It allows us to better serve customers seeking foreign currency funding.

The Bank is well positioned in the Icelandic financial market with strong market share of 30-40% in most business lines.

Corporate Governance

Good governance practices are essential for long term performance of companies as they improve good work habits, transparency and accountability, and therefore protect and enhance the interests of shareholders as well as other stakeholders. The Board of Directors of Íslandsbanki is committed to excellence in its governance framework so that it reflects compliance with the best corporate governance practices in the financial market at all times. In that regard, Íslandsbanki was, after a formal review, recognised as "Exemplary in Corporate Governance" by the Centre of Corporate Governance at the Institute for Business Research at the University of Iceland in March 2014.

Íslandsbanki's management structure consists of the CEO and the Board of Directors, comprising seven non-executive directors and three alternates. The Board undertakes the Bank's affairs and is responsible for the formulation of the Bank's general strategy as well as instructing the CEO on its further implementation and execution. The Board has a supervisory role overseeing that the Bank's organisation and activities are at all times in accordance with relevant law, regulations and good business practices. There are four Board subcommittees comprising members of the Board; Board Audit Committee; Board Risk Committee; Board Strategy Committee; and Board Corporate Governance, Compensation and Human Resource Committee.

The CEO is responsible for daily operations of the Bank pursuant to the policies and resolutions of the Board of Directors. Moreover it is the task of the CEO to ensure that the Bank's operations are at all times consistent with the Bank's Articles of Association and applicable legislation. An Executive Board is appointed by the CEO, consisting of nine members, including the CEO. The Executive Board is responsible for the Bank's operational risk management framework.

Furthermore, the Board shall monitor the execution of its policies, the sound control of accounting and financial management, and ensure that Group Internal Audit, Compliance and Risk Management are effective at all times. Further information on the Bank's risk management and risk profile can be found in the Bank's annual risk report.

Group Internal Audit operates independently from other departments. The Chief Audit Executive is appointed by the Board and is responsible for internal audit on group basis and monitoring adequacy of the Bank's risk management, control and governance processes.

The Board confirms the CEO's appointment of the Compliance Officer who is responsible for monitoring and assessing on a regular basis whether the Bank's operations, regarding securities transactions, are in compliance with applicable law.

Endorsement and Statement by the Board of Directors and the CEO

The regulatory framework for corporate governance practices within Íslandsbanki consists of legislation governing entities subject to the supervision of the Financial Supervisory Authority (FME) as well as other applicable law and regulations, including those imposed by the FME and the NASDAQ OMX Nordic Exchange in Iceland. The applicable law includes inter alia the Act on Financial Undertakings no. 161/2002, the Act on Securities Transactions no. 108/2007, the Act on Public Limited Companies no. 2/1995 and the Act on Competition no. 44/2005, available on the Icelandic legislature's website (www.althingi.is).

The Bank follows the Corporate Governance Guidelines issued in March 2012 (4th ed.) by the Iceland Chamber of Commerce, NASDAQ OMX Iceland and SA-Business Iceland (former Confederation of Icelandic Employers), available on the website of Icelandic Chamber of Commerce. The Bank's practices are in compliance with the guidelines except for certain items in Articles 1.2., 2.10., 5.1. and 5.2.C.1. of the guidelines.

A detailed description of Íslandsbanki's governance framework and associated practices, as well as a discussion on deviations from the Corporate Governance Guidelines, can be found in the Bank's Corporate Governance Statement enclosed in the unaudited Appendix.

Accounting convention

The consolidated financial statements for the year ended 31 December 2014 have been prepared on a going concern basis in accordance with the International Financial Reporting Standards (IFRS) as adopted by the European Union (EU).

Profit from the Bank's operations for the year ended 31 December 2014 amounted to ISK 22,750 million, which corresponds to a 12.8% return on equity. The Board of Directors proposes that up to 40% of the net profit will be paid in dividends to shareholders, but otherwise the profit will be added to the Bank's equity. The Board may convene a special shareholder meeting later in the year where a proposal regarding payment of dividends of profit for the previous fiscal years could be suggested. The Bank's equity, according to the consolidated statement of financial position, amounted to ISK 185,487 million at year-end. The Bank's total capital ratio, calculated according to the Act on Financial Undertakings, was 29.6%. The Board of Directors refers to Note 83 for further understanding of the capital requirements of the Bank. The Bank's total assets amounted to ISK 911,328 million at year-end 2014.

The Board of Directors draws special attention to the risks relating to the political and legal environment in Iceland where capital controls are still in place. The Bank has made appropriate provisions to reflect the risk associated with court rulings. The Board also notes that the Bank maintains a strong capital base and is therefore well positioned to meet future risks and challenges. The Board refers to Notes 4 and 57 for the principal risks and uncertainties currently faced by the Bank.

To the best of our knowledge, these consolidated financial statements provide a true and fair view of the Bank's operating profits and its financial position at 31 December 2014. It also describes the principal risks and uncertainties currently faced by the Bank.

The Board of Directors and the CEO of Íslandsbanki hf. hereby confirm the Bank's consolidated financial statements for the period 1 January to 31 December 2014 by means of their signatures.

Reykjavík, 23 February 2015

Board of Directors:

Chief Executive Officer: Birna Einarsdottir

Independent Auditors' Report

To the Board of Directors and Shareholders of Íslandsbanki hf.

We have audited the accompanying consolidated financial statements of Íslandsbanki hf., which comprise the consolidated statement of financial position as at 31 December 2014, consolidated income statement and consolidated statement of comprehensive income for the year 2014, consolidated statement of changes in equity and consolidated statement of cash flow for the year 2014, and a summary of significant accounting policies and other explanatory information.

Management's and the Board of directors Responsibility for the Consolidated Financial Statements

Management and the board of directors are responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards as adopted by the EU. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the Consolidated Financial Statements give a true and fair view, of the consolidated financial position of Íslandsbanki hf. as of 31 December 2014, and its consolidated financial performance and its consolidated cash flows for the period then ended in accordance with International Financial Reporting Standards as adopted by the EU.

Confirmation of Endorsement and Statement by the Board of Directors and the CEO

Pursuant to the requirements of Article 104 of the Icelandic Financial Statements Act No. 3/2006, we confirm to the best of our knowledge that the accompanying Endorsement and Statement by the Board of Directors and the CEO includes all information required by the Icelandic Financial Statements Act.

Kópavogur 23 February 2015

Deloitte ehf.

Pálína Árnad.

Pálína Árnadóttir
State Authorised Public Accountant

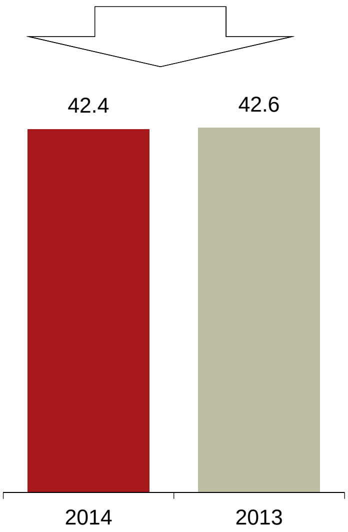
Gunnar Þorvarðarson

Gunnar Þorvarðarson
State Authorised Public Accountant

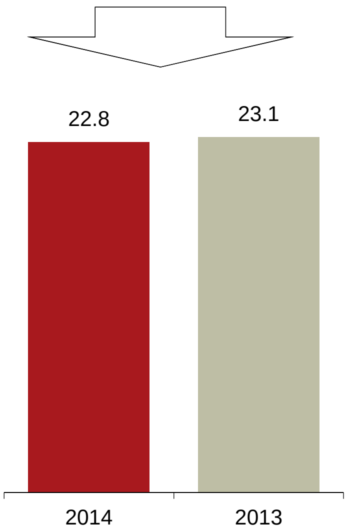
Financial Highlights 2014

Amounts on this page are in ISK billion

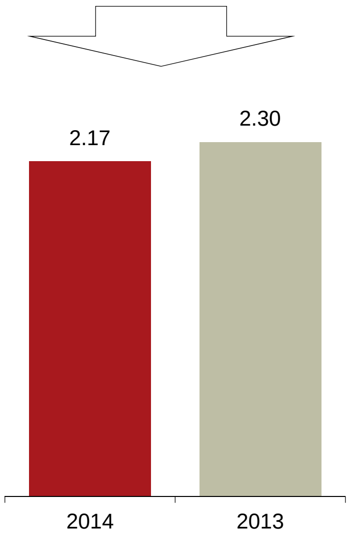
Operating income



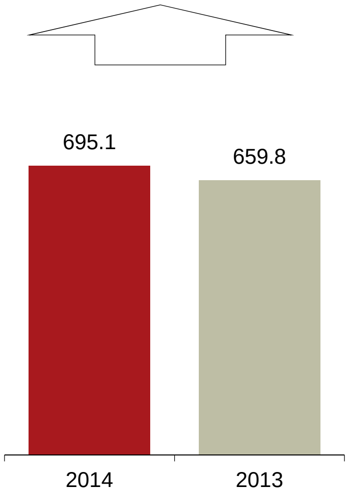
Profit after tax



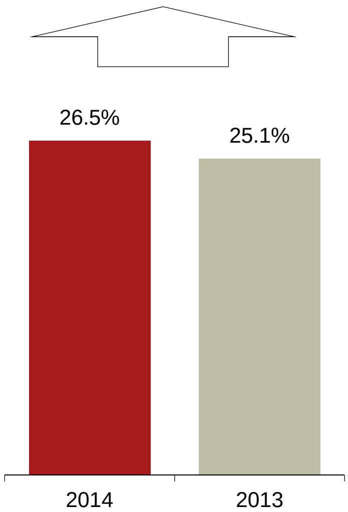
Earnings per share



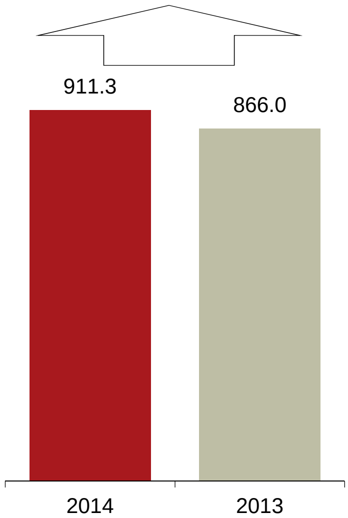
Risk Weighted Assets



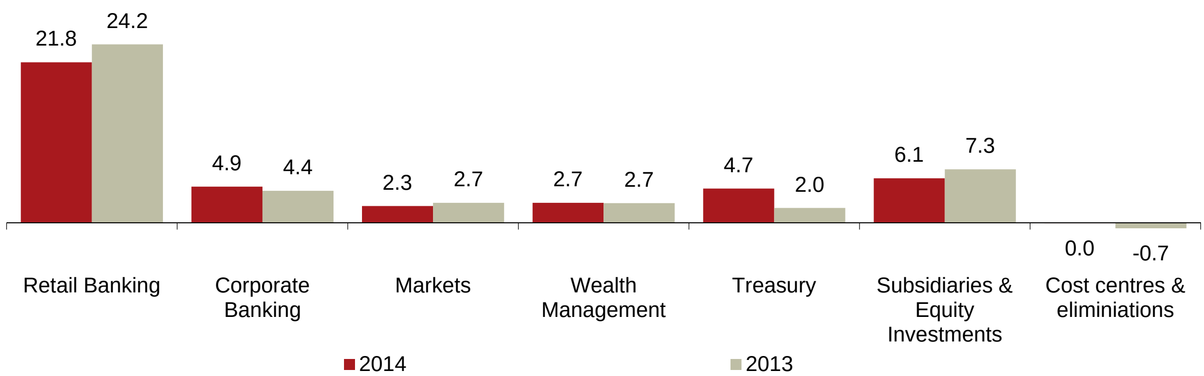
Tier 1 Capital



Total Assets



Operating income by segment



Consolidated Income Statement for the year 2014

	Notes	2014	2013
Interest income	12	51,006	54,333
Interest expense	12	(23,901)	(25,903)
Net interest income		27,105	28,430
Fee and commission income	13	17,984	16,695
Fee and commission expense	13	(6,501)	(6,262)
Net fee and commission income		11,483	10,433
Net financial income	14-16	1,568	4,612
Net foreign exchange gain (loss)	17	165	(2,423)
Share of profit or loss of associates	35	27	3
Other operating income	18	2,095	1,542
Other net operating income		3,855	3,734
Total operating income		42,443	42,597
Administrative expenses	19-23	(22,901)	(25,551)
Contribution to the Depositors' and Investors' Guarantee Fund		(1,055)	(1,016)
Bank tax		(2,444)	(2,321)
Total operating expenses		(26,400)	(28,888)
Profit before loan impairment charges and net valuation changes		16,043	13,709
Loan impairment charges and net valuation changes	24	8,810	16,299
Profit before tax		24,853	30,008
Income tax	26	(6,239)	(7,866)
Profit for the year from continuing operations		18,614	22,142
Profit from discontinued operations, net of income tax	25	4,136	927
Profit for the year		22,750	23,069

The notes on pages 15 to 93 are an integral part of these consolidated financial statements

Amounts are in ISK million

Consolidated Statement of Comprehensive Income for the year 2014

	Notes	2014	2013
Profit for the year		22,750	23,069
Other comprehensive income			
Items that are or may be reclassified to profit or loss			
Foreign currency translation differences for foreign operations	54	64	(363)
Other comprehensive income for the year (net of tax)		64	(363)
Total comprehensive income for the year		22,814	22,706
Profit attributable to:			
Equity holders of Íslandsbanki hf.		21,740	22,977
Non-controlling interests		1,010	92
Profit for the year		22,750	23,069
Total comprehensive income attributable to:			
Equity holders of Íslandsbanki hf.		21,804	22,614
Non-controlling interests		1,010	92
Total comprehensive income for the year		22,814	22,706
Basic earnings per share			
From profit for the year	27	2.17	2.30
Diluted earnings per share			
From profit for the year	27	2.17	2.30

The notes on pages 15 to 93 are an integral part of these consolidated financial statements.

Amounts are in ISK million

Consolidated Statement of Financial Position as at 31 December 2014

	Notes	31.12.2014	31.12.2013
Assets			
Cash and balances with Central Bank	28	103,389	111,779
Derivatives	30	1,810	843
Bonds and debt instruments	8	87,347	75,186
Shares and equity instruments	8	10,531	9,208
Loans to credit institutions	31	35,072	44,078
Loans to customers	32-33	634,799	554,741
Investments in associates	35-36	570	1,563
Property and equipment	40	7,402	8,772
Intangible assets	41	619	299
Deferred tax assets	49-51	521	1,275
Non-current assets and disposal groups held for sale	42	21,649	47,106
Other assets	43	7,619	11,159
Total Assets		911,328	866,009
Liabilities			
Derivative instruments and short positions	30	3,963	11,176
Deposits from Central Bank	44	69	63
Deposits from credit institutions	44	25,727	29,626
Deposits from customers	45-46	529,447	489,331
Debt issued and other borrowed funds	47	96,889	89,193
Subordinated loans	48	21,306	21,890
Current tax liabilities	49-51	8,386	10,806
Deferred tax liabilities	49-51	2	20
Non-current liabilities and disposal groups held for sale	42	2,790	9,456
Other liabilities	52	37,262	37,130
Total Liabilities		725,841	698,691
Equity			
Share capital	53	10,000	10,000
Share premium	53	55,000	55,000
Other reserves	54	2,535	2,471
Retained earnings		116,288	98,548
Total equity attributable to the equity holders of Íslandsbanki hf.		183,823	166,019
Non-controlling interests		1,664	1,299
Total Equity		185,487	167,318
Total Liabilities and Equity		911,328	866,009

The notes on pages 15 to 93 are an integral part of these consolidated financial statements.

Íslandsbanki hf. Consolidated Financial Statements 2014 10 Amounts are in ISK million

Consolidated Statement of Changes in Equity for the year 2014

	Notes	Share capital	Share premium	Other reserves	Retained earnings	Total	Non-controlling interests	Total equity
		Attributable to the equity holders of Íslandsbanki hf.						
Equity as at 31.12.2012		10,000	55,000	2,834	78,571	146,405	1,255	147,660
Translation differences for foreign operations	54			(363)		(363)		(363)
Net expense recognised directly in equity		-	-	(363)	-	(363)	-	(363)
Profit for the year					22,977	22,977	92	23,069
Total comprehensive income for the year		-	-	(363)	22,977	22,614	92	22,706
Dividends paid					(3,000)	(3,000)		(3,000)
Change in non-controlling interests						-	(148)	(148)
Acquisition of subsidiary with non-controlling interests						-	100	100
Equity as at 31.12.2013	53	10,000	55,000	2,471	98,548	166,019	1,299	167,318
Translation differences for foreign operations	54			64		64		64
Net income recognised directly in equity		-	-	64	-	64	-	64
Profit for the year					21,740	21,740	1,010	22,750
Total comprehensive income for the year		-	-	64	21,740	21,804	1,010	22,814
Dividends paid					(4,000)	(4,000)		(4,000)
Change in non-controlling interests						-	(645)	(645)
Acquisition of subsidiary with non-controlling interests							-	-
Equity as at 31.12.2014	53	10,000	55,000	2,535	116,288	183,823	1,664	185,487

The notes on pages 15 to 93 are an integral part of these consolidated financial statements.

Íslandsbanki hf. Consolidated Financial Statements 2014 11 Amounts are in ISK million

Consolidated Statement of Cash Flows for the year 2014

	Notes	2014	2013
Cash flows from operating activities:			
Profit for the year		22,750	23,069
Adjustments to reconcile profit for the year to cash flows (used in) provided by operating activities:			
Non-cash items included in profit for the year and other adjustments		(1,710)	(2,902)
Changes in operating assets and liabilities		(32,627)	(9,038)
Income tax paid		(10,685)	(2,000)
Net cash (used in) provided by operating activities		(22,272)	9,129
Cash flows from investing activities:			
Refundable shares in subsidiaries and associates		896	-
Investments in associated companies		(62)	(37)
Proceeds from sale of property and equipment		1,543	1,241
Purchase of property and equipment	40	(758)	(858)
Purchase of intangible assets	41	(464)	(164)
Net cash provided by investing activities		1,155	182
Cash flows from financing activities:			
Proceeds from borrowings		39,590	35,535
Repayment of borrowings		(34,908)	(15,715)
Dividends paid		(4,000)	(3,000)
Net cash provided by financing activities		682	16,820
Net (decrease) increase in cash and cash equivalents		(20,435)	26,131
Effects of foreign exchange rate changes		22	(508)
Cash and cash equivalents at the beginning of the year		138,433	112,810
Cash and cash equivalents at year-end		118,020	138,433

Reconciliation of cash and cash equivalents:			
Cash on hand	28	2,256	2,472
Cash balances with Central Bank, certificates of deposit and term deposit	28	91,581	105,704
Bank accounts	31	24,183	30,257
Total cash and cash equivalents		118,020	138,433

The Bank has prepared its consolidated statement of cash flows using the indirect method. The statement is based on the net profit after tax for the year and shows the cash flows from operating, investing and financing activities and the increase or decrease in cash and cash equivalents during the year. Cash and cash equivalents consist of highly liquid assets that are readily convertible into cash and which are subject to an insignificant risk of change in value. These are cash on hand, unrestricted balances with Central Bank and demand deposits with credit institutions.

Interest received in 2014 was ISK 52,000 million (2013: ISK 47,781 million) and interest paid in 2014 was ISK 25,541 million (2013: ISK 23,515 million). Interest paid is defined as having been paid when it has been deposited into the customer account and is available for the customer's disposal.

The notes on pages 15 to 93 are an integral part of these consolidated financial statements

Íslandsbanki hf. Consolidated Financial Statements 2014 12 Amounts are in ISK million

Consolidated Statement of Cash Flows for the year 2014

Non-cash items included in net profit and other adjustments:	2014	2013
Depreciation and impairment	820	979
Amortisation of intangible assets	144	126
Share of loss (gain) of associates	159	(3)
Accrued interest and foreign exchange gain on debt issued	3,320	2,802
Impairment on loans	1,856	8,378
Income due to revised estimated cash flows from loans	(10,666)	(24,677)
Foreign exchange (gain) loss	(165)	2,423
(Gain) on sale of property and equipment	(234)	(456)
Unrealised fair value gains through profit and loss	(1,491)	(1,734)
Net profit on non-current assets classified as held for sale	(4,136)	(927)
Bank tax	2,444	2,321
Income tax	6,239	7,866
Non-cash items included in net profit and other adjustments	(1,710)	(2,902)
Changes in operating assets and liabilities:		
Mandatory reserve with Central Bank	(5,949)	5,549
Loans and receivables to credit institutions	4,799	(2,133)
Loans and receivables to customers	(71,126)	701
Trading assets	(13,307)	(6,679)
Other operating assets	4,294	(6,013)
Non-current assets and liabilities held for sale	24,045	2,080
Deposits with credit institutions and Central Bank	(3,941)	(8,159)
Deposits from customers	37,918	25,333
Trading financial liabilities	(8,777)	(2,528)
Derivatives	597	(5,447)
Other operating liabilities	(1,180)	(11,742)
Changes in operating assets and liabilities	(32,627)	(9,038)

Non-cash transactions 2014

During 2014 the Bank entered into the following non-cash investing and financing activities which have been excluded from the consolidated statement of cash flows:

a) The Bank changed a loan to a subsidiary for the amount of ISK 530 million to equity holding. This transaction had no cash effect on the Bank.

Non-cash transactions 2013

During 2013 the Bank entered into the following non-cash investing and financing activities which have been excluded from the consolidated statement of cash flows:

a) The Bank reclassified shareholding in Atorka of ISK 1 billion from shares and equity instruments to investment in associates. This had no cash effect on the Bank.

b) The Bank sold part of its shareholding in an associate company which was held for sale and as a result lost significant influence over the entity. The remaining equity shares of ISK 0,7 billion were subsequently reclassifed from Non-current assets and disposal groups held for sale to Shares and equity instruments. This transaction had no cash effect on the Bank.

c) The Bank acquired four subsidiaries EFF1 ehf., EFF2 ehf., EFF4 ehf. and Fergin ehf. in 2013 and as a result, the Bank reclassified ISK 9.9 billion from Loans to customers, ISK 4.2 billion to Property and equipment and ISK 5.7 billion to Non-current assets held for sale. This transaction had no cash effect on the Bank.

The notes on pages 15 to 93 are an integral part of these consolidated financial statements

Íslandsbanki hf. Consolidated Financial Statements 2014 13 Amounts are in ISK million

Notes to the Consolidated Financial Statements

Notes to the Consolidated Financial Statements

1. Reporting entity

Íslandsbanki hf. is a limited liability company incorporated and domiciled in Iceland. The address of its registered office is Kirkjusandur 2, 155 Reykjavík, Iceland.

The consolidated financial statements for the year ended 31 December 2014 were prepared on a going concern basis and comprise Íslandsbanki hf. (the parent company) and its subsidiaries (together referred to as "the Bank"). Comparative information refers to the year ended 31 December 2013.

The Bank was incorporated on 8 October 2008 and commenced trading on 15 October 2008 when it acquired assets and liabilities relating to the domestic operations of Glitnir Banki hf. ("Glitnir").

Ownership of Íslandsbanki hf. is divided between ISB Holding ehf., a private limited liability company owned 100% by GLB Holding ehf. which is a private limited liability company owned 100% by Glitnir hf., which wields 95% of the voting rights and the Icelandic State Treasury, which wields 5% of the voting rights. The Icelandic State Treasury's holdings in financial undertakings are managed by The Icelandic State Financial Investments (ISFI - Bankasýsla Ríkisins) which reports to the Minister of Finance.

The Bank provides a wide range of financial services such as retail banking, corporate banking, brokerage services, investment management and asset-based financing. The Bank operates in the Icelandic market.

2. Basis of preparation

Statement of compliance

The consolidated financial statements have been prepared in accordance with the International Financial Reporting Standards (IFRS) as adopted by the European Union.

Information about new IFRS standards and amendments to standards are disclosed in Notes 87.34-87.35.

The consolidated financial statements were approved and authorised for issue by the Board of Directors and the CEO of Íslandsbanki hf. on 23 February 2015.

The Bank's management has made an assessment of the Bank's ability to continue as a going concern and is satisfied that the Bank has the resources to continue in business for the foreseeable future. Therefore, these consolidated financial statements have been prepared on a going concern basis.

3. Functional and presentation currency

These consolidated financial statements are presented in Icelandic krona (ISK), which is the functional currency of Íslandsbanki hf. All amounts presented in ISK have been rounded to the nearest million, except when otherwise indicated.

4. Use of significant estimates and judgements in applying accounting policies

The preparation of the consolidated financial statements in conformity with IFRS 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 recognised.

The accounting estimates and underlying assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates. The accounting estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected

The Bank's management discusses with the Audit Committee the development, selection and disclosure of the Bank's critical accounting policies and their application, and assumptions made relating to major estimation uncertainties. Information about assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment within the next financial year and about critical judgements in applying accounting policies that have the most significant effect on the amounts recognised in the consolidated financial statements is disclosed below.

a) *Uncertainties relating to court rulings, pending court cases and investigations by regulators*

Three court cases were filed against the Bank and other credit institutions, challenging the legality of fixing the principal of a mortgage to the consumer price index (CPI). Such indexation has been the industry standard for over 30 years. However, the method of calculating the index has changed over the years, most recently in 1995. The Supreme Court accepted a motion introduced by the plaintiff in the case against the Bank on seeking the opinion of the EFTA Court which concluded that indexation is permissible in consumer contracts, although Icelandic courts must decide if it is properly applied.

Notes to the Consolidated Financial Statements

4. Cont'd

The District Court of Reykjavik ruled on the case against the Bank on the 6 February 2015. It found that indexation was neither in violation of the EU Directive 93/13/EEC nor the Icelandic law on contracts. The Court also ruled on the compatibility of using zero inflation forecast in calculating the annual percentage rate of charge (APRC) and the payment schedule. Like the EFTA Court, it ruled that the increase of principal was nevertheless enforceable and that the plaintiff did not demonstrate in any way that the increase was beyond what should have been expected, given the widespread and common use of indexation in the past decades.

The Consumer Agency (the "Agency") published in September 2014 its decision in a matter regarding the terms of, and information relating to the granting of, a consumer mortgage with interest reset terms granted by the Bank's predecessor in 2005. The Agency found that the terms offered regarding the method and conditions of resetting interest to be in breach of Articles 6 and 9 of Act no. 121/1994 on Consumer Credit (superseded in November 2013). The Agency believes that the terms offer insufficient explanation on how or what can affect the decision on the revised interest rate.

The Bank has in many instances not enforced the terms in question and has decided to postpone the next scheduled interest rate change. Customers have the option of receiving better terms by restructuring their loans with the appropriate documentation, fully adapted to the new legislation on consumer loans. The decision of the Agency has been appealed to the Consumer Appellate Committee.

Several rulings of the Supreme Court of Iceland during the years 2010 to 2014 in relation to foreign currency-linked loans have affected the Bank. Most important of these rulings was a ruling in June 2010 on the illegality of a principal of loans in ISK being linked to foreign currencies. The Bank consequently recalculated illegally foreign currency-linked loans, outstanding as well as paid-up loans, in line with the instructions given by the rulings. The court rulings combined have effectively reduced the uncertainty regarding which foreign currency loans are illegal and how they should be recalculated.

The Icelandic Competition Authority ("ICA") has initiated an investigation concerning alleged violations of the Competition law by Íslandsbanki. Details of the investigation remain confidential. The Bank has presented its objections to the ICA's findings in the opposition document and will further cooperate with the ICA to resolve the case.

The Bank has recognised provisions in the consolidated financial statements 2014 relating to court rulings and sanctions which are presented under Note 52. Uncertainties are further discussed under Note 57.

b) *Impairment of loans measured at amortised cost*

The Bank's management reviews its loan portfolios on a quarterly basis to assess whether there is any objective evidence of impairment. In determining whether an impairment loss should be recognised in the income statement, the Bank's management makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from loans and receivables. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group.

When scheduling its future cash flows the Bank's management uses estimates based on loans and receivables with similar credit risk characteristics and objective evidence of impairment similar to those in the portfolio. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience. Impairment of loans and receivables is disclosed in more detail in Note 87.27.

c) *Determination of fair value of financial assets and financial liabilities*

The Bank determines the fair value of financial assets and financial liabilities that are not quoted in active markets by using valuation techniques as described in accounting policy Notes 87.5. To the extent that it is practical, models use only observable data. However, for financial instruments that trade infrequently and have little price transparency, fair value is less objective and requires varying degrees of judgement depending on liquidity, concentration, uncertainty of market factors, pricing assumptions and other risks affecting the specific instrument, such as credit risk (both own and counterparty).

d) *The application of the effective interest method*

The application of the effective interest method when calculating the amortised cost of financial assets and financial liabilities requires management to estimate future cash payments or receipts through the expected life of the financial instrument, considering all contractual terms of the financial instrument (for example, prepayment, call and similar options). Revisions to estimates of future cash flows, other than those arising from changes in market variables, generally result in the Bank having to adjust the carrying amount of the financial asset or financial liability to reflect actual and revised estimated cash flows. In such cases the adjustment is recognised as income or expense in profit or loss in the period in which the estimate is revised.

4. Cont'd

e) Liquidity

Liquidity risk is considered a material risk factor in the Bank's operations. Sound and efficient management of liquidity risk is a key factor to ensure the viability of the Bank's operations and to achieve and maintain access to funding markets. The Bank's strategy for managing liquidity risk assumes that the Bank can at all times meet its financial obligations as they fall due. The risk appetite approved by the Board is reflected in the liquidity risk limit structure and guided through the liquidity risk management framework.

The contractual maturity profile along with more detailed information on the Bank's management of liquidity risk is set out in the liquidity risk disclosure in Note 70. The contractual maturity profile is based on the earliest date on which the Bank can be required to pay and does not reflect the expected due date.

f) Investment funds

The Bank has set up a formal procedure to assess whether or not to consolidate investment funds managed and administered by the Bank on behalf of its customers and other investors in the consolidated financial statements 2014. As part of this assessment, the Bank reviews all facts and circumstances including the purpose and design of the investment fund, to determine whether the Bank, as fund manager, is acting as agent or principal. The Bank is deemed to be a principal when the Bank acts as fund manager and cannot be removed without cause, has variable returns through significant holdings and is able to influence the returns of the funds by exercising its power. Holdings where all returns belong to the customers are not considered to be exposure to variable returns. Based on this assessment, the investment funds managed and administered by the Bank have not been included in the consolidated financial statements 2014.

Notes to the Consolidated Financial Statements

Business segments

5. A business segment is a distinguishable component of the Bank that is engaged in providing products or services that are subject to risks and rewards that may be different from those of other business segments. Transactions between the business segments are on normal commercial terms and conditions. No single customer generates 10% or more of the combined revenue of the Bank. The Bank operates in the Icelandic market.

The accounting policies for the reportable segments are in line with the Bank's accounting policies. The segment profit presented is the profit reported to the chief operating decision maker (CEO) and the Board of Directors for the purpose of resource allocation and assessment of segment performance.

The Bank is organised into six main business segments based on products and services:

a) Retail banking provides comprehensive banking services to individuals and small and medium-sized enterprises through 18 branches, call centre, self service and digital banking platforms. Retail Banking also operates two separately branded units, Ergo for asset- based financing and Kreditkort, a special credit card branch.

b) Corporate Banking provides lending and tailor-made financial services to larger companies and professional investors. Building on experience and industry expertise Corporate Banking offers universal banking services to customers through cross-selling and by connecting customers to other business units of the bank. Furthermore, Corporate Banking overseas the Bank's international business in the North Atlantic region where the focus is on the seafood, the offshore supply vessel and the energy industries.

c) Markets incorporates brokerage services in securities, foreign currencies and derivatives as well as providing money market lending and interbank services. The division further offers an extensive range of corporate finance services.

d) Wealth Management offers a range of wealth and asset management products and services for individuals, corporations and institutional investors. The Wealth Management unit consists of VÍB which offers a broad range of asset management products and services and the fund management companies Íslandssjódir and Summa.

e) Treasury is responsible for the management of liquidity risk, foreign exchange risk and interest rate risk within regulatory requirements and internal limits established by the Board of Directors. Treasury is responsible for funding the Bank´s operations and managing an internal pricing framework. Treasury also manages relations with investors and rating agencies.

f) Subsidiaries and equity investments include equity investments in the banking book and subsidiaries, the most significant being:
- Midengi, an asset management company managing commercial real estate and businesses which the Bank has acquired through repossessions following loan defaults, debt restructuring and bankruptcies of its customers
- Borgun, a credit card settlement company
- Allianz Ísland hf., an agent for the German insurance company Allianz, and its holding company Hringur eignarhaldsfélag ehf.

g) Cost centres comprise Head Office, Human Resources, Legal, Risk Management, Finance, Operations & IT, Group Internal Audit, Compliance and Business Development

On the following page is an overview showing the Bank's performance with a breakdown by business segments.

Notes to the Consolidated Financial Statements

5. Cont'd

The year 2014

Operations	Retail Banking	Corporate Banking	Markets	Wealth Manage-ment	Treasury	Subsidiaries & Equity Investments	Cost Centres & Eliminations	Total
Net interest income	17,261	4,427	911	731	4,736	(510)	(451)	27,105
Net fee and commission income	4,421	122	1,499	1,939	(80)	3,562	20	11,483
Other operating income (exps.)	77	386	(98)	79	15	3,003	393	3,855
Total operating income	21,759	4,935	2,312	2,749	4,671	6,055	(38)	42,443
Administrative expenses	(6,393)	(501)	(1,000)	(1,119)	(269)	(3,404)	(10,215)	(22,901)
Insurance fund	(921)	(21)	(0)	(74)	(39)	(0)	-	(1,055)
Bank tax	-	-	-	-	(2,444)	-	-	(2,444)
Impairment and net valuation changes on loans	6,588	1,489	-	(2)	34	1,016	(315)	8,810
Profit (loss) before cost allocation & tax	21,033	5,902	1,312	1,554	1,953	3,667	(10,568)	24,853
Net segment revenue from external customers	22,132	8,335	2,624	1,387	1,277	6,478	210	42,443
Net segment revenue from other segments	(372)	(3,401)	(312)	1,362	3,394	(423)	(248)	0
At 31 December 2014								
Total segment assets	413,812	225,100	13,161	4,171	202,089	87,998	(35,003)	911,328
Total segment liabilities	397,343	14,401	783	49,867	243,479	43,231	(23,263)	725,841

The year 2013

Operations	Retail Banking	Corporate Banking	Markets	Wealth Manage-ment	Treasury	Subsidiaries & Equity Investments	Cost Centres & Eliminations	Total
Net interest income	20,674	4,294	541	781	4,647	(572)	(1,935)	28,430
Net fee and commission income	3,468	163	1,723	1,814	(222)	3,241	246	10,433
Other operating income (exps.)	51	(95)	478	103	(2,389)	4,615	971	3,734
Total operating income	24,193	4,362	2,742	2,698	2,036	7,284	(718)	42,597
Administrative expenses	(7,889)	(623)	(1,016)	(931)	(278)	(3,269)	(11,545)	(25,551)
Insurance fund	(886)	(8)	(0)	(75)	(47)	-	-	(1,016)
Bank tax	-	-	-	-	(2,321)	-	-	(2,321)
Impairment and net valuation changes on loans	5,559	9,951	2	1,158	(51)	78	(398)	16,299
Profit (loss) before cost allocation & tax	20,977	13,682	1,728	2,850	(661)	4,093	(12,661)	30,008
Net segment revenue from external customers	25,999	11,828	2,689	(87)	(6,027)	8,356	(161)	42,597
Net segment revenue from other segments	(1,806)	(7,466)	53	2,785	8,063	(1,072)	(557)	0
At 31 December 2013								
Total segment assets	395,292	182,184	261	2,823	223,219	116,868	(54,638)	866,009
Total segment liabilities	395,236	8,986	215	50,542	219,283	63,540	(39,111)	698,691

Íslandsbanki hf. Consolidated Financial Statements 2014 19 Amounts are in ISK million

Notes to the Consolidated Financial Statements

Business combination

6. Changes within the group

Loss of control of subsidiaries

On 10 January 2014 the Bank sold 71.1% of its shareholding in Bláfugl ehf. The entity was classified as a non-current asset held for sale. The Bank has derecognised the assets and liabilities, any non-controlling interests and other components related to the subsidiary. Any surplus or deficit arising on the loss of control is recognised in profit or loss in the line item "Profit from discontinued operations, net of income tax".

On 7 February 2014 the Bank sold 72.5% of its shareholding in HTO ehf. The entity was classified as a non-current asset held for sale. The Bank has derecognised the assets and liabilities, any non-controlling interests and other components related to the subsidiary. Any surplus or deficit arising on the loss of control is recognised in profit or loss in the line item "Profit from discontinued operations, net of income tax".

On 31 March 2014 the Bank sold 100% of its shareholding in EFF 4 ehf. The entity was classified as a non-current asset held for sale. The Bank has derecognised the assets and liabilities and other components related to the subsidiary. Any surplus or deficit arising on the loss of control is recognised in profit or loss in the line item "Profit from discontinued operations, net of income tax".

On 15 December 2014 the Bank sold its entire shareholding of 64.4% in GREF hf. The entity was classified as a non-current asset held for sale. The Bank has derecognised the assets and liabilities and other components related to the subsidiary. Any surplus or deficit arising on the loss of control is recognised in profit or loss in the line item "Profit from discontinued operations, net of income tax".

Quarterly statements

7. Operations by quarters:

2014	Q4*	Q3*	Q2*	Q1*	Total
Net interest income	6,469	7,068	6,922	6,646	27,105
Net fee and commission income	2,962	2,849	2,818	2,854	11,483
Net financial income	603	83	19	863	1,568
Net foreign exchange gain (loss)	116	352	(12)	(291)	165
Share of profit of associates	-	-	27	-	27
Other net operating income	509	233	240	1,113	2,095
Administrative expenses	(6,411)	(5,231)	(5,350)	(5,909)	(22,901)
Contribution to the Depositors' and Investors' Guarantee Fund	(265)	(272)	(260)	(258)	(1,055)
Bank tax	(565)	(664)	(623)	(592)	(2,444)
Loan impairment charges and net valuation changes	3,006	65	4,219	1,520	8,810
Profit before tax	6,424	4,483	8,000	5,946	24,853
Income tax	(1,434)	(1,255)	(2,156)	(1,394)	(6,239)
Profit for the period from continuing operations	4,990	3,228	5,844	4,552	18,614
(Loss) profit for the period from discontinued operations	(430)	307	515	3,744	4,136
Profit for the period	4,560	3,535	6,359	8,296	22,750

* The half year results were reviewed by the Bank's auditors, but the splits between quarters were not audited.

Íslandsbanki hf. Consolidated Financial Statements 2014 20 Amounts are in ISK million

Notes to the Consolidated Financial Statements

7. Cont'd

2013	Q4*	Q3*	Q2*	Q1*	Total
Net interest income	6,547	7,365	7,045	7,473	28,430
Net fee and commission income	2,849	2,462	2,670	2,452	10,433
Net financial income	2,747	315	669	881	4,612
Net foreign exchange (loss) gain	(1,117)	409	(152)	(1,563)	(2,423)
Share of profit of associates	-	-	-	3	3
Other net operating income	100	314	716	412	1,542
Administrative expenses	(7,928)	(5,208)	(6,179)	(6,236)	(25,551)
Contribution to the Depositors' and Investors' Guarantee Fund	(262)	(252)	(256)	(246)	(1,016)
Bank tax	(2,113)	(76)	(65)	(67)	(2,321)
Loan impairment charges and net valuation changes	7,894	555	4,857	2,993	16,299
Profit before tax	8,717	5,884	9,305	6,102	30,008
Income tax	(2,501)	(1,570)	(2,347)	(1,448)	(7,866)
Profit for the period from continuing operations	6,216	4,314	6,958	4,654	22,142
Profit (loss) for the period from discontinuing operations	1,456	(125)	(335)	(69)	927
Profit for the period	7,672	4,189	6,623	4,585	23,069

* The half year results were reviewed by the Bank's auditors, but the splits between quarters were not audited.

Íslandsbanki hf. Consolidated Financial Statements 2014 21 Amounts are in ISK million

Notes to the Consolidated Financial Statements

Financial assets and liabilities

8. The following tables show the carrying value of financial assets and financial liabilities according to their IAS 39 classification.

At 31 December 2014	Notes	Held for trading	Designated at fair value through P&L	Loans & receivables	Liabilities at amortised cost	Total carrying amount
Cash and balances with Central Bank	28	-	-	103,389	-	103,389
Loans and receivables						
Loans to credit institutions	31	-	-	35,072	-	35,072
Loans to customers	32-33	-	-	634,799	-	634,799
Loans and receivables		-	-	773,260	-	773,260
Bonds and debt instruments						
Listed		54,273	31,347	-	-	85,620
Unlisted			1,727	-	-	1,727
Bonds and debt instruments		54,273	33,074	-	-	87,347
Shares and equity instruments						
Listed		4,810	2,917	-	-	7,727
Unlisted		-	2,804	-	-	2,804
Shares and equity instruments		4,810	5,721	-	-	10,531
Derivatives	30	1,810	-	-	-	1,810
Other financial assets		-	-	3,931	-	3,931
Total financial assets		60,893	38,795	777,191	-	876,879
Derivative instruments and short positions	30	3,963	-	-	-	3,963
Deposits from Central Bank	44	-	-	-	69	69
Deposits from credit institutions	44	-	-	-	25,727	25,727
Deposits from customers	45-46	-	-	-	529,447	529,447
Debt issued and other borrowed funds	47	-	-	-	96,889	96,889
Subordinated loans	48	-	-	-	21,306	21,306
Other financial liabilities		-	-	-	25,363	25,363
Total financial liabilities		3,963	-	-	698,801	702,764

Íslandsbanki hf. Consolidated Financial Statements 2014 22 Amounts are in ISK million

Notes to the Consolidated Financial Statements

8. Cont'd

At 31 December 2013	Notes	Held for trading	Designated at fair value through P&L	Loans & receivables	Liabilities at amortised cost	Total carrying amount
Cash and balances with Central Bank	28	-	-	111,779	-	111,779
Loans and receivables						
Loans to credit institutions	31	-	-	44,078	-	44,078
Loans to customers	32-33	-	-	554,741	-	554,741
Loans and receivables		-	-	710,598	-	710,598
Bonds and debt instruments						
Listed		41,311	31,598	-	-	72,909
Unlisted		-	2,277	-	-	2,277
Bonds and debt instruments		41,311	33,875	-	-	75,186
Shares and equity instruments						
Listed		3,095	3,322	-	-	6,417
Unlisted		-	2,791	-	-	2,791
Shares and equity instruments		3,095	6,113	-	-	9,208
Derivatives	30	843	-	-	-	843
Other financial assets		-	-	9,036	-	9,036
Total financial assets		45,249	39,988	719,634	-	804,871
Derivative instruments and short positions	30	11,176	-	-	-	11,176
Deposits from Central Bank	44	-	-	-	63	63
Deposits from credit institutions	44	-	-	-	29,626	29,626
Deposits from customers	45-46	-	-	-	489,331	489,331
Debt issued and other borrowed funds	47	-	-	-	89,193	89,193
Subordinated loans	48	-	-	-	21,890	21,890
Other financial liabilities		-	-	-	22,561	22,561
Total financial liabilities		11,176	-	-	652,664	663,840

Íslandsbanki hf. Consolidated Financial Statements 2014 23 Amounts are in ISK million

Fair value information for financial instruments

9. Financial instruments carried at fair value

The fair value of a financial instrument is the transaction price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Where a market price is not readily available, the Bank applies valuation techniques based on estimates and assumptions that are consistent with that which market participants would use in setting a price for the financial instrument. In some instances the Bank uses approximation methods. These approximation methods are explained in more detail below.

The table below shows financial instruments carried at fair value categorised into levels of fair value hierarchy that reflect the significance of inputs used in making the fair value measurements as at 31 December 2014. The different levels have been defined as follows:

Level 1: Inputs that are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Bank can access at the measurement date.

Level 2: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).

Level 3: Inputs that are unobservable, e.g. internal assumptions.

At 31 December 2014

Financial assets:	Level 1	Level 2	Level 3	Total
Bonds and debt instruments	54,618	31,539	1,190	87,347
Shares and equity instruments	7,618	98	2,815	10,531
Derivative instruments	-	1,810	-	1,810
Total financial assets	62,236	33,447	4,005	99,688
Financial liabilities:				
Short positions	686	0	-	686
Derivative instruments	-	3,184	93	3,277
Total financial liabilities	686	3,184	93	3,963

The following table shows financial instruments carried at fair value categorised into levels of fair value hierarchy as at 31 December 2013.

At 31 December 2013

Financial assets:	Level 1	Level 2	Level 3	Total
Bonds and debt instruments	42,071	31,836	1,279	75,186
Shares and equity instruments	6,417	-	2,791	9,208
Derivative instruments	-	843	-	843
Total financial assets	48,488	32,679	4,070	85,237
Financial liabilities:				
Short positions	9,252	210	-	9,462
Derivative instruments	-	1,629	85	1,714
Total financial liabilities	9,252	1,839	85	11,176

Íslandsbanki hf. Consolidated Financial Statements 2014 24 Amounts are in ISK million

Notes to the Consolidated Financial Statements

9. Cont'd

Reconciliation of financial assets and liabilities categorised into Level 3

January-December 2014	Bonds and debt instruments	Shares and equity instruments	Derivatives
Fair value at 31 December 2013	1,279	2,791	(85)
Purchases	-	709	-
Sales	(32)	(383)	-
Net gains on financial instruments recognised in profit or loss	(57)	459	(8)
Transfers from level 1 or 2	-	-	-
Transfers to level 1 or 2	-	(760)	-
Fair value at 31 December 2014	1,190	2,816	(93)

January-December 2013	Bonds and debt instruments	Shares and equity instruments	Derivatives
Fair value at 31 December 2012	3,698	3,929	(5,154)
Purchases	-	1,237	-
Sales	-	(1,052)	-
Reclassified as associate	-	(1,021)	-
Settled	(759)	-	-
Net gains on financial instruments recognised in profit or loss	(437)	(164)	(5)
Transfers from level 1 or 2	-	52	-
Transfers to level 1 or 2	(1,223)	(190)	5,074
Fair value at 31 December 2013	1,279	2,791	(85)

One equity instrument, a total of ISK 760 million, was transferred from Level 3 to Level 1 because it was listed on the domestic market in Q1 2014. One foreign-currency denominated equity instrument, ISK 98 million, was transferred from Level 1 to Level 2 as its market price has been discounted by a certain percentage because it usually trades at a discount from its published market price. No other instruments were transferred between levels in 2014.

The responsibility for the valuation at fair value of financial instruments lies within the business units that are responsible for the positions. The business units are required to assess the valuation of their assets quarterly and present them to the Investment Committee which must give its approval of these valuations. Risk Management is responsible for reviewing the valuations, assessing the extent of market data used and categorising the valuation methods.

The objective of this valuation process is to arrive at a fair value measurement which reflects the price of the asset or liability that would be paid or received in an orderly transaction between market participants at the measurement date.

Where applicable, fair values are determined using quoted prices in active markets for identical assets and liabilities. The Bank defines an active market as one where transactions take place with sufficient frequency and volume. In other cases, where there is no active market, the fair value is estimated using valuation techniques such as net present value and discounted cash flow models; comparison with similar instruments for which observable market data exists; net asset value (NAV) for investment fund units or expected recovery for distressed bonds. These valuation techniques are based on various assumptions and inputs such as risk-free rate, expected revenue growth and credit and liquidity spreads. In some cases, where significant inputs into these models are not observable, expert judgement and estimation for these inputs are required.

Íslandsbanki hf. Consolidated Financial Statements 2014 25 Amounts are in ISK million

9. Cont'd

In general, actively traded bonds and shares are classified as Level 1. The Bank classifies mutual fund units as shares and equity instruments in Level 3 and estimates the fair value for these units based on NAV where the unit prices are not readily available. Unlisted equities are initially booked at their transaction price but are revalued each quarter based on the models as described above. They are classified as Level 3. For interest rate derivatives contracts such as interest rate swaps (IRS) and cross-currency interest rate swaps (CIRS) the Bank calculates the net present value of estimated future cash flows based on yield curves with key inputs such as interest swap rates and forward-rate agreements (FRAs) rates. Foreign-currency forwards and foreign-currency swaps are valued using the FX spot rate adjusted for forward pricing points that can be obtained from market sources. These products are classified as Level 2. Bond forwards and equity forwards are also classified as Level 2 as they are valued using standard models with key inputs observed from stock prices, estimated dividend rates and funding rates. In general, standard bond options are classified as Level 2. The Bank classifies non-standard bond options as Level 3 due to the level of internal estimation used in their valuation.

The Bank's Level 1 financial assets and financial liabilities contain bonds and equities that are listed either domestically or abroad. Level 2 assets and liabilities contain illiquid bonds in the domestic markets as well as derivatives. Level 3 assets contain primarily unlisted and illiquid equities and bonds and bond options.

The valuation of Level 3 financial assets is done on a case-by-case basis if the book value exceeds ISK 50 million. Assets that are valued at less than ISK 50 million represent only a fraction (approximately 3%) of the total portfolio and are only revalued if their valuation is expected to change significantly between quarters. The valuation methods are disclosed in the table below.

Valuation techniques used in the measurement of fair value of financial assets and liabilities categorised into Level 3

Valuation technique	Bonds and debt instru-ments	Shares and equity instruments	Derivatives	Significant unobservable input	Range of estimates (weighted average) for unobservable inputs	Fair value measurement sensitivity to unobservable inputs
Expected recovery	1,190	-	-	Value of assets	Bonds: 0-75% (29%)	An increase or decrease in the expected recovery would result in a similar change in the fair value
Discounted cash flow	-	274	-	Weighted average cost of capital (WACC)	11% (11%)	An increase in the WACC would result in a lower fair value and a decrease would result in a higher fair value
EV/EBITDA multiplier	-	1,813	-	EV/EBITDA	13.2-13.9 (13.7)	A higher multiplier would result in a higher fair value and a lower multiplier would result in a lower fair value
Net asset value	-	729	-	Value of assets	ISK 0-253m (ISK 40m)	An increase in net asset value would result in a higher fair value and a decrease would result in a lower fair value
Other	-	-	(93)	Bond price volatility	6% (6%)	An increase in the volatility would result in a lower fair value and a decrease would result in a higher fair value
Total	1,190	2,816	(93)			

Íslandsbanki hf. Consolidated Financial Statements 2014 26 Amounts are in ISK million

Notes to the Consolidated Financial Statements

10. Financial instruments not carried at fair value

The table below shows the fair value measurement and classification of financial assets and liabilities not carried at fair value at 31 December 2014. The different levels are defined as before (see note 9).

Assets

Loans to customers on the Bank's balance sheet that are carried at amortised cost consist of two types:

1) Loans whose carrying amount is less than their claim value, due to either impairments or deep discount.
2) Loans whose carrying amount equals the claim value.

Loans in category 1) are specifically measured at least every six months and every three months for significant amounts and therefore it is considered that their carrying amount is a good approximation of their fair value. Since measurement is partially based on internal models they are classified as Level 3. The fair value of the loans in category 2) may differ from their carrying amount because the interest rate they carry may not reflect the interest rate that similar new loans would carry. This difference stems from two sources:

a) Credit migration: The debtors may not have the same credit-worthiness they had when the loans' interest rates were last reset and the collateralisation of the loan may have changed.
b) Fixed rate loans: The interest rate level used as a base for pricing fixed rate loans may have shifted.

The Bank calculates the fair value of loans in category 2) by discounting from the carrying amount the resulting interest rate difference from 31 December 2014 to the loan's next interest reset or maturity, whichever comes first. Since the credit-worthiness is estimated using the Bank's internal models these assets are classified as Level 3.
For "Cash and balances with Central Bank", "Loans to credit institutions" and "Other financial assets" the fair value is very well approximated by the carrying amount since they are short term in nature. They are thus classified as Level 2.

Liabilities

The fair value of a financial liability with a demand feature, such as a demand deposit, is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid.

On the liabilities side most deposits are on demand or carry floating interest rates and as such their carrying amount is considered a good approximation of their fair value. For longer term, fixed rate deposits the Bank calculates the fair value with a duration approach, using the difference in each liability´s current interest rate from the rate that a similar deposit would carry today. The fair value estimate of deposits does not take into account the effect of the Payment Service Directive on interest reset dates. All deposits are classified as Level 2 based on the use of observable market interest rates to estimate the fair value.

For the fair value of "Debt issued and other borrowed funds" the Bank uses an observed market value where it is available. Issued bonds and bills with quoted market prices are classified as Level 1. If there is no quoted market price the fair value of the debt is valued in the same manner as deposits if it carries a fixed rate. If the debt carries a floating rate its fair value is estimated by comparing the margin with the Bank's current funding premium on similar debt. These liabilities are classified as Level 2. The Bank estimates its funding premium based on the interest margin on its issued papers including covered bonds, commercial papers as well as foreign currency denominated bonds.

The fair value of liabilities in "Subordinated loans" is estimated using a duration approach by comparing the contractual interest margin with the interest margin in the market on the Bank's issuance in foreign currency plus a margin to account for the fact that the subordinated liabilities are junior to the market traded debt. These liabilities are classified as Level 2.

Other financial liabilities mainly include unsettled securities transactions and liabilities to retailers for credit card provision and are classified as level 2 since their value is not observable from active market prices. Due to the short term nature of these liabilities their carrying amount is considered a good approximation of their fair value.

The following table shows the fair value for the Bank's assets and liabilities recognised at amortised cost.

At 31 December 2014	Level 1	Level 2	Level 3	Total fair value	Carrying amount
Financial assets:					
Cash and balances with Central Bank	-	103,389	-	103,389	103,389
Loans to credit institutions	-	35,072	-	35,072	35,072
Loans to customers	-	-	636,141	636,141	634,799
Other financial assets	-	3,931	-	3,931	3,931
Total financial assets	-	142,392	636,141	778,533	777,191

Íslandsbanki hf. Consolidated Financial Statements 2014 27 Amounts are in ISK million

10. Cont'd

	Level 1	Level 2	Level 3	Total fair value	Carrying amount
Financial liabilities:					
Deposits from Central Bank	-	69	-	69	69
Deposits from credit institutions	-	25,727	-	25,727	25,727
Deposits from customers	-	529,519	-	529,519	529,447
Debt issued and other borrowed funds	37,293	59,601	-	96,894	96,889
Subordinated loans	-	21,306	-	21,306	21,306
Other financial liabilities	-	25,363	-	25,363	25,363
Total financial liabilities	37,293	661,585	-	698,878	698,801

At 31 December 2013	Level 1	Level 2	Level 3	Total fair value	Carrying amount
Financial assets:					
Cash and balances with Central Bank	-	111,779	-	111,779	111,779
Loans to credit institutions	-	44,078	-	44,078	44,078
Loans to customers	-	-	556,068	556,068	554,741
Other financial assets	-	9,036	-	9,036	9,036
Total financial assets	-	164,893	556,068	720,961	719,634
Financial liabilities:					
Deposits from Central Bank	-	63	-	63	63
Deposits from credit institutions	-	29,626	-	29,626	29,626
Deposits from customers	-	489,430	-	489,430	489,331
Debt issued and other borrowed funds	33,049	56,674	-	89,723	89,193
Subordinated loans	-	21,880	-	21,880	21,890
Other financial liabilities	-	22,561	-	22,561	22,561
Total financial liabilities	33,049	620,234	-	653,283	652,664

Íslandsbanki hf. Consolidated Financial Statements 2014 28 Amounts are in ISK million

Notes to the Consolidated Financial Statements

Offsetting financial assets and financial liabilities

11. Offsetting financial assets and financial liabilities

The table below provides a summary of the financial assets and financial liabilities which are subject to enforceable master netting agreements or similar arrangements, even if they have not been offset in the balance sheet.

a) Financial assets subject to offsetting, enforceable netting arrangements and similar agreements

	Financial assets subject to netting arrangements			Amounts not set off but subject to master netting arrangements and similar agreements					
At 31 December 2014	Gross recognised financial assets before balance sheet netting	Balance sheet netting with gross recognised financial liabilities	Financial assets recognised on the balance sheet, net	Recognised financial liabilities	Cash collateral received	Financial instruments collateral received	Net amount after consideration of potential effect of netting arrangements	Assets outside the scope of offsetting disclosure requirements	Total assets recognised on the balance sheet
Derivatives	1,810	-	1,810	(306)	(48)	(18)	1,438	-	1,810
Total assets	1,810	-	1,810	(306)	(48)	(18)	1,438	-	1,810
At 31 December 2013									
Derivatives	843	-	843	(60)	(98)	(152)	534	-	843
Total assets	843	-	843	(60)	(98)	(152)	534	-	843

b) Financial liabilities subject to offsetting, enforceable netting arrangements and similar agreements

	Financial liabilities subject to netting arrangements			Amounts not set off but subject to master netting arrangements and similar agreements					
At 31 December 2014	Gross recognised financial liabilities before balance sheet netting	Balance sheet netting with gross recognised financial assets	Financial liabilities recognised on the balance sheet, net	Recognised financial assets	Cash collateral pledged	Financial instruments collateral pledged	Net amount after consideration of potential effect of netting arrangements	Liabilities outside the scope of offsetting disclosure requirements	Total liabilities recognised on the balance sheet
Derivative instruments and short positions	3,277	-	3,277	(306)	-	(1,899)	1,072	686	3,963
Total liabilities	3,277	-	3,277	(306)	-	(1,899)	1,072	686	3,963
At 31 December 2013									
Derivative instruments and short positions	1,714	-	1,714	(60)	-	-	1,654	9,462	11,176
Total liabilities	1,714	-	1,714	(60)	-	-	1,654	9,462	11,176

Íslandsbanki hf. Consolidated Financial Statements 2014 29 Amounts are in ISK million

Notes to the Consolidated Financial Statements

Net interest income

12. Net interest income is specified as follows:

	2014	2013
Interest income:		
Cash and balances with Central Bank	6,671	4,639
Loans and receivables	40,521	46,764
Financial assets held for trading	1,957	948
Financial assets designated at fair value through profit or loss	1,672	1,790
Other assets	185	192
Total interest income	51,006	54,333
Interest expense:		
Deposits from credit institutions and Central Bank	(479)	(505)
Deposits from customers	(16,919)	(18,174)
Borrowings	(4,940)	(5,753)
Subordinated loans	(911)	(951)
Other financial liabilities	(295)	(367)
Other interest expense	(357)	(153)
Total interest expense	(23,901)	(25,903)
Net interest income	27,105	28,430
Interest spread (as the ratio of net interest income to the average carrying amount of total assets)	3.0%	3.4%

Net fee and commission income

13. Net fee and commission income is specified as follows:

	2014	2013
Fee and commission income:		
Asset management	1,683	1,564
Investment Banking and brokerage	1,833	2,005
Payment processing	11,627	10,484
Loans and guarantees	1,267	1,141
Other fees and commissions income	1,574	1,501
Total fees and commission income	17,984	16,695
Commission expenses:		
Interbank charges	(157)	(331)
Brokerage	(128)	(126)
Clearing and settlement	(6,179)	(5,702)
Other commission expenses	(37)	(103)
Total commission expenses	(6,501)	(6,262)
Net fee and commission income	11,483	10,433

Íslandsbanki hf. Consolidated Financial Statements 2014 30 Amounts are in ISK million

Notes to the Consolidated Financial Statements

Net financial income

14. Net financial income is specified as follows:

	2014	2013
Net gain on financial assets and liabilities held for trading	7	891
Net gain on financial assets designated at fair value through profit or loss	1,786	3,721
Net loss on loss of control over subsidiary	(225)	-
Net financial income	1,568	4,612

Net gain on financial assets and liabilities held for trading

15. Net gain on financial assets and liabilities held for trading is specified as follows:

	2014	2013
Shares and related derivatives	(274)	498
Dividend income on shares held for trading	185	115
Bonds and related derivatives	(176)	(71)
Other derivatives	272	349
Net gain on financial assets and liabilities held for trading	7	891

Net gain on financial assets designated at fair value through profit or loss

16. Net gain on financial assets designated at fair value through profit or loss is specified as follows:

	2014	2013
Shares	1,821	3,799
Bonds	(35)	(78)
Net gain on financial assets designated at fair value through profit or loss	1,786	3,721

Net foreign exchange gain (loss)

17. Net foreign exchange gain (loss) is specified as follows:

	2014	2013
Assets:		
Cash and balances with Central Bank	(42)	(145)
Financial assets held for trading	(1,314)	3,246
Loans	1,989	(15,321)
Other assets	754	(32)
Total	1,387	(12,252)
Liabilities:		
Deposits	(2,246)	7,582
Subordinated loans	584	1,576
Debt issued and other borrowed funds	1,106	(74)
Other liabilities	(666)	188
Total	(1,222)	9,272
Unadjusted net foreign exchange gain (loss)	165	(2,980)
Foreign exchange gain reversal on loans to customers with ISK cash flow*	-	557
Net foreign exchange gain (loss)	165	(2,423)

*Further discussed under Note 24

Íslandsbanki hf. Consolidated Financial Statements 2014 31 Amounts are in ISK million

Notes to the Consolidated Financial Statements

Other operating income

18. Other operating income is specified as follows:

	2014	2013
Agency fees and service level agreement fees	269	338
Rental income from real estate	143	145
Rental income from foreclosed assets	282	349
Legal cost and fees	148	192
Realised gain on property and equipment	242	556
Other operating income (expenses)	1,011	(38)
Other operating income	2,095	1,542

Administrative expenses

19. Administrative expenses are specified as follows:

	2014	2013
Salaries and related expenses	13,307	13,361
Other administrative expenses	8,631	11,118
Depreciation	819	946
Amortisation	144	126
Administrative expenses	22,901	25,551

Salaries and related expenses

20. Salaries and related expenses are specified as follows:

	2014	2013
Salaries	10,193	10,220
Pension	1,491	1,409
Social security charges and financial activities tax	1,460	1,589
Other	163	143
Salaries and related expenses	13,307	13,361

The Bank made a provision of ISK 358 million (2013: ISK 271 million) for potential performance plan payments. In accordance with the FME rules no. 700/2011, part of the payment is deferred for a minimum of 3 years (see Note 22). Salary related expenses are included in the amount.

21. The Bank's total number of employees is as follows:

	At 31 December 2014		At 31 December 2013	
	Parent Company	The Bank	Parent Company	The Bank
Average number of employees	990	1,253	1,056	1,265
Positions at the end of the year	945	1,206	988	1,201

Average number of employees for the Bank in 2014 includes 114 employees (2013: 84 employees) in disposal groups held for sale, whose salaries are not included in the salaries and related expenses.

Íslandsbanki hf. Consolidated Financial Statements 2014 32 Amounts are in ISK million

Notes to the Consolidated Financial Statements

Employment terms for the Board of Directors, the CEO and Management Board

22. Employment terms for the Board of Directors, the CEO and Management Board are specified as follows:

2014	Salaries
Fridrik Sophusson, Chairman of the Board	7.5
John E. Mack, Vice-Chairman of the Board	5.4
Árni Tómasson, member of the Board	5.4
Helga Valfells, member of the Board	5.8
Marianne Økland, member of the Board	5.4
Neil Graeme Brown, member of the Board	5.4
Þóranna Jónsdóttir, member of the Board	5.8
Daniel Levin, former member of the Board	3.6
María E. Ingvadóttir, former member of the Board	4.1
Total	48.4

2014	Salaries	Performance based payments
Birna Einarsdóttir, CEO	38.6	4.8
8 Managing Directors	198.7	22.4

2013	Salaries
Fridrik Sophusson, Chairman of the Board	7.5
John E. Mack, Vice-Chairman of the Board	5.8
Árni Tómasson, member of the Board	5.4
Daniel Levin, member of the Board	5.7
Helga Valfells, member of the Board	1.4
Marianne Økland, member of the Board	5.7
María E. Ingvadóttir, member of the Board	5.4
Neil Graeme Brown, member of the Board	5.7
Þóranna Jónsdóttir, member of the Board	1.4
Alternate board members	0.2
Total	44.2

2013	Salaries	Performance based payments
Birna Einarsdóttir, CEO	36.4	3.6
7 Managing Directors	180.7	18.2

The employer's contribution to pension funds and other benefits for the Board, CEO and Management Board amounted to ISK 42.5 million in 2014 (2013: ISK 51.8million). There were no share based payments in the years 2014 and 2013.

The performance based salaries are based on FME rules on renumeration policy for financial undertakings (700/2011). The rules reflect a conservative framework for remuneration schemes within the financial sector. The remuneration policy shall not encourage unreasonable risk taking, nor contravene the long-term interests of the under taking and the stability of the financial system. The policy shall conform to viewpoints related to the protection of the undertaking's customers, its creditors and shareholders or guarantee capital owners and in other respects conform to proper and sound business practices.The rules state that the aggregate of variable remuneration including deferred payments shall not amount to more than 25% of the annual salary of the person in question, exclusive of variable remuneration. Payment of at least 40% of the variable remuneration shall be deferred for a minimum of three years if the variable remuneration is in excess of 10% of the annual salary of the person in question, exclusive of variable remuneration. Risk management, compliance and internal audit shall review and analyse whether variable remuneration complies with the undertaking's remuneration policy and the FME rules. The rules prohibit employees in these units to be paid performance based salaries.

Íslandsbanki hf. Consolidated Financial Statements 2014 33 Amounts are in ISK million

Notes to the Consolidated Financial Statements

Auditors' fees

23. Auditors' fees are as follows:

	2014	2013
Audit of the annual accounts	94	104
Review of interim accounts	27	33
Other services	42	31
Auditors' fees	163	168

Loan impairment charges and net valuation changes

24. Loan impairment charges and net valuation changes:

	2014	2013
Impairment charged to the income statement:		
Specific impairment losses on financial assets	(2,822)	(6,438)
Impairment of foreign exchange gain	-	557
Net specific impairment losses on financial assets	(2,822)	(5,881)
Collective impairment	967	(1,940)
Total impairment charged to the income statement (see Note 34)	(1,855)	(7,821)
Net valuation changes on loans:		
Income due to revised estimated future cash flow from loans	10,665	24,677
Net specific impairment losses on financial assets	(2,822)	(5,881)
Foreign exchange loss (see Note 17)*	-	(557)
Net valuation changes on loans	7,843	18,239
Collective impairment	967	(1,940)
Loan impairment charges and net valuation changes	8,810	16,299

* In 2013 foreign exchange gain on foreign currency loans to customers with revenue and cash flows in ISK was impaired and offset against total foreign exchange gain as per Note 17.

Profit from discontinued operations

25. Profit from discontinued operations are specified as follows:

	2014	2013
Net profit from sale of foreclosed mortgages	1,589	785
Net share of loss from disposal groups held for sale	(941)	(822)
Net profit from sale of subsidiaries and associates	3,488	964
Profit from discontinued operations	4,136	927

Íslandsbanki hf. Consolidated Financial Statements 2014 34 Amounts are in ISK million

Notes to the Consolidated Financial Statements

Effective income tax

26. Income tax for the year 2014 is calculated at 20%. Special financial activities tax (FAT) is calculated as 6% of taxable profits above ISK 1 billion. The effective income tax rate in the Bank's income statement for 2014 is 25.1%. The difference is specified as follows:

Income tax recognised in the income statement is specified as follows:

	2014	2013
Current tax expense	4,423	6,496
Special financial activities tax	1,275	1,833
Difference in prior year's imposed and calculated income tax	(103)	(52)
Origination and reversal of temporary differences due to deferred tax assets	644	(411)
Total	6,239	7,866

The effective income tax rate is specified as follows:

	2014		2013	
Profit before tax	24,853		30,008	
20% income tax calculated on the profit of the year	4,971	20.0%	6,002	20.0%
Special financial activities tax	1,275	5.1%	1,833	6.1%
Tax on income not subject to tax	(976)	(3.9%)	(938)	(3.1%)
Non-deductable expenses	471	1.9%	667	2.2%
Other differences	498	2.0%	302	1.0%
Effective income tax	6,239	25.1%	7,866	26.2%

The Bank is taxed jointly with its subsidiary Íslandssjódir hf. whereby the taxable income of the subsidiary is added to the taxable income of the parent and taxed as one. Joint taxation is only applicable for calculation of income taxes. Tax losses brought forward which originate before the permission for a joint taxation was issued by the tax authorities cannot be used except to offset taxes of the entity where they originated.

Earnings per share

27. Earnings per share are specified as follows:

Basic earnings per share, ISK

Profit attributable to ordinary shareholders	2014	2013
Net profit to the equity holders of the parent, according to the statement of comprehensive income	21,740	22,977
Average outstanding shares:		
Weighted average number of outstanding shares for the period, million	10,000	10,000
From profit for the year	2.17	2.30

Diluted earnings per share, ISK

Profit attributable to ordinary shareholders (diluted)		
Average outstanding shares for the calculation of diluted earnings per share	10,000	10,000
Number of total shares at the end of the period, million, diluted	10,000	10,000
From profit for the year	2.17	2.30

There have been no transactions involving ordinary shares or potential ordinary shares between the reporting date and the date of the completion of these consolidated financial statements which would require the restatement of earnings per share.

Íslandsbanki hf. Consolidated Financial Statements 2014 35 Amounts are in ISK million

Notes to the Consolidated Financial Statements

Cash and balances with Central Bank

28. Specification of cash and balances with Central Bank:

	31.12.2014	31.12.2013
Cash on hand	2,256	2,472
Balances with Central Bank other than mandatory reserve deposits	10,738	6,619
Term Deposit	80,843	-
Certificates of deposit	-	99,085
Included in cash and cash equivalents	93,837	108,176
Mandatory reserve deposits with Central Bank	9,552	3,603
Cash and balances with Central Bank	103,389	111,779

The average balance of the Central bank current account for each month must be equivalent to at least mandatory reserve deposits, amounted to ISK 9,629 million (December 2013: ISK 8,153 million).

The Central Bank's auctions of 28-day Certificates of deposit have been discontinued. Instead, financial institutions that engage in transactions with the Central Bank are offered two types of term deposits that are eligible as collateral for Central Bank facilities.

Pledged assets

	31.12.2014	31.12.2013
29. Financial assets which have been pledged as collaterals for liabilities	96,633	106,062

The Bank has issued covered bonds under Icelandic law, with maturities of up to 12 years, which are pledged on a pool of consumer mortgage loans. The underlying cover pool must withstand a weekly stress test with regards to interest rates and exchange rates. The Bank also pledged a pool of customer loans as collateral for an asset-backed bond issued to the Central Bank. Furthermore, the Bank pledged a pool of customer loans as collateral in a currency swap agreement with the Central Bank in order to reduce the Bank's foreign exchange imbalance and has also pledged cash collateral in foreign currency for International Swaps and Derivatives Association (ISDA) agreements with foreign financial institutions.

Derivative instruments and short positions

30. Derivative instruments and short positions:

At 31 December 2014

	Assets	Notional values related to assets	Liabilities	Notional values related to liabilities
Interest rate swaps	360	10,800	1,027	18,950
Cross currency interest rate swaps	886	34,369	1,926	24,252
Equity forwards	144	1,605	117	1,482
Foreign exchange forwards	16	1,468	97	3,695
Foreign exchange swaps	306	4,744	2	963
Bond forwards	98	4,371	15	1,100
Bond options			93	25,000
Derivatives	1,810	57,357	3,277	75,442
Short positions in listed bonds	-	-	686	-
Total	1,810	57,357	3,963	75,442

Íslandsbanki hf. Consolidated Financial Statements 2014 36 Amounts are in ISK million

Notes to the Consolidated Financial Statements

30. Cont'd

At 31 December 2013

	Assets	Notional values related to assets	Liabilities	Notional values related to liabilities
Interest rate swaps	21	2,000	1,364	19,500
Cross currency interest rate swaps	525	28,240	28	6,585
Equity forwards	21	7	182	104
Foreign exchange forwards	197	6,498	34	712
Foreign exchange swaps	42	1,176	7	3,193
Bond forwards	37	1,987	14	2,065
Bond options	-	-	85	25,000
Derivatives	843	39,908	1,714	57,159
Short positions in listed bonds	-	-	9,462	-
Total	843	39,908	11,176	57,159

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

Short positions are in Icelandic government bonds and institutions with government guarantees. As a primary dealer the Bank has access to securities lending facilities provided by the Central Bank and the Housing Financing Fund. Majority of the securities lending facilities have a maturity of less than a year.

Loans

31. Loans to credit institutions:

	31.12.2014	31.12.2013
Money market loans	10,889	13,821
Bank accounts	24,183	30,257
Loans to credit institutions	35,072	44,078

32. Loans to customers:

	31.12.2014	31.12.2013
Loans and advances to customers at amortised cost	634,799	554,741
Loans to customers	634,799	554,741

Íslandsbanki hf. Consolidated Financial Statements 2014 37 Amounts are in ISK million

Notes to the Consolidated Financial Statements

33. Loans to customers at amortised cost:

At 31 December 2014

	Gross amount	Specific impairment allowance	Loans less impairment allowance
Loans to customers:			
Individuals	268,053	(5,205)	262,848
Commerce and services	83,590	(3,932)	79,658
Construction	21,472	(2,721)	18,751
Energy	7,315	-	7,315
Financial services	121	-	121
Industrial and transportation	63,019	(1,141)	61,878
Investment companies	15,531	(1,620)	13,911
Public sector and non-profit organisations	12,234	(18)	12,216
Real estate	100,774	(1,234)	99,540
Seafood	82,449	(1,037)	81,412
Loans to customers before collective impairment allowance			637,650
Collective impairment allowance			(2,851)
Loans to customers	654,558	(16,908)	634,799

At 31 December 2013

	Gross amount	Specific impairment allowance	Loans less impairment allowance
Loans to customers:			
Individuals	263,446	(8,402)	255,044
Commerce and services	85,340	(3,818)	81,522
Construction	20,656	(2,016)	18,640
Energy	3,614	-	3,614
Financial services	34	-	34
Industrial and transportation	48,224	(1,791)	46,433
Investment companies	13,839	(3,533)	10,306
Public sector and non-profit organisations	6,943	(49)	6,894
Real estate	69,732	(3,085)	66,647
Seafood	70,829	(1,540)	69,289
Loans to customers before collective impairment allowance			558,423
Collective impairment allowance			(3,682)
Loans to customers	582,657	(24,234)	554,741

Íslandsbanki hf. Consolidated Financial Statements 2014 38 Amounts are in ISK million

Notes to the Consolidated Financial Statements

34. Financial assets - impairments

The following table shows the movement in the provision for impairment losses for loans and receivables.

	Specific impairment allowance	Collective impairment allowance	Total
At 1 January 2014	24,234	3,682	27,915
Reclass 1 January	(137)	137	-
Amounts written-off	(9,745)	-	(9,745)
Recoveries of amounts previously written-off	934	-	934
Principal credit adjustment	(1,200)	-	(1,200)
Charged to the income statement	2,822	(967)	1,855
At 31 December 2014	16,908	2,851	19,759

	Specific impairment allowance	Collective impairment allowance	Total
At 1 January 2013	45,191	1,738	46,929
Amounts written-off	(19,254)	4	(19,251)
Recoveries of amounts previously written-off	1,240	-	1,240
Principal credit adjustment	(8,824)	-	(8,824)
Charged to the income statement	5,881	1,940	7,821
At 31 December 2013	24,234	3,682	27,915

	2014	2013
Impairment losses charged to the income statement:		
Loans to customers	1,855	7,821
Impairment losses charged to the income statement	1,855	7,821

Specific impairment allowance comprises impairment for financial assets that are assessed individually and collectively assessed allowance comprises estimates of impairment losses that have been incurred but not identified in the reporting period for a group of loans that have similar credit risk characteristics.

Íslandsbanki hf. Consolidated Financial Statements 2014 39 Amounts are in ISK million

Notes to the Consolidated Financial Statements

Investment in associates

35. Changes in investment in associates:

	31.12.2014	31.12.2013
Investments in associates at the beginning of the year	1,563	503
Additions during the period	62	37
Transfers	-	1,020
Revaluation	(20)	-
Share of results	27	3
Distribution of capital	(1,062)	-
Investment in associates	570	1,563

36. The Bank's interest in its principal associates are as follows:

	Ownership at year-end
FAST GP ehf., Kirkjusandi 2, 155 Reykjavík	35.0%
Atorka Group hf., Túngötu 14, 101 Reykjavík	26.8%
Reiknistofa bankanna hf., Katrínartúni 2, 105 Reykjavík	30.8%
Audkenni hf., Borgartúni 31, 105 Reykjavík	20.9%

Summarised financial information in respect of the Bank's associates is set out below:

	31.12.2014	31.12.2013
Total assets	8,644	12,046
Total liabilities	(5,352)	(7,517)
Net assets	3,292	4,529
Bank's share of net assets of associates	570	1,563

	2014	2013
Total revenue	4,620	3,979
Total loss of associates for the year	(1,232)	(78)

Íslandsbanki hf. Consolidated Financial Statements 2014 40 Amounts are in ISK million

Notes to the Consolidated Financial Statements

Investment in subsidiaries

37. Significant subsidiaries:

	Location	Owner-ship
Borgun hf., Ármúla 30, 108 Reykjavík	Iceland	63.5%
Íslandssjódir hf., Kirkjusandi 2, 155 Reykjavík	Iceland	100%
Midengi ehf., Lækjargötu 12, 155 Reykjavík	Iceland	100%
Hringur eignarhaldsfélag ehf., Digranesvegi 1, 200 Kópavogur	Iceland	100%
Allianz Ísland hf., Digranesvegi 1, 200 Kópavogur	Iceland	100%
D-1 ehf., Kirkjusandi 2, 105 Reykjavík	Iceland	100%
Geysir Green Investment Fund slhf., Kirkjusandi 2, 105 Reykjavík	Iceland	100%
Fergin ehf., Hesthálsi 6-8, 110 Reykjavík	Iceland	80%
Frumherji hf., Hesthálsi 6-8, 110 Reykjavík	Iceland	80%
23 other subsidiaries (SME)		

38. Net comprehensive income (NCI) in subsidiaries

The following table summarises the infomation relating to the Bank's subsidiary that has material NCI.

Borgun hf.

Non-controlling interests percentage	36.5%	36.5%
	2014	2013
Loans and receivables	4,118	3,897
Other assets	24,818	21,092
Liabilities	24,571	21,939
Net assets	4,365	3,050
Carrying amount of NCI	1,593	1,113
Revenue	4,212	3,615
Profit	1,316	994
Total comprehensive income	1,316	994
Profit allocated to NCI	480	363
Cash flows from operating activities	3,300	2,993
Cash flows from investing activities	(485)	(1,295)
Cash flows from financing activities	-	-
Net increase in cash and cash equivalents	2,815	1,698

Íslandsbanki hf. Consolidated Financial Statements 2014 41 Amounts are in ISK million

Related party disclosures

39. Ultimate controlling party

The Bank has determined that ISB Holding ehf. is the ultimate controlling party of the Bank with GLB Holding ehf. having significant influence. This is reflected in related party transactions.

Entities which are controlled, jointly controlled or significantly influenced by the government (state-controlled entities) are not considered as being a related party if neither entity actually influenced the other and if the state did not actually influence either entity with regards to transactions between them. The Bank's transactions with state-controlled entities during the year were based on general business terms of the Bank.

Related party transactions

The Bank has a related party relationship with its associates, the Board of Directors of the parent company and the ulitmate controlling party, the chief executive officer, close family members of individuals referred to herein and entities with significant influence as the largest shareholders of the Bank.

All loans to employees are provided on general business terms of the Bank. Included in assets are loans to key management.

Related parties have transacted with the Bank during the period as follows:

			31.12.2014			31.12.2013
	Assets	Liabilities	Total	Assets	Liabilities	Total
CEO and Man. Directors (incl. comp. owned by them)	253	(130)	123	178	(285)	(107)
Members of the Board (incl. comp. owned by them)	8,658	(1,133)	7,525	462	(2,393)	(1,931)
Associated companies and other related parties	553	(1,316)	(763)	288	(3,824)	(3,536)
Total	9,464	(2,579)	6,885	928	(6,502)	(5,574)

	31.12.2014	31.12.2013
Guarantees	544	478
Loan commitments, overdrafts and credit card commitments	609	124

Impairment allowances of ISK -165 million (2013: ISK 70 million) were recognised during the year against balances outstanding with associated companies. No share option programmes were operated during 2014. For related party remuneration see Note 22.

Íslandsbanki hf. Consolidated Financial Statements 2014 42 Amounts are in ISK million

Property and equipment

40. Property and equipment are specified as follows:

At 31 December 2014	Land and buildings	Fixtures, equipment & vehicles	Total
Historical cost			
Balance at the beginning of the year	7,843	4,402	12,245
Additions during the year	376	382	758
Disposals and write-offs during the year	(1,466)	(251)	(1,717)
Balance at 31.12.2014	6,753	4,533	11,286
Accumulated depreciation			
Balance at the beginning of the year	(1,386)	(2,087)	(3,473)
Depreciation during the year	(120)	(512)	(632)
Disposals during the year	66	155	221
Balance at 31.12.2014	(1,440)	(2,444)	(3,884)
Carrying amount at 31.12.2014	5,313	2,089	7,402
Depreciation rates	0-2%	8-33%	

Official real estate value of buildings and leased land	4,091
Insurance value of buildings as at 31.12.2014	5,848
Insurance value of fixtures, equipment and vehicles as at 31.12.2014	2,300

At 31 December 2013	Land and buildings	Fixtures, equipment & vehicles	Total
Historical cost			
Balance at the beginning of the year	3,198	4,117	7,315
Change from previous year	1,004	-	1,004
Additions during the year	233	625	858
Net acquisition through business combinations	4,100	-	4,100
Disposals and write-offs during the year	(692)	(340)	(1,032)
Balance at 31.12.2013	7,843	4,402	12,245
Accumulated depreciation			
Balance at the beginning of the year	(51)	(1,685)	(1,736)
Change from previous year	(1,004)	-	(1,004)
Depreciation during the year	(135)	(630)	(765)
Impairment during the year	(214)	-	(214)
Disposals during the year	18	228	246
Balance at 31.12.2013	(1,386)	(2,087)	(3,473)
Carrying amount at 31.12.2013	6,457	2,315	8,772
Depreciation rates	0-2%	8-33%	

Official real estate value of buildings and leased land	4,383
Insurance value of buildings as at 31.12.2013	7,523
Insurance value of fixtures, equipment and vehicles as at 31.12.2013	2,086

Íslandsbanki hf. Consolidated Financial Statements 2014 43 Amounts are in ISK million

Intangible assets

41. Intangible assets are specified as follows:

At 31 December 2014	Purchased software	Developed software	Total
Historical cost			
Balance at the beginning of the year	478	200	678
Additions during the year	462	-	462
Internal development	-	2	2
Balance at 31.12.2014	940	202	1,142
Accumulated amortisation and impairment losses			
Balance at the beginning of the year	(246)	(133)	(379)
Amortisation during the year	(94)	(50)	(144)
Balance at 31.12.2014	(340)	(183)	(523)
Carrying amount at 31.12.2014	600	19	619
Amortisation rates	25%	25%	

At 31 December 2013	Purchased software	Developed software	Total
Historical cost			
Balance at the beginning of the year	314	200	514
Additions during the year	164	-	164
Balance at 31.12.2013	478	200	678
Accumulated amortisation and impairment losses			
Balance at the beginning of the year	(170)	(83)	(253)
Amortisation during the year	(76)	(50)	(126)
Balance at 31.12.2013	(246)	(133)	(379)
Carrying amount at 31.12.2013	232	67	299
Amortisation rates	25%	25%	

Íslandsbanki hf. Consolidated Financial Statements 2014 44 Amounts are in ISK million

Notes to the Consolidated Financial Statements

Non-current assets and disposal groups held for sale

42. Specification of non-current assets and disposal groups held for sale:

	31.12.2014	31.12.2013
Repossessed collateral	8,592	10,722
Assets of disposal groups classified as held for sale	13,057	36,384
Total	21,649	47,106

Repossessed collateral:

	31.12.2014	31.12.2013
Land and property	8,176	8,544
Industrial equipment and vehicles	51	34
Shares and equity instruments	365	2,144
Total	8,592	10,722

The Bank classified the assets and liabilities of its subsidiaries Fastengi ehf., Hafnargata 7 ehf., IG Invest ehf., Fjárvari ehf., Bréfabær ehf., Smyrlaheidi ehf., LT lódir ehf., Geysir Green Investment Fund slhf., Gráhella ehf., ÍSB fasteignir ehf., Fergin ehf., Frumherji hf., and Manston Properties Ltd. as assets and liabilities of disposal groups held for sale.

Shares and equity instruments comprise shares in the Bank's associates and are classfied as non-current assets held for sale.

Assets of disposal groups classified as held for sale:

	31.12.2014	31.12.2013
Cash	150	535
Equity instruments	775	775
Receivables	1,050	785
Tax assets	78	225
Properties and land	6,820	29,256
Equipment	411	379
Other assets	3,773	4,429
Total	13,057	36,384

Liabilities associated with assets classified as held for sale:

	31.12.2014	31.12.2013
Payables	80	502
Deferred tax liabilities	76	644
Income tax payables	45	416
Borrowings	2,284	7,148
Other liabilities	305	746
Total	2,790	9,456

Other assets

43. Other assets are specified as follows:

	31.12.2014	31.12.2013
Receivables	4,845	4,816
Unsettled securities transactions	1,660	5,099
Accruals	606	731
Prepaid expenses	213	200
Other assets	295	313
Other assets	7,619	11,159

Íslandsbanki hf. Consolidated Financial Statements 2014 45 Amounts are in ISK million

Deposits from Central Bank and credit institutions

44. Deposits from Central Bank and credit institutions are specified as follows:

	31.12.2014	31.12.2013
Repurchase agreements with Central Bank	69	63
Deposits from credit institutions	25,727	29,626
Deposits from Central Bank and credit institutions	25,796	29,689

Deposits from customers

45. Deposits from customers are specified by type as follows:

	31.12.2014	31.12.2013
Demand deposits	421,332	394,345
Time deposits	108,115	94,986
Deposits from customers	529,447	489,331

Demand deposits include deposits with maturity of up to 3 months.

46. Deposits from customers are specified by owners as follows:

		31.12.2014		31.12.2013
	Amount	% of total	Amount	% of total
Central government and state-owned enterprises	11,437	2%	5,086	1%
Municipalities	6,810	1%	4,193	1%
Other companies	310,317	59%	292,792	60%
Individuals	200,883	38%	187,260	38%
Deposits from customers	529,447	100%	489,331	100%

Debt issued and other borrowed funds

47. Specification of debt issued and other borrowed funds:

	31.12.2014	31.12.2013
Non-listed issued bonds	27,810	46,758
Listed issued bonds	66,460	41,006
Loans from credit institutions	2	2
Other debt securities	2,617	1,427
Debt issued and other borrowed funds	96,889	89,193

Non-listed bonds include an asset-backed bond issued to the Central Bank which matures in July 2019 and is pledged on a pool of loans to customers. Listed bonds are covered bonds pledged on a pool of mortgage loans, short-term unsecured bonds (commercial paper) and bonds issued under the Bank's GMTN programme. The Bank did not repurchase any of its own debt during 2014.

At the beginning of 2014, the Bank had five listed covered bond series, three CPI linked and two non-indexed. The CPI linked issues had a total outstanding amount of ISK 19.1 billion but the non-indexed issues a total of ISK 4.2 billion. Seven auctions were held during the year and both the CPI linked and the non-indexed issues were offered to investors quarterly except in the third quarter when only the CPI linked issues where offered. Two new covered bond series were issued in 2014, the CPI linked issue ISLA CBI 20 and the non-indexed issue ISLA CB 19. The total amount of covered bonds issued in 2014 was ISK 8.8 billion, thereof ISK 4.6 billion non-indexed and ISK 4.1 billion CPI linked. Outstanding covered bonds at year-end amounted to ISK 32.1 billion.

The Bank continued to sell short-term unsecured bonds (commercial paper) in 2014. Ten auctions were held where a new 6-month series was offered and older series tapped, if possible. The total outstanding amount of commercial paper at year-end was ISK 4.4 billion.

During 2014 the Bank issued two issues of unsecured bonds under the GMTN programme. In March SEK 300 million were tapped into the outstanding four-year issue since December 2013. The tap issue has a coupon rate of 3-month STIBOR + 300 bps which is 70 bps lower than the official issue. In May the Bank issued for the first time in Euros. The senior unsecured 2-year bond has a fixed rate of 3% and EUR 100 million were issued.

The Bank has not had any defaults of principal, interest or other breaches with respect to its debt issued and other borrowed funds.

Íslandsbanki hf. Consolidated Financial Statements 2014 46 Amounts are in ISK million

Notes to the Consolidated Financial Statements

Subordinated loans

48. Specification of subordinated loans:

	Currency	Interest	Maturity date	Book value 31.12.2014
Loans which qualify as Tier 2 capital:				
Subordinated loans - unlisted	EUR	4.1%	31.12.2019	21,306
Tier 2				21,306
Subordinated loans				21,306

	Currency	Interest	Maturity date	Book value 31.12.2013
Loans which qualify as Tier 2 capital:				
Subordinated loans - unlisted	EUR	4.2%	31.12.2019	21,890
Tier 2				21,890
Subordinated loans				21,890

Subordinated loans consist of a Tier 2 government bond of EUR 138 million.

Subordinated loans are financial liabilities of the Bank which consist of liabilities in the form of subordinated loan capital which, in case of the Bank's voluntary or compulsory winding-up, will not be repaid until after the claims of ordinary creditors have been met. In the calculation of the capital ratio the subordinated loans are included within Tier 2. Subordinated loans usually have a maturity of a minimum of 10 years. To ensure that the amount of capital outstanding doesn't fall sharply, once a Tier 2 issue matures, the regulator demands that the subordinated issue is subjected to a progressive discount, of 20% per annum, during the last five years of its maturity.

Tax assets and tax liabilities

49. Tax in the balance sheet:

	31.12.2014		31.12.2013	
	Assets	Liabilities	Assets	Liabilities
Current tax	-	8,386	-	10,806
Deferred tax	521	2	1,275	20
Tax in the balance sheet	521	8,388	1,275	10,826

The deferred tax assets are mainly due to the write-off of goodwill in relation to the acquisition of Byr in December 2011. The goodwill is deductible for tax purposes over a period of 5 years.

50. Changes in the deferred tax assets and the tax liabilities during the year are as follows:

	Assets	Liabilities
Deferred tax assets and tax liabilities 1.1.2013	864	20
Transferred deferred tax liabilities to deferred tax assets 1.1.2013	(20)	(20)
Calculated income tax for 2013	(6,170)	46
Income tax payable in 2014	6,626	(26)
Prior year income tax adjustment	(25)	-
Deferred tax assets and tax liabilities 31.12.2013	1,275	20
Calculated income tax for 2014	(5,331)	67
Income tax payable in 2015	4,659	(66)
Prior year income tax adjustment	(82)	(19)
Deferred tax assets and tax liabilities 31.12.2014	521	2

Íslandsbanki hf. Consolidated Financial Statements 2014 47 Amounts are in ISK million

Notes to the Consolidated Financial Statements

51. Movements in temporary differences during the year were as follows:

2014	Net balance at 1 January	Recognised in profit or (loss)	Balance at 31 December Net	Deferred tax assets	Deferred tax liabilities
Property and equipment	(212)	8	(204)	-	(204)
Assets and liabilities denominated in foreign currency	(156)	(31)	(187)	-	(187)
Other intangible assets	1,433	(740)	693	693	-
Deferred foreign exchange difference	127	90	217	218	(1)
Tax loss carry forwards	63	(63)	-	-	-
	1,255	(736)	519	911	(392)
Set-off of deferred tax assets together with liabilities of the same taxable entities			-	(390)	390
Tax assets (liabilities)	1,255	(736)	519	521	(2)

2013	Net balance at 1 January	Recognised in profit or (loss)	Balance at 31 December Net	Deferred tax assets	Deferred tax liabilities
Property and equipment	(225)	13	(212)	-	(212)
Assets and liabilities denominated in foreign currency	(159)	3	(156)	-	(156)
Other intangible assets	2,154	(721)	1,433	1,433	-
Deferred foreign exchange difference	(973)	1,100	127	134	(7)
Tax loss carry forwards	47	16	63	63	-
	844	411	1,255	1,630	(375)
Set-off of deferred tax assets together with liabilities of the same taxable entities			-	(355)	355
Tax assets (liabilities)	844	411	1,255	1,275	(20)

Íslandsbanki hf. Consolidated Financial Statements 2014 48 Amounts are in ISK million

Notes to the Consolidated Financial Statements

Other liabilities

52. Specification of other liabilities:

	31.12.2014	31.12.2013
Accruals	3,250	3,163
Liabilities to retailers for credit card provision	22,639	20,563
Provision for effects of court rulings*	2,808	4,699
Provision for estimated losses from guarantees and others**	1,629	2,211
Capital gains tax	1,623	1,816
Unsettled securities transactions	1,798	840
Deferred income	192	206
Sundry liabilities	3,323	3,632
Other liabilities	37,262	37,130

Provision:	Provision for effects of court rulings*	Provision for estimated losses from guarantees and others**	Total
Balance 1 January 2014	4,699	2,211	6,910
Provision used during the year	(1,891)	-	(1,891)
New provisions and reversed provisions during the year	-	(582)	(582)
Balance at 31.12.2014	2,808	1,629	4,437

*The provision above reflects amounts owed to customers with paid-up loans as a result of court rulings and subsequent recalculations of illegal foreign currency-linked loans.

Equity

53. Share capital

Authorised share capital of the Bank is 10,000 million ordinary shares of ISK 1 each. At 31.12.2014 paid up share capital totalled ISK 65,000 million which is the total stated share capital of the Bank.

Issued share capital

	31.12.2014	31.12.2013
Ordinary fully paid shares of ISK 1 krona each	10,000	10,000
Share capital	10,000	10,000

The Bank has one class of ordinary shares which carry no right to fixed income.

Share premium account

	31.12.2014	31.12.2013
Premium arising on issue of equity shares	55,000	55,000
Share premium account	55,000	55,000

Total share capital

	31.12.2014	31.12.2013
Ordinary share capital	10,000	10,000
Share premium account	55,000	55,000
Total share capital	65,000	65,000

Íslandsbanki hf. Consolidated Financial Statements 2014 49 Amounts are in ISK million

Notes to the Consolidated Financial Statements

54. Other reserves are specified as follows:

	Other reserves
Other reserves as at 1.1.2013	2,834
Translation differences	(363)
Other reserves as at 31.12.2013	2,471
Translation differences	64
Other reserves as at 31.12.2014	2,535

Operating lease commitments

55. Future non-cancellable minimum operating lease payments, where the Bank is the lessee, are due as follows:

	31.12.2014	31.12.2013
Up to 1 year	240	199
1-5 years	760	828
Later than 5 years	493	365
Operating lease commitments	1,493	1,392

The Bank leases a number of branch and office premises under operating leases. The typical lease period is 20 years with a continuation clause. In some leases the rent is based on the consumer price index and changes accordingly.

Balance of custody assets

56. Balance of custody assets:

	31.12.2014	31.12.2013
Custody assets	666,715	754,166

Custody assets are under custody, but not managed by the Bank.

Contingencies

57. **Indexed loans**

Three court cases have been filed, one against the Bank and the others against the Housing Financing Fund (HFF) and Landsbanki, challenging the legality of fixing the principal of a mortgage to the consumer price index (CPI). Such indexation has been the industry standard in Iceland for over 30 years. However, the method of calculating the index has changed over the years, with the most recent change being introduced in 1995. The courts have upheld a motion by the plaintiffs in both cases to seek an opinion of the EFTA court on some key issues.

The case against the Bank is based on the indexation being in violation of the EU Directive 93/13/EU on unfair terms in consumer loan contracts. The Directive does not prohibit the use of price indexation, provided that the consumer is adequately informed about the method of calculating the index and the factors that affect changes in the index. Thus, the case does not challenge the indexation as such, but only the context in which it is deployed. It will not affect corporate customers as the EU directive is limited to consumer loans. As the directive does not require full harmonisation, it was not adopted by Iceland in its entirety. Instead, the existing contract law was amended by adding four new articles. The Supreme Court accepted the motion introduced by the plaintiff on seeking the opinion of the EFTA Court on the implications of the differences between the directive and the local law. The case was heard on 9 April 2014 and the opinion was published on 28 August 2014. In short, the Court stated that:

1. The EU Directive 93/13/EEC does not generally prohibit contractual terms on the indexation of mortgage loans in contracts between a supplier and a consumer. It is for the referring court to assess whether the term at issue is deemed to be unfair.
2. The Directive does not limit the discretion of an EEA State to determine, whether through legislation or by means of administrative regulation, the factors that may cause changes in a pre-determined index, such as the Icelandic consumer price index, as well as the methods for measuring those changes, provided they are explicitly described in the contract.
3. It is for the competent court to establish whether a particular contract term has been negotiated individually within the meaning of the Directive.

Íslandsbanki hf. Consolidated Financial Statements 2014 50 Amounts are in ISK million

Notes to the Consolidated Financial Statements

57. Cont'd

4. It is for the competent court to establish whether a contract term relating to the indexation of repayment instalments of a loan to finance real estate purchases must be regarded as having been explicitly and comprehensibly described to the consumer.

5. Article 6(1) of the Directive must be interpreted as meaning that, where a national court considers that a given term is unfair within the meaning of the Directive, that court must ensure that such a clause is not binding to the consumer provided that the contract is capable of continuing in existence without the unfair term, in so far as, in accordance with the rules of domestic law, such a continuity of the contract is legally possible.

Thus, the general conclusion of the EFTA court was that indexation is permissible in consumer contracts, but Icelandic courts must decide if it is properly applied and described to the consumer.

The District Court of Reykjavik ruled on the case (and the HFF case) on 6 February 2015. It found that indexation was neither in violation of EU Directive 93/13/EEC nor the Icelandic law on contracts. Although not presented as an argument by the plaintiff in the beginning of the court proceedings, the Court also ruled on the compatibility of using zero-inflation forecast in calculating the annual percentage rate of charge (APRC) and the payment schedule. Like the EFTA Court and the Consumer Agency (see below), it found that although such a forecast was not satisfactory in light of the 1994 Act on Consumer Credit, the increase of principal was nevertheless enforceable. The Court found that the plaintiff did not demonstrate in any way that the increase was beyond what he should have expected, given the widespread and common use of indexation in the last decades. The ruling in the HFF case was founded on the same arguments.

The Landsbanki case changed during the court process making the case very similar to the one the Bank is defending aside from the issue regarding the assumption of no inflation when calculating the ARPC. An EFTA Court opinion on the Landsbanki case was published on 24 November 2014. The Court opinion stated that: "although the Court considers the granting of CPI linked mortgages to be legal, it however found that the procedures applied by Landsbanki, and its predecessor, in calculating the annual percentage rate of charge in the payment plan, to be in breach of Article 12 of Act No. 121/1994 on Consumer Credit, and possibly Article 6 of the same Act and moreover Article 5 of Act No. 57/2005, on the surveillance of unfair business practices and market transparency. The Court believed the breach to have occurred when the calculation of the APRC assumed that the CPI would remain unchanged until the end of the contract. The Court believes that the known index level should have been applied when calculating the APRC and hence the payment schedule."

The Consumer Agency (the "Agency") published in February 2014 its decision on a matter regarding the terms of, and information relating to the granting of, a consumer price indexed ("CPI linked") mortgage by Íslandsbanki in 2005. In short, the decision was based on the arguments later presented by the EFTA Court. Presumably, the Consumer Appellate Committee will decide on the case along the same lines now presented by the Icelandic Courts.

The procedure in question has been upgraded following the implementation of the new Act on Consumer Credit.

Variable rate loans

The Consumer Agency (the "Agency") published in September 2014 its decision on a matter regarding the terms of, and information relating to the granting of, a consumer mortgage with interest reset terms by Íslandsbanki in 2005. The Agency found that the terms offered by Íslandsbanki, and its predecessor, regarding the method and conditions of resetting interest to be in breach of Articles 6 and 9 of Act no. 121/1994 on Consumer Credit (superseded in November 2013). The Agency believes that the terms offer insufficient explanation on how or what can affect the decision on the revised interest rate. To support its decision, the Agency cites among other things a former 2009 decision of the Consumer Appellate Committee. The Bank has stated officially that it disagrees with the Agency's decision on the point that the law requires such detailed explanations on the outcome of a change in interest rate. The terms explicitly state the time period when the Bank can change the interest rate (every 5 years) and, moreover, that the borrower can settle the loan without a pre-settlement charge if he or she is not content with the change. The precedent quoted by the Agency did not involve such terms.

As previously mentioned, Article 12 of the former Consumer Credit Act allows the calculation of the ARPC on the assumption that the price level, interest rate and other charges will remain unchanged to the end of the credit agreement. Thus, the Bank notified each borrower on the effects of variable interest rates, for example the payment schedule document did state: "Please note that this schedule is based on the present CPI, interest rate and service charges list in effect at Íslandsbanki at the time of issuance.

There is no doubt that similar terms were applied by all major financial institutions serving the housing loan market, including the Housing Financing Fund (HFF). The Bank has not enforced the terms in question in many instances and has decided to postpone the next scheduled interest rate change. Customers have the option of receiving better terms by restructuring their loans with the appropriate documentation, fully adapted to the new legislation on consumer loans. The decision of the Agency has been appealed to the Consumer Appellate Committee.

Foreign currency loans

Several rulings of the Supreme Court of Iceland during the years 2010 to 2014 in relation to foreign currency-linked (FX-linked) loans have affected the Bank. Most important of these rulings was a ruling in June 2010 on the illegality of the principal of loans in ISK being linked to foreign currencies. Consequently, such loans could not carry Libor/Euribor interest rates.

The effects of these rulings and the subsequent corrections to the recalculations of illegal FX-linked loans have been reflected in the value of the loans in the Bank's Consolidated Financial Statements.

57. Cont'd

The court rulings combined have to this day effectively reduced the uncertainty regarding which foreign currency loans are illegal and how they should be recalculated. The Bank made an announcement to the effect that it would recalculate illegally FX-linked loans, outstanding as well as paid-up loans, in line with the instructions given by the rulings. This process is in its final stages, the last mass-recalculation in process involves corporate financial leasing contracts.

As for later developments, some former rulings were based on the Bank being the dominant and expert party in the contractual relationship. Recent judgements imply that former rulings do not necessarily apply to other financial institutions or large companies as counterparties, especially if those conduct their business in part abroad or deal in foreign currency contracts on a regular basis. Moreover, the Supreme Court found in favour of a bank in a case in which a customer did not pay instalments on a regular basis and deviated significantly from the original payment schedule. Consequently, the Bank revised its categorisation on which loans should be recalculated. The result did only slightly differ from the previous categorisation.

Two significant court cases in which the plaintiffs contested the legality of three corporate Glitnir/Íslandsbanki loan contracts were concluded in February 2015. Although such contracts are not great in numbers, they carry the greatest sums. Thus, the precedent value was significant (approx. ISK 3-5 billion in the two cases). In the District Court the Bank argued that the contracts differ from those previously ruled on by way of the method by which the loan was disbursed. If the contract says that the debtor can explicitly request payment in any currency and the contract is fulfilled in that manner, the maximum contract amount can be presented in ISK without offsetting the foreign currency loan validity of the contract. The District Court ruled in favour of the Bank in both cases, finding the contracts in question valid and fully enforceable as foreign denominated loans. The Supreme Court agreed in both cases, with verdicts passed on 15 January 2015 and 12 February 2015. In light of these precedents, one or two additional court cases involving smaller sums are expected to be dropped by the plaintiffs.

Settlement of the 2011 Byr acquisition

The Bank acquired Byr (a former Savings Bank) in 2011 from the Byr Winding-up Committee (the "Committee") and the Icelandic Ministry of Finance and Economic Affairs (the "Ministry"). According to standard practice, the Bank retained the right to re-evaluate the value of the assets acquired and subsequently to demand a refund if the value of the assets was not in line with what was presented in the official accounts of the company. A claim amounting to ISK 6,943 million plus interest was filed with the Committee in June 2013. The claim is filed as a priority claim, according to Article 110 of Law 21/1991, to be set off against a bond amounting to ISK 5,834 million (with settlement dates in November 2014 and 2015). Payments on the bond have been, and will be, made with reservation. The Committee rejected the claim with a letter dated 30 September 2013. At a creditors meeting in December 2013 it was decided that the Committee would refer the dispute to the District Court of Reykjavík. A formal claim amounting to ISK 911 million plus interest was filed with the Ministry on 24 September 2014. Both claims, on the Ministry and on the Committee, have been filed with the District Court of Reykjavík. Furthermore, the District Court has appointed two independent professionals, at the request of Íslandsbanki, to perform a formal evaluation of the Bank's claim on the Ministry and the Committee. The evaluation is expected to be completed before the end of the second quarter of 2015. The Bank has not recognised any revenues relating to this claim in its Consolidated Financial Statements.

Formal investigation by the Icelandic Competition Authority regarding an alleged violation of competition law by Íslandsbanki

The Icelandic Competition Authority (“ICA”) has initiated an investigation concerning alleged violations of the Competition law by the Bank. Details of the investigation remain confidential.

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

The Bank strongly disagrees with the ICA's findings and has presented its objections and is working with the ICA to resolve the case. However, should the ICA's findings be final, sanctions may come into consideration, in accordance with Article 37 of the Competition Act.

The Bank has made a settlement with the ICA regarding a particular implementation on the payment card market. The Bank was the first to reach a settlement with the ICA but the examination also included Arion Bank, Landsbanki, Borgun and Valitor. It is stated in the settlement with the ICA that the Bank has shown a great will to cooperate and thereby shortened the time of investigation but the Bank believes good cooperation with the ICA is important to promote sound business practices in local financial markets.

Formal request for information by the EFTA Surveillance Authority into alleged unlawful state aid to Íslandsbanki

On 22 October 2013 the EFTA Surveillance Authority (“ESA”), following a complaint dated 23 September 2013, formally requested information on alleged unlawful state aid granted to Íslandsbanki hf. through long term funding at favourable interest rates by the Central Bank of Iceland.

The Icelandic authorities and the Bank have sent all relevant information and their observations as per the ESA request, in order to determine whether or not the measures complained of involve state aid based on interpretation of Article 61 of the EEA Agreement, or qualify for an exemption under Article 61(2) or (3) of the EEA Agreement. Both parties state that the measures, which are the topic of the complaint, cannot be considered state aid within the meaning of Article 61 (1) of the EEA Agreement, as the funding in question was provided at what has to be considered market rates at the time and were indeed favourable to the Central Bank. However, should ESA disagree, then the measures must be considered state aid compatible with the functioning of the EEA Agreement under Article 61(3) (b) of the EEA Agreement.

Notes to the Consolidated Financial Statements

57. Cont'd

The Depositors' and Investors' Guarantee Fund

In 2010, under a previous legislation, the Bank was required to grant the Depositors' and Investors' Guarantee Fund a declaration of guarantee in case the fund's assets did not meet the required minimum amount. Accordingly, the Bank issued a declaration of guarantee for future obligations amounting to ISK 3,724 million. The Bank did not recognise a liability in its financial statement in respect of this declaration which is now considered void. The amended legislation does not stipulate a requirement for such a declaration of guarantee. However, there remains some uncertainty as to its validity in relation to losses originated in the period from October 2008 to June 2012.

Events after the balance sheet date

58. No events have arisen after the reporting period that require amendments or additional disclosures in the consolidated financial statements for year 2014.

Risk management

59. **Risk governance**

The Bank is exposed to various risk factors and managing these risk factors is an integral part of the Bank's operations.

Íslandsbanki's management body has a dual structure, meaning that the Board of Directors has a supervising role and the CEO has responsibility for daily operations.

The ultimate responsibility for ensuring an adequate risk management framework lies with the Board of Directors. The Board defines and communicates the acceptable level of risk through the Bank's Risk Appetite Statement and the risk management policies.

The Chief Executive Officer (CEO) is responsible for developing and maintaining adequate and effective risk management and internal control functions within Íslandsbanki. In addition, the CEO appoints the Chief Risk Officer (CRO) as well as other members of the Executive Board, the Risk Committee, the Asset and Liability Committee and the Investment Committee.

The Chief Audit Executive is appointed by the Board and directs Group Internal Audit by Board authorisation. The Chief Audit Executive is responsible for internal audit matters within the group, the Bank and its subsidiaries, including outsourced projects. Group Internal Audit provides the Bank with independent, objective assurance and consulting services designated to add value and improve the Bank's operations. It helps the Bank to evaluate and improve the effectiveness of its risk management, controls, and governance processes.

The Compliance Officer is responsible for regular monitoring and assessment of the suitability and efficacy of the Bank's measures concerning securities transactions. Its aim is to ensure that the work of the Bank, its Board and employees is consistent at all times with the applicable internal and external regulatory framework and with sound, appropriate business practice. The Board is authorised to entrust the Compliance department with additional tasks if they are in accordance with statutory requirements.

The Chief Risk Officer (CRO) is a member of the Executive Board and is responsible for the risk management organisation within Íslandsbanki. The CRO heads the risk management department and is responsible for defining the daily tasks of the department and to assess the adequacy of its professional skills. In addition, the CRO is responsible for organising risk management within Íslandsbanki in order to ensure that Íslandsbanki has the right resources and an appropriate organisation to manage its risks efficiently. This includes risk management functions in branches and subsidiaries.

Risk Management is responsible for maintaining and developing internal directives and frameworks regarding risk management and internal control. The department is also responsible for setting competency standards, for training staff on the Bank's policies, internal directives and frameworks related to risk management and internal control. In addition, Risk Management provides the managers of business units with information and guidance regarding risk management and internal control issues.

Risk Management advises on risk and risk assessment. It develops, maintains and tests risk models and provides other forms of support within its expertise.

Risk Management reports on risk and compliance to limits to internal and external stakeholders and ensures an appropriate escalation in the event of limit breaches.

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

60. **Risk management committee structure**

The implementation of the risk management practises and internal monitoring in accordance with Board authorisation is delegated to the management committees: the Executive Board, the Risk Committee, the Asset and Liability Committee, and the Investment Committee. Under this authorisation, these management committees issue detailed guidelines for risk assessment and individual risk thresholds in accordance with the Bank's defined risk appetite. The members of the management committees are appointed by the CEO, and their mandate and rules of procedure are documented in a charter, presented to the Board.

Notes to the Consolidated Financial Statements

60. Cont'd

The Executive Board is responsible for the operational risk framework and governs the Bank's Operational Risk Policy. The operational risk framework covers how operational risk is identified, assessed, measured, monitored, controlled and mitigated in the Bank. In addition, the Executive Board supervises reputational risk, business risk and strategic risk. The Executive Board approves concepts for new products and it´s approval is a prerequisite for product development according to the Bank´s formal product approval process.

The Risk Committee is responsible for supervising and monitoring the Bank's credit risk and credit concentration risk. The Risk Committee governs the Bank's Credit Risk Policy and other credit rules and procedures. The Risk Committee can delegate authorisation power to subcommittees and decides on credit authorisation limits to individual employees.

The Risk Committee and each of its subcommittees have the authority to decide on credit proposals, credit risk and counterparty credit risk within defined limits. Decisions on exposures that exceed committee limits shall be referred to a more senior committee. In particular, if a credit decision exceeds the authorisation limits of the Risk Committee an extension of the limit needs to be approved by the Board.

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

The Asset and Liability Committee (ALCO) supervises other financial risks, including market risk, liquidity risk and interest rate risk in the banking book (non-trading portfolio). ALCO decides on and sets limits for these risks and governs the Bank's Market Risk Policy and Liquidity Risk Policy. ALCO also oversees the Bank's capital allocation framework and transfer pricing mechanism. The committee supervises the capital management framework and makes proposals to the Board regarding issues related to capital management.

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

Credit risk

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

This risk comprises default risk, recovery risk, country risk, settlement risk and credit concentration risk.

Credit concentration risk is the significantly increased risk that is driven by common underlying factors, e.g. sector, economy, geographical location, type of financial instrument or due to connections or relations among counterparties. This includes large individual exposures to parties under common control and significant exposures to groups of counterparties whose likelihood of default is driven by common underlying factors.

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

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

A thorough analysis of the counterparty's financial standing, analysis of past and estimated future cash flows as well as the borrower's general ability to repay its obligations forms the basis for all credit decisions. The Bank structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, groups of borrowers, countries and industry segments. The Bank measures and consolidates its credit risk for each counterparty or group of connected clients in accordance with internal and external criteria of connection between parties.

The Bank employs a range of policies and practices to mitigate credit risk. The most traditional of these is the taking of security in borrower's assets. The principal collateral types for loans are real properties, vehicles, equipment, vessels and securities. When applicable, other credit risk mitigants are employed.

62. **Maximum credit exposure**

The Bank's credit risk exposure comprises both on-balance sheet and off-balance sheet items. Maximum exposure to credit risk for on-balance sheet assets is the net carrying amount as reported in the statement of financial position before the collective impairment allowance is subtracted, see note 33. The maximum exposure for off-balance sheet items is the amount that the Bank might have to pay out against financial guarantees and loan commitments, less provisions the Bank has made because of these items. The maximum credit exposure for a derivative contract is calculated by adding future credit exposure to the market value of the contract as described in Annex III of the European Parliament directive 2006/48/EC (Basel II).

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

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

Notes to the Consolidated Financial Statements

Credit risk exposure

62. Cont'd

Maximum credit exposure 31.12.2014

	Individuals	Central governments	Commerce and services	Construction	Energy	Financial services	Industrial and transportation	Investment companies	Public sector and non-profit organisations	Real estate	Seafood	Total
Cash and balances with CB	-	103,389	-	-	-	-	-	-	-	-	-	103,389
Derivatives	28	-	423	17	805	2,644	28	16	121	49	-	4,131
Bonds and debt instruments	-	79,834	-	-	291	5,785	-	890	251	296	-	87,347
Loans to credit institutions	-	-	-	-	-	35,072	-	-	-	-	-	35,072
Loans to customers:	262,848	-	79,658	18,751	7,315	121	61,878	13,911	12,216	99,540	81,412	637,650
Overdrafts	12,751	-	10,075	3,432	34	60	4,762	549	1,343	2,164	2,058	37,228
Credit cards	15,583	-	1,334	156	4	23	355	29	132	43	31	17,690
Mortgages	186,583	-	-	-	-	-	-	-	-	-	-	186,583
Leases	10,241	-	15,559	2,581	-	1	5,960	213	196	1,249	231	36,231
Other loans	37,690	-	52,690	12,582	7,277	37	50,801	13,120	10,545	96,084	79,092	359,918
Off-balance sheet items:												
Financial guarantees	1,444	-	2,318	2,281	-	1,170	1,134	39	39	166	533	9,124
Undrawn loan commitments	-	-	996	8,248	5,816	-	2,639	1,400	7,247	4,234	443	31,023
Undrawn overdrafts	9,216	-	7,459	1,618	23	3,673	2,561	187	1,874	975	1,361	28,947
Credit card commitments	23,183	-	3,455	477	31	167	906	166	818	197	144	29,544
Total maximum credit exposure	296,719	183,223	94,309	31,392	14,281	48,632	69,146	16,609	22,566	105,457	83,893	966,227

Íslandsbanki hf. Consolidated Financial Statements 2014 55 Amounts are in ISK million

62. Cont'd

Maximum credit exposure 31.12.2013

	Individuals	Central governments	Commerce and services	Construction	Energy	Financial services	Industrial and transportation	Investment companies	Public sector and non-profit organisations	Real estate	Seafood	Total
Cash and balances with CB	-	111,779	-	-	-	-	-	-	-	-	-	111,779
Derivatives	10	1,036	53	-	520	434	131	43	-	4	137	2,368
Bonds and debt instruments	-	67,268	-	-	58	6,326	-	967	116	451	-	75,186
Loans to credit institutions	-	-	-	-	-	44,078	-	-	-	-	-	44,078
Loans to customers:	255,044	-	81,522	18,640	3,614	34	46,433	10,306	6,894	66,647	69,289	558,423
Overdrafts	14,885	-	9,862	4,109	1	20	4,000	290	1,746	2,208	2,318	39,439
Credit cards	16,008	-	1,265	154	4	14	369	28	140	51	47	18,080
Mortgages	176,421	-	-	-	-	-	-	-	-	-	-	176,421
Leases	9,586	-	14,244	2,451	8	-	5,227	213	304	1,475	228	33,736
Other loans	38,144	-	56,151	11,926	3,601	-	36,837	9,775	4,704	62,913	66,696	290,747
Off-balance sheet items:												
Financial guarantees	1,299	-	2,559	2,343	-	1,500	1,298	24	11	48	492	9,574
Undrawn loan commitments	-	-	392	879	9,069	-	3,880	-	-	4,995	186	19,401
Undrawn overdrafts	9,646	-	5,634	1,013	202	1,102	2,125	195	1,704	726	1,324	23,671
Credit card commitments	22,594	-	3,267	408	12	91	800	124	887	160	144	28,487
Total maximum credit exposure	288,593	180,083	93,427	23,283	13,475	53,565	54,667	11,659	9,612	73,031	71,572	872,967

Íslandsbanki hf. Consolidated Financial Statements 2014 56 Amounts are in ISK million

Notes to the Consolidated Financial Statements

63. Credit exposure covered by collateral

Collateral and other credit mitigants vary between types of obligors and credit facilities. Loans to credit institutions are usually unsecured. For loans to individuals the principal collateral taken is residential property against mortgages. In the case of corporate entities the Bank takes a charge over assets such as real estate, fishing vessels, cash and securities and as well as other collateral including accounts receivables, inventory, vehicles and equipment. Loans to government entities and to municipalities are more often than not unsecured. Derivative exposures are generally made under ISDA master agreements with Credit Support Annex or corresponding terms with pledged collateral in the form of cash and government bonds.

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

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

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

At 31 December 2014	Real estate	Fishing vessels	Cash & securities	Vehicles & equipment	Other collateral	Credit exposure covered by collateral
Derivatives	-	-	2,500	-	-	2,500
Loans and commitments to customers:	391,139	74,032	5,991	33,473	24,174	528,809
Individuals	213,550	41	469	9,901	12	223,973
Commerce and services	40,484	290	472	14,525	8,838	64,609
Construction	13,217	269	59	2,473	1,592	17,610
Energy	1,260	-	411	1	152	1,824
Financial services	39	-	32	1	-	72
Industrial and transportation	16,487	-	148	5,760	7,914	30,309
Investment companies	4,973	-	3,434	248	2,642	11,297
Public sector and non-profit organisations	1,510	-	11	179	-	1,700
Real estate	94,859	-	650	143	564	96,216
Seafood	4,760	73,432	305	242	2,460	81,199
Total	391,139	74,032	8,491	33,473	24,174	531,309

At 31 December 2013	Real estate	Fishing vessels	Cash & securities	Vehicles & equipment	Other collateral	Credit exposure covered by collateral
Derivatives	-	-	1,820	-	-	1,820
Loans and commitments to customers:	321,247	59,488	6,895	31,053	14,603	433,286
Individuals	202,593	26	1,410	8,791	5	212,825
Commerce and services	30,764	217	1,098	12,998	5,193	50,270
Construction	8,912	143	84	3,961	1,418	14,518
Energy	3,242	-	87	-	122	3,451
Financial services	4	-	-	-	-	4
Industrial and transportation	18,161	-	98	4,682	5,029	27,970
Investment companies	4,108	-	2,783	44	55	6,990
Public sector and non-profit organisations	1,438	3	3	223	-	1,667
Real estate	47,377	25	445	155	21	48,023
Seafood	4,648	59,074	887	199	2,760	67,568
Total	321,247	59,488	8,715	31,053	14,603	435,106

Íslandsbanki hf. Consolidated Financial Statements 2014 57 Amounts are in ISK million

64. Credit quality of financial assets

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

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

	Neither past due nor impaired	Past due but not impaired	Classified as impaired	Total carrying amount
At 31 December 2014				
Cash and balances with Central Bank	103,389	-	-	103,389
Derivatives	4,131	-	-	4,131
Bonds and debt instruments	87,347	-	-	87,347
Loans to credit institutions	35,072	-	-	35,072
Loans to customers:	595,903	27,619	14,128	637,650
Individuals	237,253	18,752	6,843	262,848
Commerce and services	75,572	2,253	1,833	79,658
Construction	17,319	914	518	18,751
Energy	7,315	-	-	7,315
Financial services	84	37	-	121
Industrial and transportation	60,295	881	702	61,878
Investment companies	12,500	766	645	13,911
Public sector and non-profit organisations	12,165	51	-	12,216
Real estate	96,905	1,969	666	99,540
Seafood	76,495	1,996	2,921	81,412
Total	825,842	27,619	14,128	867,589

	Neither past due nor impaired	Past due but not impaired	Classified as impaired	Total carrying amount
At 31 December 2013				
Cash and balances with Central Bank	111,779	-	-	111,779
Derivatives	2,368	-	-	2,368
Bonds and debt instruments	75,186	-	-	75,186
Loans to credit institutions	44,078	-	-	44,078
Loans to customers:	496,705	34,618	27,100	558,423
Individuals	222,791	23,944	8,309	255,044
Commerce and services	71,177	3,759	6,586	81,522
Construction	16,780	1,005	855	18,640
Energy	3,614	-	-	3,614
Financial services	34	-	-	34
Industrial and transportation	43,175	1,318	1,940	46,433
Investment companies	9,293	506	507	10,306
Public sector and non-profit organisations	6,818	52	24	6,894
Real estate	58,694	2,356	5,597	66,647
Seafood	64,329	1,678	3,282	69,289
Total	730,116	34,618	27,100	791,834

Íslandsbanki hf. Consolidated Financial Statements 2014 58 Amounts are in ISK million

65. Neither past due nor impaired loans

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

The rating of corporate customers is based on a company's most recent financial statement, together with a qualitative assessment of its management, market position and industry sector.

For retail customers the Bank uses two different statistical rating models. One model is for individuals and another is for small companies with a total exposure to the Bank of less than ISK 150 million. These models are behavioural scoring models and use information about a customer's payment history, amount of debt and deposits, and demographic variables to assess the probability that a customer will default on any of his obligations within 12 months of the rating assessment.

The table below shows loans that are neither past due nor impaired aggregated in five customer groups based on the default probability. Group 1-4 represents low risk, group 5-6 moderate risk, group 7-8 increased risk, risk class 9 high risk, and risk class 10 represents customers in default. Unrated are loans originating from subsidiaries of Íslandsbanki that do not have rating models, in addition to loans that are yet to be rated or with an expired rating.

Note that the same customer can have loans that are more than 90 days past due or impaired, and at the same time other loans that are neither past due nor impaired. Those customers will be in risk class 10 and their loans that are neither past due nor impaired are included in the table below.

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

	Risk class 1-4	Risk class 5-6	Risk class 7-8	Risk class 9	Risk class 10	Unrated	Total
At 31 December 2013							
Loans to customers							
Individuals	8,388	77,267	82,203	44,295	7,609	3,029	222,791
Commerce and services	14,544	20,982	27,505	2,751	2,768	2,627	71,177
Construction	-	4,279	10,864	606	601	430	16,780
Energy	2,150	1,445	19	-	-	0	3,614
Financial services	6	1	19	5	-	3	34
Industrial and transportation	13,909	16,431	8,796	3,278	410	351	43,175
Investment companies	837	3,220	3,654	924	142	516	9,293
Public sector and non-profit organisations	1,756	3,060	1,804	93	3	102	6,818
Real estate	127	35,019	11,140	1,470	8,093	2,845	58,694
Seafood	21,363	29,347	11,719	300	1,339	261	64,329
Total	63,080	191,051	157,723	53,722	20,965	10,164	496,705

Íslandsbanki hf. Consolidated Financial Statements 2014 59 Amounts are in ISK million

66. Past due but not impaired loans

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

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

At 31 December 2014	Past due 4-30 days	Past due 31-60 days	Past due 61-90 days	Past due more than 90 days	Total past due loans
Loans to customers:					
Individuals	8,331	3,458	680	6,283	18,752
Commerce and services	1,144	516	256	337	2,253
Construction	429	116	76	293	914
Energy	-	-	-	-	-
Financial services	37	-	-	-	37
Industrial and transportation	390	156	104	231	881
Investment companies	145	363	47	211	766
Public sector and non-profit organisations	38	6	7	-	51
Real estate	914	602	179	274	1,969
Seafood	1,203	162	37	594	1,996
Total	12,631	5,379	1,386	8,223	27,619

At 31 December 2013	Past due 4-30 days	Past due 31-60 days	Past due 61-90 days	Past due more than 90 days	Total past due loans
Loans to customers:					
Individuals	8,615	4,181	786	10,362	23,944
Commerce and services	1,349	1,000	335	1,075	3,759
Construction	330	279	24	372	1,005
Energy	-	-	-	-	-
Financial services	-	-	-	-	-
Industrial and transportation	375	203	45	695	1,318
Investment companies	181	35	137	153	506
Public sector and non-profit organisations	38	6	1	7	52
Real estate	1,040	460	109	747	2,356
Seafood	790	107	78	703	1,678
Total	12,718	6,271	1,515	14,114	34,618

Íslandsbanki hf. Consolidated Financial Statements 2014 60 Amounts are in ISK million

67. Restructuring and forbearance

Restructuring of customers' debt has been one of the Bank's main tasks since October 2008. This has been a challenge as a large part of customers needed forbearance measures. Legal issues, the political environment and the general economy have contributed in ways of uncertainty and complications. The Bank set in place processes and resources to perform this task and the Bank's management team has been kept well informed on the status of the restructuring on a regular basis.

The Bank has offered several debt relief measures and restructuring frameworks for its customers since its establishment. These restructuring frameworks include principal adjustment and recalculation of currency linked loans, debt adjustment for companies and individuals, 110% adjustment of mortgages, the Government's debt relief scheme, write-offs and tailor made solutions in complicated cases where general solutions do not suffice.

Other forbearance measures which the Bank has made available to its customers include temporary payment holidays, extension of loan terms, capitalisation of arrears and waiving of covenants. In many cases these measures are precursors to the more formal restructuring process.

68. Assets obtained by taking possession of collateral

Details of non-financial assets obtained by the Bank during the year by taking possession of collateral held as security against loans.

	2014	2013
Property and land	5,307	7,941
Industrial equipment and vehicles	47	120
Vehicle	210	305

The Bank pursues realisation of the collateral in an orderly manner. The Bank does not generally use the non-cash collateral for its own operations. The Bank's employees are not permitted to purchase foreclosed assets.

69. Large exposure disclosure

When the Bank's total exposure to a group of connected clients is 10% or higher of the Bank's capital base it is considered a large exposure. Both on-balance sheet and off-balance sheet items from all types of financial instruments are included in the exposure as defined by FME rules 625/2013. The Bank has internal criteria that define connections between clients. These criteria reflect the Bank's interpretation of Article (1)(a) of law 161/2002 on Financial Undertakings, where groups of connected clients are defined.

The exposure is evaluated both gross and net of credit risk mitigating effects eligible according to the FME rules. Net of mitigating effects, the Bank has currently one large exposure which is 12% of its capital base. No large exposure is above the maximum 25% single large exposure limit set by the law.

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

		31.12.2014
Client groups	Gross	Net
Group 1	69%	0%
Group 2	12%	12%

		31.12.2013
Client groups	Gross	Net
Group 1	78%	0%

Íslandsbanki hf. Consolidated Financial Statements 2014 61 Amounts are in ISK million

Liquidity risk

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

Liquidity risk management

The Bank's main source of funding is customer deposits. The Bank's Treasury is responsible for the Bank's funding and liquidity management within the limits approved by the Board and the Asset and Liability Committee. The Interbank desk manages the Bank's intraday liquidity.

Risk management is responsible for measuring, monitoring and reporting on the Bank's liquidity position.

The Bank's liquidity risk policy assumes that the Bank has at all times sufficient liquidity to meet liabilities and other obligations over the next twelve months.

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

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

In the table below the total amount for loans to customers is shown before collective impairment allowance and is therefore higher than the total amount shown in the financial statement. The tables showing the cash flow of assets only include principal payments whereas for the financial liabilities the cash flow includes both principal and interest.

Maturity analysis 31 December 2014

Financial liabilities	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total	Carrying amount
Short positions	686	-	-	-	-	-	686	686
Deposits from Central Bank	69	-	-	-	-	-	69	69
Deposits from credit institutions	22,262	3,054	434	-	-	-	25,750	25,727
Deposits from customers	341,454	80,037	72,685	20,602	28,342	-	543,120	529,447
Debt issued and other borrow. funds	2	4,255	18,940	71,141	14,365	-	108,703	96,889
Subordinated loans	-	-	837	27,292	-	-	28,129	21,306
Other financial liabilities	32,715	5,108	7,868	(296)	-	-	45,395	45,395
Total	397,188	92,454	100,764	118,739	42,707	-	751,852	719,519

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

Off-balance sheet liabilities	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Financial guarantees	9,124	-	-	-	-	-	9,124
Undrawn loan commitments	31,023	-	-	-	-	-	31,023
Undrawn overdrafts	28,947	-	-	-	-	-	28,947
Credit card commitments	29,544	-	-	-	-	-	29,544
Total	98,638	-	-	-	-	-	98,638
Total non-derivative financial liabilities and off-balance sheet liabilities	495,826	92,454	100,764	118,739	42,707	-	850,490

Íslandsbanki hf. Consolidated Financial Statements 2014 62 Amounts are in ISK million

70. Cont'd

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

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

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

Financial assets	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total	Carrying amount
Cash and balances with CB	22,546	80,843	-	-	-	-	103,389	103,389
Bonds and debt instruments	1,076	20,645	25,298	35,209	5,119	-	87,347	87,347
Shares and equity instruments	-	-	-	-	-	10,531	10,531	10,531
Loans to credit institutions	23,185	11,837	50	-	-	-	35,072	35,072
Loans to customers	5,481	73,629	55,235	176,402	326,903	-	637,650	634,799
Other financial assets	1,703	825	1,865	54	27	3,144	7,619	7,619
Total financial assets	53,991	187,779	82,448	211,665	332,049	13,675	881,607	878,757

Derivative financial assets	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Gross settled derivatives							
Inflow	-	6,387	11,738	35,515	1,710	-	55,350
Outflow	-	(5,885)	(11,063)	(34,724)	(1,975)	-	(53,647)
Total	-	502	675	791	(265)	-	1,703
Net settled derivatives	-	242	-	-	-	-	242
Total	-	744	675	791	(265)	-	1,945

The tables below show the comparative amounts for financial assets and liabilities at the end of 2013.

Maturity analysis 31 December 2013

Financial liabilities	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total	Carrying amount
Short positions	9,462	-	-	-	-	-	9,462	9,462
Deposits from Central Bank	63	-	-	-	-	-	63	63
Deposits from credit institutions	26,804	2,457	413	-	-	-	29,674	29,626
Deposits from customers	346,352	47,265	52,685	29,918	29,429	-	505,649	489,331
Debt issued and other borrowed funds	2	6,765	15,988	52,993	28,397	-	104,145	89,193
Subordinated loans	-	-	749	6,869	24,919	-	32,537	21,890
Other financial liabilities	33,576	4,874	9,196	-	74	-	47,720	47,720
Total financial liabilities	416,259	61,361	79,031	89,780	82,819	-	729,250	687,285

Íslandsbanki hf. Consolidated Financial Statements 2014 63 Amounts are in ISK million

70. Cont'd

Off-balance sheet liabilities	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Financial guarantees	9,574	-	-	-	-	-	9,574
Undrawn loan commitments	19,401	-	-	-	-	-	19,401
Undrawn overdraft	23,671	-	-	-	-	-	23,671
Credit card commitments	28,487	-	-	-	-	-	28,487
Total	81,133	-	-	-	-	-	81,133
Total non-derivative financial liabilities and off-balance sheet liabilities	497,392	61,361	79,031	89,780	82,819	0	810,383

Derivative financial liabilities	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Gross settled derivatives							
Inflow	-	3,865	8,742	65,955	-	-	78,562
Outflow	-	(3,906)	(8,321)	(71,328)	-	-	(83,555)
Total	-	(41)	421	(5,373)	-	-	(4,993)
Net settled derivatives	-	(195)	-	-	-	-	(195)
Total	-	(236)	421	(5,373)	-	-	(5,188)

Financial assets	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total	Carrying amount
Cash and balances with CB	12,695	99,084	-	-	-	-	111,779	111,779
Bonds and debt instruments	5,503	35,250	67	26	31,805	2,535	75,186	75,186
Shares and equity instruments	46	-	9	344	-	8,986	9,385	9,208
Loans to credit institutions	29,420	14,497	161	-	-	-	44,078	44,078
Loans to customers	932	75,481	42,852	150,591	289,067	-	558,923	554,741
Other financial assets	7,102	1,541	102	1,658	-	3,169	13,572	11,159
Total financial assets	55,698	225,853	43,191	152,619	320,872	14,690	812,923	806,151

Derivative financial assets	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Gross settled derivatives							
Inflow	-	4,793	3,732	10,508	2,523	-	21,556
Outflow	-	(4,605)	(3,584)	(10,265)	(2,813)	-	(21,267)
Total	-	188	148	243	(290)	-	289
Net settled derivatives	-	58	-	-	-	-	58
Total	-	246	148	243	(290)	-	347

As a part of managing liquidity risk, the Bank holds a portfolio of liquid assets to meet unexpected outflow of funds or a temporary shortage in access to new funding. These assets are subject to strict criteria with respect to credit quality, liquidation time and price volatility. The table below shows the composition and amount of the Bank's liquidity back-up at the end of 2014 and end of 2013.

Composition and amount of liquidity back-up	31.12.2014	31.12.2013
Cash and balances with Central Bank	103,455	111,779
Domestic bonds eligible as collateral against borrowing at the Central Bank	29,478	20,873
Foreign government bonds	46,593	34,618
Short-term placements with credit institutions	34,006	41,192
Composition and amount of liquidity back-up	213,532	208,462

Íslandsbanki hf. Consolidated Financial Statements 2014 64 Amounts are in ISK million

Notes to the Consolidated Financial Statements

Market risk

71. The Bank defines market risk as the current or prospective risk to earnings and capital arising from adverse movements in the level or volatility of prices of market instruments, such as those that arise from changes in interest rates, equity prices, commodity prices and foreign exchange rates.

Market risk management

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

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

Interest rate risk

72. Interest rate risk is defined as the current or prospective risk to earnings or capital arising from adverse movements in interest rates.

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

73. Interest rate risk in the trading portfolios

The fixed income trading unit invests mainly in government bonds and bonds issued by the Housing Financing Fund (HFF), which are guaranteed by the Icelandic government. These positions can include short positions. Government bonds are either indexed to the Icelandic Consumer Price Index (CPI) or non-indexed, with duration up to 10 years. HFF bonds are CPI linked and have duration up to 13 years. All bond trading positions are subject to BPV limits, both intraday and end-of-day. In addition to BPV limits, short and long positions in each instrument are subject to separate limits. Risk Management monitors these limits and reports all breaches to ALCO.

Note that in the table below the total market value of long and short positions may not be exactly the same as reported in Note 8. The reason for this difference is that Note 8 sums up the net positions in each security while the table below ignores netting of long and short positions in specific securities between different portfolios.

Trading bonds and debt instruments, long positions	31.12.2014			31.12.2013		
	MV	Duration	BPV	MV	Duration	BPV
Indexed	1,772	8.03	(1.42)	3,282	7.41	(2.43)
Non-Indexed	48,260	0.41	(1.96)	35,848	0.32	(1.13)
Total	50,032	0.68	(3.38)	39,130	0.91	(3.56)

Trading bonds and debt instruments, short positions	31.12.2014			31.12.2013		
	MV	Duration	BPV	MV	Duration	BPV
Indexed	-	-	-	291	6.39	0.19
Non-Indexed	73	7.39	0.05	2,878	2.23	0.64
Total	73	7.39	0.05	3,169	2.61	0.83

Net position of trading bonds and debt instruments	49,959	0.67	(3.33)	35,961	0.76	(2.73)

Íslandsbanki hf. Consolidated Financial Statements 2014 65 Amounts are in ISK million

73. Cont'd

The Bank holds a significant amount of foreign Aa1 and Aaa credit-rated government bills in its liquidity portfolio but the Bank's policy is to only invest in bills with a credit rating of Aa3 or higher according to Moody's long-term issuer rating. These bills are held for cash management purposes and can be liquidated with a short notice. Duration ranges up to seven months and the sensitivity measured in BPV was ISK -1.3 million at the end of 2014 (2013: ISK -0.8 million).

Foreign government bills	31.12.2014		31.12.2013	
Country	Market value	BPV	Market value	BPV
Canada	1,094	(0.02)	-	-
Denmark	1,036	(0.02)	1,063	(0.02)
France	6,944	(0.30)	1,585	(0.01)
Germany	15,434	(0.41)	4,755	(0.09)
Netherlands	6,944	(0.18)	2,377	(0.02)
Norway	1,708	(0.04)	3,760	(0.13)
Sweden	4,109	(0.14)	5,375	(0.13)
UK	-	-	1,902	(0.02)
USA	9,323	(0.24)	14,433	(0.44)
Total	46,592	(1.35)	35,250	(0.86)

74. Sensitivity analysis for interest rate risk in the trading portfolios

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

Sensitivity analysis for trading bonds and debt instruments		31.12.2014		31.12.2013	
		Profit or (loss)			
Currency (ISK million)	Parallel shift in yield curve (basis points)	Downward shift	Upward shift	Downward shift	Upward shift
ISK, indexed	100	142	(142)	243	(243)
ISK, non-indexed	100	59	(59)	28	(28)
CHF	40	-	-	-	-
EUR	20	18	(18)	2	(2)
GBP	40	-	-	1	(1)
JPY	20	-	-	-	-
USD	40	10	(10)	18	(18)
Other total	40	-	-	-	-
Total		229	(229)	292	(292)

Notes to the Consolidated Financial Statements

75. Interest rate risk in the non-trading portfolio

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

The Bank holds a government bond designated at fair value amounting to ISK 30.6 billion (2013: ISK 30.8 billion). The bond pays floating rates and carries relatively low interest rate risk.

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

In the table below the total amount for loans to customers is shown before collective impairment allowance is subtracted and is therefore not the same as the total amount shown in the financial statement. Loans with specific impairment have been placed in the category 0-3 months since such loans bear no interest rate risk until possibly after debt restructuring. Note that collective impairment has been added to the total amount for loans to customers at 31 December 2013 as well.

Non-trading portfolio interest rate adjustment periods 31 December 2014

Assets	0-3 months	3-12 months	1-2 years	2-5 years	5-10 years	Over 10 years	Total
Balances with Central Bank	103,389	-	-	-	-	-	103,389
Bonds and debt instruments	31,119	-	67	1,230	291	367	33,074
Loans to credit institutions	35,072	-	-	-	-	-	35,072
Loans to customers	451,071	47,768	29,963	97,052	1,868	9,809	637,531
Total assets	620,651	47,768	30,030	98,282	2,159	10,176	809,066
Off-balance sheet items	68,186	7,508	21,649	112	-	-	97,455
Liabilities							
Short positions	-	-	-	-	-	-	-
Deposits from Central Bank	69	-	-	-	-	-	69
Deposits from credit institutions	25,306	421	-	-	-	-	25,727
Deposits from customers	514,898	3,643	1,030	2,383	7,493	-	529,447
Debt issued and other borrowed funds	17,723	9,403	22,760	34,421	12,582	-	96,889
Subordinated loans	21,306	-	-	-	-	-	21,306
Total liabilities	579,302	13,467	23,790	36,804	20,075	-	673,438
Off-balance sheet items	77,732	3,272	7,701	17,850	-	-	106,555
Net interest gap on 31 December 2014	31,803	38,537	20,188	43,740	(17,916)	10,176	126,528

Íslandsbanki hf. Consolidated Financial Statements 2014 67 Amounts are in ISK million

75. Cont'd

Non-trading portfolio interest rate adjustment periods 31 December 2013

Assets	0-3 months	3-12 months	1-2 years	2-5 years	5-10 years	Over 10 years	Total
Balances with Central Bank	111,779	-	-	-	-	-	111,779
Bonds and debt instruments	31,302	632	20	1,275	154	493	33,876
Loans to credit institutions	43,917	161	-	-	-	-	44,078
Loans to customers	401,397	46,565	57,552	38,803	1,586	12,516	558,419
Total assets	588,395	47,358	57,572	40,078	1,740	13,009	748,152
Off-balance sheet items	19,191	30,980	1,001	4,733	-	-	55,905
Liabilities							
Short positions	2,439	399	-	832	-	-	3,670
Deposits from Central Bank	63	-	-	-	-	-	63
Deposits from credit institutions	29,225	401	-	-	-	-	29,626
Deposits from customers	476,312	2,944	-	2,885	7,190	-	489,331
Debt issued and other borrowed funds	20,518	4,369	2,450	45,263	7,208	9,386	89,194
Subordinated loans	21,890	-	-	-	-	-	21,890
Total liabilities	550,447	8,113	2,450	48,980	14,398	9,386	633,774
Off-balance sheet items	20,046	23,638	5,338	8,195	-	-	57,217
Net interest gap on 31 December 2013	37,093	46,587	50,785	(12,364)	(12,658)	3,623	113,066

76. Sensitivity analysis for interest rate risk in the non-trading portfolios

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

Sensitivity analysis for non-trading bonds and debt instruments		31.12.2014		31.12.2013	
		Profit or (loss)			
Currency (ISK million)	Parallel shift in yield curve (basis points)	Downward shift	Upward shift	Downward shift	Upward shift
ISK, indexed	40	891	(891)	113	(113)
ISK, non-indexed	100	(82)	82	206	(206)
CHF	40	(5)	5	(2)	2
EUR	20	(7)	7	(6)	6
GBP	40	1	(1)	1	(1)
JPY	20	0	(0)	1	(1)
USD	40	5	(5)	14	(14)
Other	40	4	(4)	(4)	4
Total		807	(807)	323	(323)

Notes to the Consolidated Financial Statements

Currency risk

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

The analysis of the Bank's foreign currency exposure presented below is based on the contractual currency of the underlying balance sheet items. Additionally, there are off-balance sheet items that carry currency risk and are included in the total currency imbalance. The off-balance sheet amounts below represent the notional amounts of derivatives and unsettled spot agreements. The tables below summarise the Bank's exposure to currency risk at 31 December 2014 and 31 December 2013, based on contractual currencies, off-balance sheet items, but excluding assets categorised as held for sale.

Currency analysis 31 December 2014

Assets	EUR	USD	GBP	CHF	JPY	Other	Total
Cash and balances with Central Bank	263	168	95	30	9	202	767
Bonds and debt instruments	29,322	9,323	-	-	-	7,948	46,593
Shares and equity instruments	203	257	-	1	-	-	461
Loans to credit institutions	9,092	12,091	2,137	3,911	1,238	5,131	33,600
Loans to customers	62,131	25,654	6,124	7,869	7,206	10,990	119,974
Other assets	318	1,672	132	1	37	111	2,271
Total assets	101,329	49,165	8,488	11,812	8,490	24,382	203,666
Liabilities							
Deposits from credit institutions	140	16	13	-	13	1	183
Deposits from customers	39,200	26,309	5,385	2,364	1,586	10,962	85,806
Debt issued and other borrowed funds	15,572	-	-	-	-	13,212	28,784
Subordinated loans	21,306	-	-	-	-	-	21,306
Other liabilities	3,704	5,792	763	-	117	510	10,886
Total liabilities	79,922	32,117	6,161	2,364	1,716	24,685	146,965
On-balance sheet imbalance	21,407	17,048	2,327	9,448	6,774	(303)	56,701
Off-balance sheet items							
Off-balance sheet assets	19,202	21,345	662	-	-	12,677	53,886
Off-balance sheet liabilities	29,552	34,234	79	8,979	6,468	4,694	84,006
Net off-balance sheet items	(10,350)	(12,889)	583	(8,979)	(6,468)	7,983	(30,120)
Net currency imbalance on 31 December 2014	11,057	4,159	2,910	469	306	7,680	26,581

Íslandsbanki hf. Consolidated Financial Statements 2014 69 Amounts are in ISK million

Notes to the Consolidated Financial Statements

77. Cont'd

Currency analysis 31 December 2013

Assets	EUR	USD	GBP	CHF	JPY	Other	Total
Cash and balances with Central Bank	326	194	108	29	10	252	919
Bonds and debt instruments	8,757	14,779	1,902	-	-	10,206	35,644
Shares and equity instruments	377	261	11	1	-	-	650
Loans to credit institutions	5,494	18,566	817	2,967	267	13,869	41,980
Loans to customers	56,060	10,813	4,661	6,486	6,834	4,665	89,519
Other assets	4,261	1,801	152	-	33	66	6,313
Total assets	75,275	46,414	7,651	9,483	7,144	29,058	175,025
Liabilities							
Deposits from credit institutions	189	504	-	-	13	-	706
Deposits from customers	38,627	28,978	5,153	1,419	876	9,483	84,536
Debt issued and other borrowed funds	-	-	-	-	-	8,937	8,937
Subordinated loans	21,890	-	-	-	-	-	21,890
Other liabilities	1,911	5,839	875	2	33	156	8,816
Total liabilities	62,617	35,321	6,028	1,421	922	18,576	124,885
On-balance sheet imbalance	12,658	11,093	1,623	8,062	6,222	10,482	50,140
Off-balance sheet items							
Off-balance sheet assets	12,838	17,024	533	-	519	613	31,527
Off-balance sheet liabilities	17,022	24,558	437	7,582	4,651	3,689	57,939
Net off-balance sheet items	(4,184)	(7,534)	96	(7,582)	(4,132)	(3,076)	(26,412)
Net currency imbalance on 31 December 2013	8,474	3,559	1,719	480	2,090	7,406	23,728

Íslandsbanki hf. Consolidated Financial Statements 2014 70 Amounts are in ISK million

Notes to the Consolidated Financial Statements

78. Sensitivity analysis for currency risk

The table below shows how the currency imbalance is affected by either depreciation or appreciation of each currency assuming other risk factors being held constant. The shift number is the 99% percentile of a 10-day return distribution for each currency for the previous 365 days. The adverse movement of each currency is applied for the impact of the shift and demonstrates how the Bank's equity and income statement would be affected by the shifts.

Sensitivity analysis for currency risk 31 December 2014

Currency (shift)	Shift effect
EUR (1%)	(111)
USD (2%)	(83)
CHF (2%)	(9)
GBP (2%)	(58)
JPY (4%)	(12)
Other (3%)	(211)
Total	(484)

Sensitivity analysis for currency risk 31 December 2013

Currency (shift)	Shift effect
EUR (6%)	(508)
USD (5%)	(178)
CHF (5%)	(24)
GBP (5%)	(86)
JPY (9%)	(188)
Other (6%)	(444)
Total	(1,428)

Shares and equity instruments

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

80. Sensitivity analysis for shares and equity instruments

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

Sensitivity analysis for equities		31.12.2014		31.12.2013	
		Profit or (loss)			
Portfolio (ISK million)	Change in equity prices	Downward shift	Upward shift	Downward shift	Upward shift
Trading	20%	(349)	349	(233)	233
Non-trading	40%	(2,366)	2,366	(2,792)	2,792
Total		(2,715)	2,715	(3,025)	3,025

Derivatives

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

Inflation risk

82. The Bank is exposed to inflation risk since the value of CPI-indexed assets exceeds CPI-indexed liabilities. The value of these assets and liabilities changes according to changes in the CPI at any given time and all changes in the CPI index affect profit and loss. On 31 December 2014 the CPI gap amounted to ISK 57.5 billion (31 December 2013: ISK 6.4 billion). Thus, a 1% increase in the index would lead to an ISK 575 million increase in the balance sheet and a 1% decrease would lead to a corresponding decrease, other risk factors held constant.

Notes to the Consolidated Financial Statements

Capital management

83. Risk exposure and capital base

The Bank's total capital ratio, calculated according to the Act on Financial Undertakings, was 29.6% and the Tier 1 ratio was 26.5%.

As required in the Basel II rules, the Bank's Board of Directors sets a minimum capital target for the Bank. The Board has approved a minimum capital target for the Bank to be 18% of RWA. The target is based on the Bank's internal capital adequacy assessment (ICAAP) and the views expressed by the regulator through the latest SREP results. The capital target is intended to support the Bank's business strategy and takes into account changes or uncertainties in the operating environment. Unlike the 8% regulatory minimum, the Bank's capital target can change over time reflecting changes in the Bank's risk profile, business strategy and external environment. Thus, falling below the capital target does not impose any direct regulatory actions but the Bank's dividend payments and remuneration can be impacted.

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

The table below shows the capital base, risk weighted assets and the resulting capital ratios of the Bank at 31 December 2014 and 31 December 2013.

	2014	2013
Tier 1 capital		
Ordinary share capital	10,000	10,000
Share premium	55,000	55,000
Other reserves	2,535	2,471
Retained earnings	116,288	98,548
Non-controlling interests	1,664	1,299
Tax assets	(521)	(1,275)
Intangible assets	(619)	(299)
Other regulatory adjustments	-	(159)
Total Tier 1 capital	184,347	165,585
Tier 2 capital		
Other regulatory adjustments	-	(160)
Qualifying subordinated liabilities	21,306	21,890
Total regulatory capital	205,653	187,315
Risk weighted assets		
- due to credit risk	583,375	551,938
- due to market risk:	33,326	28,849
Market risk, trading book	6,594	5,105
Currency risk FX	26,732	23,744
- due to operational risk	78,401	78,970
Total risk weighted assets	695,102	659,757
Capital ratios		
Tier 1 ratio	26.5%	25.1%
Total capital ratio	29.6%	28.4%

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

Íslandsbanki hf. Consolidated Financial Statements 2014 72 Amounts are in ISK million

Operational risk

84. The Bank has adopted the definition of operational risk from the Directive 2006/48/EC of the European Parliament and of the Council, where operational risk is defined "as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events". The Bank's definition of operational risk includes legal risk, compliance risk, and reputational risk.

The Board of Directors has approved an Operational Risk Management Policy, applicable to the Bank and its subsidiaries. The policy outlines a framework for operational risk management in the Bank. The operational risk management framework is described in further detail in several subdocuments, such as the Business Continuity Management Framework, the Security Policy, and the Crisis Communication Policy, all of which are approved by the Executive Board.

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

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

Accounting policies

85. Basis of measurement

The consolidated financial statements are prepared on a historical cost basis, except for the following assets and liabilities, which are measured at fair value: bonds and debt instruments, shares and equity instruments, short positions in listed bonds and derivative financial assets and liabilities.

Non-current assets and disposal groups held for sale are measured at the lower of carrying amount and fair value less costs to sell.

86. Changes in presentation

The following comparative amounts have been changed due to change in presentations between the years:

a) The Bank no longer uses the term latent impairment allowance and now presents provision for impairment losses for loans in two categories, specific allowance and collective allowance. Specific allowance comprises impairment for financial assets that are assessed individually and collective allowance comprises estimates of impairment losses that have been incurred but not identified in the reporting period for a group of loans that have similar credit risk characteristics.

b) The Bank has changed its presentation in Note 65 "Neither past due nor impaired loans" in that a separate column has been added disclosing unrated loans. These are loans without a formal risk rating or with an expired rating which were previously included in risk class nine. Comparable figures have been adjusted accordingly.

c) The Bank has changed its presentation in Note 70 "Liquidity Risk" where a separate column has been added disclosing the carrying amount of financial assets and liabilities. The comparable disclosure has been adjusted accordingly.

d) Comparable information in Note 75 "Interest rate risk in the non-trading portfolio" has been changed in that the total for loans to customer has increased from ISK 554,741 million to ISK 558,419 million bringing the total assets to ISK 748,152 million.

e) The comparable information in Note 5 "Business Segments" has been changed in that Net segment revenue from external customers has changed from ISK 58,896 million to ISK 42,597 million as a result of a change in presentation of the Statement of Comprehensive Income for the year 2013 when impairment and net valuation changes on loans was no longer classified as part of the total operating income.

Notes to the Consolidated Financial Statements

87. **Significant accounting policies**

The accounting policies set out below have been applied consistently by all Bank entities to all periods presented in these consolidated financial statements.

Set out below is an index of the significant accounting policies, the details of which are available on the pages that follow.

87. Cont'd

1. Basis of consolidation

a) Business combinations

Business combinations are accounted for using the acquisition method on the acquisition date, when control is transferred to the Bank, with the identification of the acquirer, the combining entity that obtains control of the acquiree and recognition and measurement of the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquire.

The acquiree's identifiable assets, liabilities and contingent liabilities that meet the conditions for recognition under IFRS 3 Business combinations are recognised at their fair value at the acquisition date, except that:

- Deferred tax assets and liabilities are recognised and measured in accordance with IAS 12 Income Taxes;
- Assets and liabilities related to employee benefit arrangements are recognised and measured in accordance with IAS 19 Employee Benefits;
- Liabilities or equity instruments related to the replacement by the Bank of an acquiree's share-based payment awards are measured in accordance with IFRS 2 Share-based Payment;
- Assets (or disposal groups) that are classified as held for sale at the acquisition date in accordance with IFRS 5 Non-current Assets Held for Sale and Discontinued Operations are measured in accordance with that standard.

The consideration transferred by the Bank is measured at fair value, which is calculated as the sum of the acquisition date fair value of the assets transferred by the Bank, the liabilities incurred by the Bank to former owners of the acquiree and the equity interests issued by the Bank, if any. The consideration transferred does not include amounts related to the settlement of pre-existing relationships. Such amounts are generally recognised in profit or loss.

Where applicable, the consideration transferred includes any asset or liability resulting from a contingent consideration arrangement, measured at its acquisition date fair value. Subsequent changes in the fair value of contingent consideration classified as an asset or liability are accounted for in accordance with relevant IFRSs. Changes in the fair value of contingent consideration classified as equity are not recognised.

Any goodwill that arises on the acquisition is tested annually for impairment. Any gain on a bargain purchase is recognised in profit or loss immediately. Transaction costs are expensed as incurred, except if they are related to the issue of debt or equity securities.

Transaction costs, other than those associated with the issue of debt or equity securities, that the Bank incurs in connection with a business combination are expensed as incurred.

Where a business combination is achieved in stages, the Bank's previously held interests in the acquiree are remeasured to fair value at the acquisition date and the resulting gain or loss, if any, is recognised in profit or loss. Amounts arising from interests in the acquiree prior to the acquisition date that have previously been recognised in other comprehensive income are reclassified to profit or loss, where such treatment would be appropriate if that interest were disposed of.

If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the Bank reports provisional amounts for the items for which the accounting is incomplete. Those provisional amounts are adjusted during the measurement period, or additional assets or liabilities are recognised, to reflect new information obtained about facts and circumstances that existed as of the acquisition date that, if known, would have affected the amounts recognised as of that date. The measurement period is the period from the date of acquisition to the date the Bank obtains complete information about facts and circumstances that existed as at the acquisition date, subject to a maximum of one year.

b) Non-controlling interests

Non-controlling interests represent the proportion of profit or loss and net assets not owned, directly or indirectly, by the Bank.

For each business combination, the Bank measures at the acquisition date components of non-controlling interests in the acquiree, that are present ownership interests and entitle their holders to a proportionate share of the entity's net assets in the event of liquidation, at either:

- fair value; or
- the present ownership instruments' proportionate share in the recognised amounts of the acquiree's identifiable net assets.

All other components of non-controlling interests are measured at their acquisition-date fair values, unless another measurement basis is required by IFRSs.

When the proportion of the equity held by non-controlling interests changes, the carrying amounts of the controlling and non-controlling interests are adjusted to reflect the changes in their relative interests in the subsidiary. Any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received is recognised directly in equity and attributed to the owners of the parent. No adjustments are made to goodwill and no gain or loss is recognised in profit or loss.

87. Cont'd

The Bank presents non-controlling interests within equity in the consolidated statement of financial position, separately from the equity attributable to equity holders of the Bank. Profit or loss and each component of other comprehensive income attributed to the owners of the parent and to the non-controlling interests are presented separately in the consolidated statement of comprehensive income even if this results in the non-controlling interests having a deficit balance. The proportion allocated to the parent and non-controlling interests are determined on the basis of present ownership interests.

c) Subsidiaries

Subsidiaries are entities, or investees, controlled by the Bank. Control exists when the Bank is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Power exists if the Bank directly or indirectly holds more than half the voting rights in an undertaking or otherwise has power to control management and operating policy decisions. Operating policy control may be exercised through agreements about the undertaking's activities.

The Bank reassesses whether it has control if there are changes to one or more of the elements of control. This includes circumstances in which protective rights held, e.g. those resulting from a lending relationship, become substantive and lead to the Bank having power over an investee.

When assessing whether an investor controls an investee an investor with decision-making rights determines whether it acts as principal or as an agent of other parties. A number of factors, such as the remuneration of the decision-maker, are considered in making this assessment.

Subsidiaries which the Bank acquires exclusively with a view to resale, often through restructuring or repossession following a customer default when the Bank expects that their carrying amount to be recovered principally through a sale transaction, are classified as Non-current assets and disposal groups held for sale and measured according to IFRS 5 (see Note 87.13).

Changes in the Bank's ownership interest in a subsidiary that do not result in the Bank losing control of the subsidiary are accounted for as equity transactions i.e. transactions with owners in their capacity as owners.

d) Loss of control

When the Bank is committed to a sale plan involving the loss of control of a subsidiary and criteria for classification are met (see Note 87.13), it classifies all the assets and liabilities of that subsidiary as held for sale in its consolidated financial statements. This is regardless of whether the Bank will retain a non-controlling interest in the subsidiary after the sale.

On the loss of control, the Bank derecognises the assets and liabilities of the subsidiary, any non-controlling interests and the other components of equity related to the subsidiary. Any surplus or deficit arising on the loss of control is recognised in profit or loss in the line item “Net financial income (expenses)”. If the Bank retains any interest in the previous subsidiary, then such interest is measured at fair value at the date that control is lost. Subsequently, that retained interest is accounted for as an equity-accounted investee or in accordance with the Bank´s accounting policy for financial instruments, depending on the level of influence retained.

When the disposal of subsidiaries meets the definition of discontinued operations (see Note 87.29), the Bank presents the gain or loss from disposal in the income statement in the line item “Profit (loss) from discontinued operations, net of income tax”.

e) Transactions eliminated on consolidation

The financial statements of subsidiaries are included in the consolidated financial statements from the date on which control commences until the date when control ceases.

In preparing the consolidated financial statements, the parent company combines its financial statements with those of its subsidiaries, line by line by adding together like items of assets, liabilities, equity, income and expenses, and applies the required consolidation procedures. In preparing the consolidated financial statements, intra-group balances and transactions and any unrealised income, expenses and cash flows, with the exception of foreign currency transaction gains and losses, arising from transactions between the group entities, are eliminated. Unrealised losses are eliminated in the same way as unrealised gain, but only to the extent that there is no evidence of impairment.

If a group entity uses accounting policies other than those adopted in the consolidated financial statements for like transactions and events in similar circumstances, the Bank makes appropriate adjustments to that entity's financial statements when preparing the consolidated financial statements.

Consolidation of subsidiaries held exclusively with a view to subsequent disposal requires the application of acquisition accounting (see Note 87.1(c)).

f) Funds management

The Bank manages and administers assets and securities held in investment funds on behalf of investors. The financial statements of these entities are not included in these consolidated financial statements, except when the Bank has control over the entity.

When assessing whether to consolidate an investment fund, the Bank reviews all facts and circumstances including its purpose and design to determine whether the Bank, as fund manager, is acting as agent or principal. The Bank is deemed to be a principal when the Bank acts as fund manager and cannot be removed without cause, has variable returns through significant holdings and is able to influence the returns of the funds by exercising its power. Holdings where all returns belong to the customers are not considered to be exposure to variable returns.

87. Cont'd

2. Foreign currencies

a) *Foreign currency transactions*

Items included in the financial statements of each of the Bank's entities are measured using the functional currency of the respective entity. Transactions in foreign currencies are translated into functional currencies at the spot exchange rate at the date of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated into functional currencies at the spot exchange rate at that date. The foreign currency gain or loss on monetary items is the difference between amortised cost in the functional currency at the beginning of the year, adjusted for effective interest and payments during the year, and the amortised cost in foreign currency translated at the spot exchange rate at the end of the year.

Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the spot exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are translated into the functional currency at the spot exchange rate at the date that the fair value was determined.

Foreign currency differences arising on retranslation are recognised in profit or loss (see Note 87.23).

3. Financial assets

For the purpose of measuring its financial assets, the Bank classifies them at inception in one of the following categories (see also Note 8):

- Loans and receivables; or
- Financial assets at fair value through profit or loss, either as:
  - held for trading; or
  - designated as at fair value through profit or loss.

a) *Loans and receivables*

Loans and receivables are non-derivative financial instruments with fixed or determinable payments that are not quoted in an active market and that the Bank does not intend to sell immediately or in the near term, other than those that the Bank designates upon initial recognition as financial assets at fair value through profit or loss. Loans and receivables include loans originated by the Bank to its customers and credit institutions, acquired loans, participations in loans from other lenders and finance lease receivables (see Note 87.10 (b)).

When the Bank purchases a financial asset and simultaneously enters into an agreement to resell the asset (or a substantially similar asset) at a fixed price on a future date (reverse repurchase transactions), the arrangement is accounted for as a loan or receivable, and the underlying asset is not recognised in the consolidated financial statements of the Bank.

Loans and receivables are recognised when cash is advanced to borrowers. On initial recognition they are measured at fair value plus incremental direct transaction costs. Subsequently, they are measured at amortised cost using the effective interest method. Amortised cost is calculated by taking into account the amount at which the loans and receivables are measured at initial recognition less principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount (such as due to discounts or premiums on acquisition and fees and costs that are an integral part of the effective interest rate), and minus any reduction for impairment (see Note 87.27). Accrued interest is included in the carrying amount of the loans and receivables in the statement of financial position.

Gains and losses on loans and receivables are recognised in profit or loss in the line item "Interest income" when the loans and receivables are derecognised and in the line item "Net foreign exchange gain (loss)" when the loans and receivables are re-measured for foreign exchange differences. The losses arising from impairment are recognised in profit or loss in the line item "Loan impairment charges and net valuation changes".

A large proportion of the Bank's current loans and receivables were acquired at a deep discount. Credit losses already incurred were reflected in the purchase price and included in the estimated future cash flows when computing the effective interest rates of the loans and receivables. A loan and receivable is defined as having been acquired at a deep discount when the fair value on acquisition is considerably lower than the balance according to the terms of the loan. The difference is explained by severe financial difficulties of the debtor which manifests itself in a higher credit spread when estimating the fair value of the loan and not because of changes in business environment since the terms of the loan were agreed, i.e. market interest rates.

Discounts arising at the initial recognition of the acquired loans and receivables and resulting from the difference between market interest rates and nominal interest rates of the loans and receivables are amortised over the expected life of the financial asset. However, a shorter period is used if this is the period to which the discounts relate.

87. Cont'd

b) *Financial assets designated at fair value through profit or loss*

The Bank designates certain financial assets upon their initial recognition as financial assets at fair value through profit or loss when doing so results in more relevant information because:

- It eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise from measuring assets or liabilities or recognising the gains and losses from them on different bases; or
- Financial assets and/or financial liabilities are managed and their performance is evaluated on a fair value basis, in accordance with the Bank's risk management or investment strategy, and information about it is provided internally on that basis to the Bank's key management personnel; or
- The financial assets and/or financial liabilities contain an embedded derivative that significantly modifies the cash flows that would otherwise have been required under the contract.

Assets classified according to the above-mentioned conditions consist of:

- Fixed interest rate loans originated by the Bank whose fixed interest has been swapped into floating by entering into corresponding interest rate swaps;
- Debt and equity instruments, which are acquired by the Bank with a view to profiting from their total return and which are managed and evaluated on a fair value basis.

Financial assets designated by the Bank as at fair value through profit or loss are initially recognised and subsequently measured at fair value in the statement of financial position, with transaction costs recognised immediately in profit or loss. Changes in fair value are recognised in profit or loss in the line item "Net financial income (expenses)", except for interest earned, which is recognised in the line item "Interest income" on an accrual basis.

c) *Financial assets held for trading*

Financial assets held for trading are financial assets acquired principally for the purpose of selling or repurchasing in the near term, or for holding as part of a portfolio that is managed together for short-term profit or position taking. Financial assets held for trading consist of bonds and debt instruments, shares and equity instruments, and derivatives with positive fair value which are not designated as hedging instruments.

Financial assets held for trading are initially recognised and subsequently measured at fair value in the statement of financial position, with transaction costs recognised immediately in profit or loss. Changes in fair value are recognised in profit or loss in the line item "Net financial income (expenses)", except for interest earned, which is recognised in the line item "Interest income" on an accrual basis.

4. Financial liabilities

Except for financial guarantees (see Note 87.14) and loan commitments (see Note 87.15), for the purpose of measuring its financial liabilities, the Bank classifies them in one of the following categories (see also Note 8):

- Financial liabilities held for trading; or
- Financial liabilities measured at amortised cost.

The Bank does not designate financial liabilities as at fair value through profit or loss.

a) *Financial liabilities held for trading*

Financial liabilities held for trading are financial liabilities incurred principally for the purpose of generating profits from short-term price fluctuations or from the dealer's margin. Financial liabilities held for trading consist of short positions in listed bonds and derivatives with negative fair value which are not classified as financial guarantees or are not designated as hedging instruments.

Financial liabilities held for trading are initially recognised and subsequently measured at fair value in the statement of financial position with transaction costs recognised directly in profit or loss. Changes in fair value are recognised in profit or loss in the line item "Net financial income (expenses)", except for interest incurred, which is recognised as "Interest expense" on an accrual basis.

b) *Financial liabilities measured at amortised cost*

Financial liabilities measured at amortised cost are non-derivative financial liabilities which are not classified by the Bank as financial liabilities held for trading. Financial liabilities measured at amortised cost include deposits, debt issued and other borrowed funds and subordinated loans.

Financial liabilities measured at amortised cost are recognised initially at fair value net of transaction costs incurred, and subsequently are carried at amortised cost using the effective interest method. Amortised cost is calculated by taking into account the amount at which the financial liabilities are measured at initial recognition minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount (such as due to discounts or premiums and fees and costs that are an integral part of the effective interest rate). Accrued interest is included in the carrying amount of the liabilities in the statement of financial position.

87. Cont'd

5. Determination of fair value of financial assets and financial liabilities

A number of the Bank's accounting policies and disclosures require the determination of fair value for measurement and/or disclosure purposes. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (i.e. an exit price).

When available, the Bank measures the fair value of financial assets and financial liabilities using quoted prices in an active market for that instrument. A market is considered active if quoted prices are readily and regularly available and those prices represent actual and regularly occurring transactions. The fair value is based on the most recent observed market prices at the balance sheet date. For all other financial instruments, the Bank determines fair value using other valuation techniques.

If a market for a financial instrument is not active, the Bank establishes its fair value using a valuation technique. The objective of valuation techniques is to arrive at a fair value measurement that reflects the price that would be received to sell the asset or paid to transfer the liability in an orderly transaction between market participants at the measurement date. Valuation techniques incorporate all factors that market participants would consider in setting a price and are consistent with accepted methodologies for pricing financial instruments. Fair values reflect the credit risk of the instrument and include adjustments to take account of the credit risk of the Bank entity and the counterparty where appropriate. Periodically, the Bank calibrates the valuation techniques and tests them for validity using prices from observable current market transactions for the same instrument, without modification or repackaging, or based on other available observable market data.

All long and short positions are measured at the latest closing price as obtained from the relevant securities market. The best evidence of the fair value of a financial instrument at initial recognition is the transaction price unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument (i.e. without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets. When such evidence exists, the Bank recognises the difference between the transaction price and fair value in profit or loss in the line item Net financial income (expenses) on initial recognition of the financial instrument. In cases where use is made of data which is not from observable markets, the difference between the transaction price and the value produced by the valuation technique, if any, is recognised in profit or loss in the line item Net financial income (expenses), depending upon individual facts and circumstances of each transaction and not later than when the data becomes observable or when the instrument is redeemed, transferred or sold.

a) Valuation models

The Bank measures fair values using a fair value hierarchy, which reflects the significance of the inputs used in making the measurements. Further discussion on the fair value hierarchy can be found in Note 9.

Valuation techniques include net present value and discounted cash flow models, comparison with similar instruments for which market observable prices exist, Black-Scholes option pricing models and other valuation models. Assumptions and inputs used in valuation techniques include risk-free and benchmark interest rates, credit spreads and other premia used in estimating discount rates, bond and equity prices, foreign currency exchange rates, equity and equity index prices and expected price volatilities and correlations.

The Bank uses widely recognised valuation models for determining the fair value of common and more simple financial instruments, such as interest rate and currency swaps that use only observable market data and require little management judgement and estimation. Observable prices or model inputs are usually available in the market for listed debt and equity securities, exchange-traded derivatives and simple over-the-counter derivatives such as interest rate swaps. Availability of observable market prices and model inputs reduces the need for management judgement and estimation and also reduces the uncertainty associated with determining fair values. Availability of observable market prices and inputs varies depending on the products and markets and is prone to changes based on specific events and general conditions in the financial markets.

For more complex financial instruments, the Bank uses proprietary models, which usually are developed from recognised valuation models. Some or all of the inputs into these models may not be market observable, in which case the inputs are derived from market prices or rates or estimated based on assumptions. The value produced by a model or other valuation technique is adjusted to allow for a number of factors as appropriate, because valuation techniques cannot appropriately reflect all factors market participants take into account when entering into a transaction. Valuation adjustments are recorded to allow for model risks, bid-ask spreads, liquidity risks, as well as other factors, to the extent that the Bank believes a third-party market participant would take them into account in pricing a transaction. Management believes that these valuation adjustments are necessary and appropriate to fairly state financial instruments carried at fair value in the statement of financial position.

Management judgement and estimation are usually required for selection of the appropriate valuation model to be used, determination of expected future cash flows of the financial instrument being valued, determination of the probability of counterparty default and prepayments and selection of appropriate discount rates.

87. Cont'd

Fair value estimates obtained from models are adjusted for any other factors, such as liquidity risk or model uncertainties, to the extent that the Bank believes that a third party market participant would take them into account in pricing a transaction. Fair values reflect the credit risk of the instrument and include adjustments to take account of the credit risk of the Bank and the counterparty where appropriate. For measuring derivatives that might change classification from being an asset to a liability or vice versa such as interest rate swaps, fair values take into account both credit valuation adjustment (CVA) and debit valuation adjustment (DVA) when market participants take this into consideration in pricing the derivatives.

Model inputs and values are calibrated against historical data and published forecasts and, where possible, against current or recent observed transactions in different instruments and against broker quotes. This calibration process is inherently subjective and it yields ranges of possible inputs and estimates of fair value, and management judgement is required to select the most appropriate point in the range.

b) Valuation framework

The Bank has an established control framework with respect to the measurement of fair values. This framework includes the Bank's market risk function, which is independent of front office management and reports to the Chief Risk Officer, and which has overall responsibility for independently verifying the results of trading and investment operations and all significant fair value measurements. Specific controls include, model validation and review of significant unobservable inputs. The final decision on the validity of the valuation is in the hands of the Bank's investment committee.

6. Recognition and derecognition of financial assets and financial liabilities

The Bank uses trade date accounting to recognise purchases and sales of financial assets, i.e. they are recognised on the date on which the Bank commits to purchase or sell the asset, except for loans, which are recognised on the date when cash is advanced by the Bank to the borrowers. For a financial asset purchased, the Bank recognises on the trade date a financial asset to be received and a financial liability to pay. For a financial asset sold, the Bank derecognises the asset on the trade date, recognises any gains or losses on disposal and recognises a receivable from the buyer.

The Bank recognises financial liabilities held for trading on the trade date, i.e. on the date at which the Bank becomes a party to the contractual provisions of the financial instrument. The Bank recognises financial liabilities measured at amortised cost on the date when they originated. The Bank derecognises a financial liability when its contractual obligations are discharged or cancelled or expire.

The Bank derecognises financial assets in the following circumstances:
• When the contractual rights to the cash flows from the financial assets expire, or
• When the Bank transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which:
- The Bank transfers substantially all the risks and rewards of ownership of the financial assets, or
- The Bank neither transfers nor retains substantially all the risks and rewards of ownership of the financial assets and it does not retain control of the financial assets.

Any interest in transferred financial assets that qualify for derecognition that is created or retained by the Bank is recognised as a separate asset or liability. On derecognition of a financial asset, the difference between the carrying amount of the asset (or the carrying amount allocated to the portion of the asset transferred), and the sum of (i) the consideration received (including any new asset obtained less any new liability assumed) and (ii) any cumulative gain or loss that had been recognised in other comprehensive income is recognised in profit or loss.

The Bank enters into transactions whereby it transfers assets recognised in its statement of financial position, but retains either all or substantially all risks and rewards of the transferred assets or a portion of them. If all or substantially all risks and rewards are retained, then the transferred assets are not derecognised from the statement of financial position of the Bank. Transfers of assets with retention of all or substantially all risks and rewards include, for example, repurchase transactions and securities lending.

The Bank does not derecognise from its statement of financial position securities which the Bank sells under agreements to repurchase at a specified future date ("repos") at a fixed price or at the sale price plus a lender's return. The Bank recognises the cash received as a liability in its statement of financial position. The difference between the sale and repurchase prices is recognised as interest expense over the life of the agreement using the effective interest method.

Securities lending and borrowing transactions are usually collateralised by securities or cash. The transfer of securities to counterparties is only reflected in the statement of financial position if the risks and rewards of ownership are also transferred. Cash advanced or received as collateral is recorded as an asset or liability.

Notes to the Consolidated Financial Statements

87. Cont'd

In transactions in which the Bank neither retains nor transfers substantially all the risks and rewards of ownership of a financial asset and it retains control over the asset, the Bank continues to recognise the asset to the extent of its continuing involvement, determined by the extent to which it is exposed to changes in the value of the transferred asset.

Substantial modifications of terms of existing financial assets, or replacements with new ones with significantly different terms, result in the Bank derecognising the original financial assets and recognising new financial assets at fair value. (See also Note 87.27(a)) with respect to renegotiated loans.

7. Offsetting financial assets and financial liabilities

Financial assets and liabilities are offset and the net amount presented in theconsolidated statement of financial position when, and only when, the Bank has a legal right to set off the amounts and it intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

8. Derivative financial instruments

Derivatives entered into by the Bank may be in the form of stand-alone contracts or embedded in other contracts, in which case the Bank assesses whether it is required to separate and account for the embedded derivatives as if they were stand-alone contracts. That would be the case when the economic characteristics and risks of the embedded derivatives are not closely related to the economic characteristics and risks of the host contracts; stand-alone contracts with the same terms as the embedded derivatives would meet the definition of a derivative for accounting purposes; and the combined contracts are not classified by the Bank as financial assets or financial liabilities held for trading or designated by the Bank as at fair value through profit or loss.

Derivatives which do not classify as equity instruments of the Bank are classified as financial assets or financial liabilities, measured at fair value and presented in the statement of financial position in separate line items as assets or liabilities, depending on whether their fair value at the reporting date is positive (assets) or negative (liabilities). When the Bank is required to separate and account for embedded derivatives as if they were stand-alone contracts, the Bank presents the fair value of the embedded derivatives in the statement of financial position in the same line items in which the Bank presents the related host contracts.

The Bank did not apply hedge accounting during the year ended 31 December 2014, nor during the comparative period. Accordingly, the Bank accounted for all its derivative financial assets and liabilities as financial assets or financial liabilities held for trading in accordance with Notes 87.3(b) and 87.4(a).

9. Investments in associates

Associates are those entities over which the Bank has significant influence, which is the power to participate in the financial and operating policy decisions of the entity but is not control or joint control over those policies. Significant influence generally exists when the Bank holds between 20% and 50% of the voting power, including potential voting rights that are currently exercisable or convertible, if any.

Investments in associates are accounted for using the equity method and are initially recognised at cost. The investments include goodwill identified on acquisition. The carrying amount of the investments is adjusted for post-acquisition changes in the Bank's share of net assets of the associates and for impairment losses, if any (see Note 87.27(b)). Therefore, the consolidated financial statements include the Bank's share of the total recognised gains and losses of associates, from the date that significant influence commences until the date that significant influence ceases. When the Bank's share of losses exceeds its interest in the associate, the carrying amount of that associate is reduced to nil and recognition of further losses is discontinued except to the extent that the Bank has incurred legal or constructive obligations or made payments on behalf of the associate. If the associate subsequently reports profits, the Bank resumes recognising its share of profits only after its share of profits equals the share of losses not recognised.

Whenever there is an objective evidence that an investment in associates may be impaired, the entire carrying amount of the investment is tested for impairment by comparing its recoverable amount with its carrying amount, goodwill included in the carrying amount of an investment in an associate is not recognised separately and is therefore not tested separately for impairment according to the requirements for impairment testing of goodwill

Investments in associates which are classified as held for sale are not accounted for using the equity method but in accordance with the accounting policy disclosed in Note 87.13.

87. Cont'd

10. Leases

The Bank classifies leases based on the substance of the arrangements and the extent of the transfer of risks and rewards incidental to ownership of leased assets. A lease is classified as an operating lease if the lessor does not transfer substantially all the risks and rewards incidental to ownership. A lease is classified as a finance lease if the lessor transfers substantially all the risks and rewards incidental to ownership.

a) Bank as a lessee

Lease payments under operating leases where the Bank is the lessee are recognised as an expense on a straight-line basis over the lease term.

b) Bank as a lessor

When the Bank is the lessor in a finance lease, the Bank recognises a finance lease receivable equal to the net investment in the lease and presents it in the line item “Loans to customers” in the statement of financial position. The Bank applies its accounting policies for derecognition and impairment of loans and receivables also to its finance lease receivables. The Bank recognises the finance income from finance lease receivables in profit or loss in the line item “Interest revenue” over the period of the lease so as to give a constant periodic rate of return on the net investment in the lease.

When the Bank is lessor in arrangements which involve the legal form of leases, but which in substance do not involve leases, the Bank does not apply lease accounting to those arrangements and instead the Bank accounts for them as loans and receivables.

11. Property and equipment

a) Recognition and measurement

Items of property and equipment are measured at cost less accumulated depreciation and impairment losses.

Where parts of an item of property and equipment have different useful lives, those components are accounted for as separate items of property and equipment.

b) Subsequent costs

The Bank recognises in the carrying amount of an item of property and equipment the cost of replacing part of such an item when that cost is incurred if it is probable that the future economic benefits embodied with the item will flow to the Bank and the cost of the item can be measured reliably. The decision if subsequent costs are added to the acquisition cost of the property or equipment, is based on whether an identified component, or part of such component, has been replaced or not, or if the nature of the subsequent cost means a contribution of a new component. All other costs are recognised in profit or loss as incurred.

c) Depreciation

Items of property and equipment are depreciated from the date they are available for use, except for land, which is not depreciated. Each part of a depreciable item of property and equipment with a cost that is significant in relation to the total cost of the item is depreciated separately. The depreciable amount of each significant item of property and equipment is determined after deducting its residual value. Depreciation is expensed in profit or loss on a straight-line basis over the estimated useful lives of each part of an item of property and equipment. The estimated useful lives for the current and comparative periods of significant items of property and equipment are as follows:

Buildings	50 years
Fixtures	6 - 12 years
Equipment	4 years
Vehicles	3 years

The depreciation method, useful lives and residual values are reviewed at each reporting date and adjusted if appropriate.

12. Intangible assets

a) Goodwill

The Bank recognises goodwill as an asset only when it results from a business combination. Goodwill relating to acquisition of associates is not recognised separately as an asset but it is included in the carrying amount of investments in associates in the statement of financial position. For the measurement of goodwill at initial recognition, (see Note 87.1(a)).

Goodwill is allocated from the acquisition date to cash-generating units (CGUs) and it is subsequently measured at cost less accumulated impairment losses. Goodwill is tested by the Bank for impairment annually or whenever there is an indication that the CGUs may be impaired.

87. Cont'd

b) Software

Software acquired by the Bank is measured at cost less accumulated amortisation and impairment losses.

Expenditure on internally developed software is recognised as an asset when the Bank is able to demonstrate its intention and ability to complete the development and use the software in a manner that will generate future economic benefits, and can reliably measure the costs to complete the development. The capitalised costs of internally developed software include all costs directly attributable to developing the software and capitalised borrowing costs, and are amortised over its useful life. Internally developed software is stated at capitalised cost less accumulated amortisation and impairment.

Subsequent expenditure on software assets is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred.

Software is amortised on a straight-line basis in profit or loss over its estimated useful live, from the date that it is available for use. The estimated useful life of software for the current and comparative periods is four years.

13. Non-current assets and disposal groups held for sale

Non-current assets and disposal groups (comprising groups of assets and liabilities associated with those assets, including non-current assets) are classified as held for sale and presented in separate line items on the face of the statement of financial position if the Bank expects to recover their carrying amount principally through a sale transaction rather than through continuing use. For this to be the case, the assets, or disposal groups, must be available for immediate sale in their present condition subject only to terms that are usual and customary for sales of such assets, or disposal groups, and their sale must be highly probable.

Immediately before classification as held for sale, the assets, or components of disposal groups, are remeasured in accordance with applicable IFRSs. Thereafter, the assets, or disposal groups, are measured at the lower of their carrying amount and fair value less costs to sell, except for deferred tax assets, financial assets and investment properties, which are measured in accordance with the accounting policies of the Bank applicable to those assets. Once classified as held for sale, intangible assets are no longer amortised, property and equipment is no longer depreciated and investments in associates are no longer equity accounted. Liabilities associated with assets classified as held for sale are measured in accordance with the accounting policies of the Bank applicable to those liabilities.

Non-current assets and the assets and liabilities of a disposal group classified as held-for-sale are presented separately from other assets and liabilities in the statement of financial position. Non-controlling interests in a disposal group classified as held-for-sale are presented within equity consistent with the requirements of IAS28 and are not reclassified as a liability.

Any impairment loss on a disposal group is allocated first to any goodwill included in the disposal group, and then to the remaining assets and liabilities on a pro rata basis, except for that no loss is allocated to inventories, financial assets, deferred tax assets and investment property.

Impairment losses on initial classification of non-current assets and disposal groups as held for sale and subsequent gains and losses on remeasurement are recognised in profit or loss. Gains are not recognised in excess of any cumulative impairment loss.

Income earned and expenses incurred on assets and disposal groups held for sale continue to be recognised in the appropriate line items in profit or loss until the transaction is complete. However, income and expenses on assets and liabilities of subsidiaries acquired by the Bank exclusively with a view to resale are recognised in profit or loss in the line item “Profit (loss) from discontinued operations, net of income tax” (see Note 87.29).

14. Financial guarantees

Financial guarantees are contracts that require the Bank to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payments when due, in accordance with the terms of a debt instrument. Financial guarantees are issued by the Bank to credit institutions and other parties on behalf of its customers so that they can secure loans, overdrafts and banking facilities. Liabilities arising from financial guarantees issued by the Bank are initially measured at their fair value, being the premium received, and the initial fair value is amortised on a straight line basis over the life of the guarantee. The liabilities are subsequently carried at the higher of the unamortised premium and the best estimate of the expenditure required to settle the liability when a payment under the contracts has become probable. The estimates are determined based on experience of similar transactions and history of past losses, supplemented by a judgement by the management.

Any increase in the liabilities arising from financial guarantees is recognised in profit or loss. The premium received is recognised as revenue in profit or loss in the line item "Fee and commission income".

87. Cont'd

15. Loan commitments

Loan commitments are firm commitments of the Bank to provide credit under pre-specified terms and conditions. All loan commitments issued by the Bank are outside the scope of IAS 39. As such, the Bank recognises a provision for loan commitments in the statement of financial position, in the line item "Other liabilities", only when the Bank is committed to making a loan that would be considered to be impaired or when the commitment becomes onerous. The related expense is then recognised in profit or loss. Loan commitment fees received by the Bank are recognised in accordance with the accounting policy disclosed in Note 87.21.

16. Provisions

Provisions are recognised when the Bank has a present obligation (legal or constructive) as a result of a past event, if it is probable that the Bank will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.

The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at the balance sheet date, taking into account the risks and uncertainties surrounding the obligation. Where a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows. When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, the receivable is recognised as an asset if it is virtually certain that the reimbursement will be received and the amount of the receivable can be measured reliably.

The Bank recognises a contingent liability assumed in a business combination if it is a present obligation that arises from past events and its fair value can be measured reliably, even if it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation.

17. Employee benefits

All Bank entities are required to pay fixed contributions to publicly or privately administered pension plans on a mandatory and contractual basis. The Bank has no further payment obligations once these contributions have been paid by the Bank. The Bank recognises these contributions as salary related expenses when they become due. The Bank does not have a defined benefit pension plan.

Termination benefits are recognised by the Bank as a salary expense when the Bank is demonstrably committed, without realistic possibility of withdrawal, to a formal detailed plan to either terminate employment before the normal retirement date, or to provide termination benefits as a result of an offer made to encourage voluntary redundancy. Termination benefits for voluntary redundancies are recognised as an expense if the Bank has made an offer of voluntary redundancy, it is probable that the offer will be accepted, and the number of acceptances can be estimated reliably.

Short-term employee benefits include salaries, short-term cash bonuses, social security contributions, short-term compensated absences and non-monetary benefits for current employees. Short-term employee benefit obligations are expensed by the Bank as the related service is provided. A liability is recognised for the amount expected to be paid under short-term cash bonus plans if the Bank has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

18. Share capital

a) Share capital

The share capital disclosed in the consolidated financial statement represents the total nominal value of ordinary shares issued by the parent company and outstanding at the reporting date. Incremental costs directly attributable to the issuance of ordinary shares are recognised as a deduction from equity, net of any tax effects.

b) Dividends on shares

Dividends payable to shareholders of the parent company are recognised as a liability and deducted from equity in the period in which the dividends are approved by the shareholders in the parent company's annual general meeting. Dividends payable to non-controlling shareholders in subsidiaries are recognised as a liability and deducted from equity in the period in which the dividends are approved by the shareholders' meeting of the subsidiaries. Dividends declared after the reporting date are not recognised as a liability at the reporting date.

87. Cont'd

19. Cash and cash equivalents

Cash and cash equivalents in the consolidated statement of cash flows consist of cash on hand, treasury bills, demand deposits with the Central Bank and with other credit institutions, short-term loans to credit institutions and other liquid debt securities at floating interest rates. Cash and cash equivalents comprise balances with less than three months maturity from the date of acquisition, that are subject to an insignificant risk of changes in their fair value and which are used by the Bank in the management of its short-term cash commitments.

20. Interest income and expense

For all financial assets and financial liabilities measured at amortised cost interest income and expense is recognised in profit or loss using the effective interest method. For all financial assets and financial liabilities held for trading and for all financial assets designated at fair value through profit or loss, interest income and expense is recognised through profit or loss on an accrual basis.

The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability (or group of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, when appropriate, to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Bank estimates cash flows, considering all contractual terms of the financial instrument, but does not consider future credit losses. The calculation generally includes all fees and amounts paid or received between parties to the contract that are an integral part of the effective interest rate, as well as transaction costs and all other premiums or discounts.

The effective interest rate is established on initial recognition of financial assets and financial liabilities and their carrying amount is subsequently adjusted if the Bank revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original effective interest rate (i.e. the effective interest rate established at initial recognition) and the change in carrying amount is recorded as interest income or expense. For floating rate instruments, interest income or expense is generally recognised based on the current market rate plus or minus amortisation or accretion of the discount or premium based on the original effective interest rate. Interest on impaired financial assets is calculated by applying the original effective interest rate of the financial asset to the carrying amount as reduced by any allowance for impairment.

Interest income and expense include gains and losses on derecognition of loans and receivables and financial liabilities measured at amortised cost.

21. Net fee and commission income

Net fee and commission income comprises fees and commission income and expenses. Fees and commissions are generally recognised on an accrual basis when the service has been provided.

Fees and commission income and expense that are integral to the effective interest rate on a financial asset or liability are included in the measurement of the effective interest rate.

Loan commitment fees for loans that are likely to be drawn down are deferred and recognised as an adjustment to the effective interest rate of the loan. When a loan commitment is not expected to result in the draw-down of a loan, loan commitment fees are recognised in profit or loss on a straight-line basis over the commitment period.

Loan syndication fees are recognised as revenue in profit or loss when the syndication has been completed and the Bank has retained no part of the loan package for itself or has retained a part at the same effective interest rate as the other participants.

Commission and fees arising from negotiating, or participating in the negotiation of, a transaction for a third party, such as the arrangement of the acquisition of shares or other securities or the purchase or sale of businesses, are recognised on completion of the underlying transaction.
Portfolio and other management advisory and service fees are recognised based on the applicable service contracts, usually on a time-apportionate basis.

Asset management fees related to investment funds are recognised rateably over the period in which the service is provided. The same principle is applied for wealth management, financial planning and custody services that are continuously provided over an extended period of time. Performance-linked fees or fee components are recognised when the performance criteria is fulfilled.

87. Cont'd

22. Net financial income (expenses)

Net financial income (expenses) consist of net gains on financial assets and liabilities held for trading, net gain on financial assets designated at fair value through profit or loss and net gain on loss of control over subsidiaries.

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

Net gain (loss) on financial assets and liabilities held for trading includes all realised and unrealised fair value changes of financial assets and liabilities classified by the Bank as held for trading, except for interest income and interest expense (which are included in the line items “Interest income” and “Interest expense”, (see Note 87.20) and foreign exchange gains and losses (which are included in the line item “Net foreign exchange gain (loss)”, (see Note 87.23). Dividend income from financial assets held for trading is recognised in profit or loss when the Bank's right to receive payment is established.

Changes in fair value of derivatives that are classified as held for trading but which are economic hedges of financial assets designated at fair value through profit or loss are presented in the notes to the consolidated financial statements as an offset to net gains on financial assets designated at fair value through profit or loss (see Note 15).

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

Net gain (loss) on financial assets designated at fair value through profit or loss includes all realised and unrealised fair value changes of financial assets designated by the Bank as at fair value through profit or loss, except for interest income and interest expense (which are included in the line items “Interest income” and “Interest expense”, see Note 87.20) and foreign exchange gains and losses (which are included in the line item “Net foreign exchange gain (loss)”, see Note 87.23). Dividend income from financial assets designated at fair value through profit or loss is recognised in profit or loss when the Bank's right to receive payment is established.

Net gain on financial assets designated at fair value through profit or loss also include changes in fair value of derivatives that are classified by the Bank as held for trading but which are economic hedges of financial assets designated by the Bank as at fair value through profit or loss.

23. Net foreign exchange gain (loss)

Net foreign exchange gain (loss) disclosed as a separate line item in the income statement comprises all foreign exchange differences arising on the settlement of foreign currency monetary assets and liabilities and on translating foreign currency monetary assets and liabilities at rates different from those at which they were translated on initial recognition during the period or in previous financial statements.

Net foreign exchange gain (loss) also includes foreign exchange differences arising on translating non-monetary assets and liabilities which are measured by the Bank at fair value in foreign currencies and whose other gains and losses are also recognised in profit or loss.

On the face of the income statement, net foreign exchange gain (loss) is offset by impairment losses and reversal of impairment losses due to foreign exchange gain on loans in foreign currencies to customers with revenue and cash flows in ISK, as the Bank does not expect to recover the foreign exchange gain on these loans.

24. Administrative expenses

Administrative expenses consist of salaries and related expenses, depreciation of property and equipment, amortisation of intangible assets and other administrative expenses, such as housing costs, advertising expenses and information system related expenses.

25. Impairment of non-financial assets

The carrying amounts of the Bank's non-financial assets, other than investment property and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. For goodwill and intangible assets that have indefinite useful lives or that are not yet available for use, the recoverable amount is estimated each year at the same time. An impairment loss is recognised if the carrying amount of an asset or cash-generating unit (CGU) exceeds its estimated recoverable amount. Impairment losses on goodwill are recognised in profit or loss under the line item “Impairment of goodwill”.

An impairment loss for non-financial assets is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised. An impairment loss in respect of goodwill is never reversed.

87. Cont'd

Impairment of associates

Whenever there is an objective evidence that an investment in associates may be impaired, the entire carrying amount of the investment is tested for impairment by comparing its recoverable amount with its carrying amount, goodwill included in the carrying amount of an investment in an associate is not recognised separately and is therefore not tested separately for impairment according to the requirements for impairment testing of goodwill.

26. Bank tax

Bank tax is a tax on credit institutions which stated purpose is to create revenue for the Icelandic government to meet increased costs attributable to the insolvency of the Icelandic banks in October 2008. Furthermore, the tax is intended as a deterrent to increased risk appetite. Following the Icelandic governments debt relief initiatives introduced in 2013, the bank tax rate was set at 0.376% of total liabilities in excess of ISK 50bn effective from 1 January 2013. The Bank tax is shown in a separate line in the income statement.

27. Loan impairment charges and net valuation changes

Loan impairment charges and net valuation changes is the net amount recognised in profit or loss following a revision of estimates of receipts from loans and receivables. It is made up of income due to revision of estimated future cash flows and expenses due to individually and collectively assessed impairment losses on loans and receivables (see Note 86.27).

a) *Impairment charges*

A financial asset or a group of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. It may not be possible to identify a single, discrete event that caused the impairment. Rather the combined effect of several events may have caused the impairment. Losses expected as a result of future events, no matter how likely, are not recognised.

Impairment of loans and receivables

If there is objective evidence that an impairment loss has been incurred on loans and receivables, their carrying amount is reduced through the use of an allowance account to the present value of expected future cash flows, discounted at their original effective interest rate.

The criteria that the Bank uses to determine that there is objective evidence of an impairment loss include:
- Delinquency in contractual payments of principal or interest;
- Cash flow difficulties experienced by the borrower (for example, equity ratio, net income, percentage of sales);
- Breach of loan covenants or conditions;
- Initiation of bankruptcy proceedings;
- Deterioration of the customer's competitive position;
- Deterioration in the value of collateral;
- Downgrading of an asset;
- Restructuring and forbearance.

The Bank's management first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant. Loans and receivables that are not impaired individually become a part of a portfolio which is assessed for impairment. Collective assessment based on a portfolio assumes that loans and receivables have similar credit risk characteristics. Objective evidence of impairment of a group of loans and receivables exists if objective data indicates a decrease in expected future cash flows from a portfolio of loans and the decrease can be measured reliably but cannot be identified with the individual loans in the portfolio.

Interest income on impaired loans and receivables is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring impairment losses.

Calculation of recoverable amount

The recoverable amount of the Bank's loans and receivables is calculated as the present value of estimated future cash flows. The discount rate used for fixed rate loans and receivables is the effective interest rate computed at initial recognition. For variable rate loans and receivables the discount rate is the current effective interest rate.

The recoverable amount of other assets or cash generating units (CGUs) is the greater of their value in use and fair value less cost to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset or CGU. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the CGU to which the asset belongs.

87. Cont'd

Loan write-offs:

When a loan is uncollectible, it is written-off against the related allowance for impairment. Such loans are written-off after all the necessary procedures have been completed and the amount of the loss has been determined.

Reversals of impairment

An impairment loss in respect of loans and receivables is reversed if the subsequent increase in recoverable amount can be related objectively to an event occurring after the impairment loss was recognised.

Renegotiated loans

Where possible, the Bank seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated, the loan is no longer considered past due. Management continuously reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment.

If the terms of a financial asset are renegotiated or modified or an existing financial asset is replaced with a new one due to financial difficulties of the customer then an assessment is made whether the financial asset should be derecognised. If the cash flows of the renegotiated asset are substantially different, then the contractual rights to the cash flows from the original financial asset are deemed to have expired. In this case the original financial asset is derecognised and the new financial asset is recognised at fair value. The impairment loss is measured as follows:

- If the expected restructuring does not result in derecognition of the existing asset, the estimated cash flows arising from the modified financial asset are included in the measurement of the existing asset based on their expected timing and amounts discounted at the original effective interest rate of the existing financial asset.
- If the expected restructuring results in derecognition of the existing asset, then the expected fair value of the new asset is treated as the final cash flow from the existing financial asset at the time of derecognition. This amount is discounted from the expected date of derecognition to the reporting date using the original effective interest rate of the existing financial asset.

Provision for collective impairment

Provision for collective impairment losses reflects estimates of impairment losses that have been incurred but not identified in the reporting period for a group of loans that have similar credit risk characteristics.

b) Net valuation changes

At each reporting date, the Bank assesses the current status of loans and advances and whether there is any objective evidence of changes in expected cash flows, for example due to differences in estimated and actual payments, changes in the value of collaterals and improvement in the financial situation of debtors. If, in a subsequent period, the amount of an impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised or acquired, the previously recognised impairment loss is reversed. The amount of any reversal is recognised in profit or loss in the line item “Net valuation changes on loans and receivables”.

The Bank acquired part of the loans and advances at a deep discount. When loans and receivables are acquired at a deep discount, credit losses already incurred are reflected in the purchase price. The Bank includes such incurred credit losses in the estimated cash flows when computing the effective interest rate.

If the Bank revises its estimate of payments or receipts, the Bank adjusts the carrying amount of the loans and advances, to reflect actual and revised estimated cash flows. If there is any change in expected cash flows, the Bank recalculates the carrying amount of these loans and advances as the present value of the revised estimated future cash flows, using their effective interest rate method. The difference between the revised carrying amount of the loans and their current carrying amount, which includes accrued interest, indexation, foreign exchange differences and actual payments received by the Bank, is recognised in profit or loss in the line item “Net valuation changes on loans and receivables”. Upwards changes in estimated future cash flows are first recognised as a reversal of previously recognised impairment losses.

87. Cont'd

28. Income tax

Income tax, disclosed as a separate line item in the income statement comprises current and deferred tax from continuing operations, excluding the Bank's share of income tax of the Bank's equity-accounted associates. Income tax from discontinued operations is included in the line item “Profit (loss) from discontinued operations, net of income tax” in the income statement (see Note 87.29).

Income tax is recognised in profit or loss, except to the extent that it relates to items recognised in other comprehensive income or directly in equity, in which case the Bank recognises it in other comprehensive income or directly in equity, consistent with the recognition of the underlying item to which it relates.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is calculated based on temporary differences between the carrying amounts of assets and liabilities as presented in the tax return on the one hand, and in the consolidated financial statements on the other, taking into consideration any tax loss carry forwards. This difference is due to the fact that tax assessments are based on premises that differ from those governing the financial statements, mostly because revenues, especially of financial assets, are recognised earlier in the financial statements than in the tax return.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. A deferred tax asset is reduced to the extent that it is no longer probable that the related tax benefit will be realised.

Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, using tax rates enacted or substantially enacted at the reporting date.

Tax assets and tax liabilities are presented separately from other assets and liabilities in the statement of financial position, whereby current tax liabilities are distinguished from deferred tax assets and deferred tax liabilities. However, tax assets and tax liabilities that are part of disposal groups held for sale (see Note 87.13) are included in the line items “Non-current assets and disposal groups held for sale“ and „Non-current liabilities and disposal groups held for sale“, respectively, in the statement of financial position.

Current tax assets and current tax liabilities are offset in the statement of financial position if the Bank has a legally enforceable right to set off the recognised amounts and intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously. Deferred tax assets and liabilities are offset in the statement of financial position if the Bank has a legally enforceable right to set off current tax assets against current tax liabilities, and the deferred tax assets and the deferred tax liabilities relate to taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realised simultaneously.

29. Discontinued operations

The Bank presents in a separate line in the income statement the profit or loss from discontinued operations, net of income tax. Discontinued operations consist of subsidiaries acquired by the Bank exclusively with a view to resale that meet the criteria to be classified as held for sale (see Note 87.13) from acquisition date.

The profit or loss from discontinued operations consists of (a) the post-tax profit or loss of the subsidiaries acquired by the Bank exclusively with a view to resale, (b) the post-tax gain or loss recognised on the measurement to fair value less costs to sell and on the disposal of the subsidiaries acquired by the Bank exclusively with a view to resale and (c) the post-tax profit or loss from the sale of foreclosed assets held for sale.

30. Offsetting income and expenses

The Bank presents income and expenses on a net basis in the income statement only when required or permitted under IFRSs.

31. Earnings per share

The Bank presents basic and diluted earnings per share (EPS) for its ordinary shares. Basic EPS are calculated by dividing the profit or loss attributable to ordinary shareholders of the Bank by the weighted average number of ordinary shares outstanding during the period. Diluted EPS are determined by adjusting the profit or loss attributable to ordinary shareholders and the weighted average number of ordinary shares outstanding for the effects of all dilutive potential ordinary shares, if any.

87. Cont'd

32. Segment reporting

A business segment is a component of the Bank that engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses that relate to transactions with any of the Bank's other components. Each business segment is engaged in providing products or services which are subject to risk and return that are different from those of other business segments, and which are subject to regular review by the Bank's Board of Directors and Chief Executive Officer for the purpose of allocating resources and assessing performance.

33. Initial application of new standards and amendments to standards which had an effect on the consolidated financial statements of the Bank

The initial application of the following new standards and amendments to standards which became effective for the Bank on 1 January 2014 affected the consolidated financial statements of the Bank as follows:

a) IFRS 10 Consolidated Financial Statements changed the definition of control such that the Bank is required to consolidate an investee when the Bank has (a) power over the investee, (b) exposure, or rights, to variable returns from its involvement with the investee, and (c) the ability to use its power over the investee to affect the Bank's returns from its involvement with the investee. The Bank initiated an application project where the potential effect of the initial application of IFRS 10 was examined and documented. The Bank has subsequently determined that the application does not have a material effect on the consolidated financial statements of the Bank.

b) IFRS 12 Disclosure of Interests in Other Entities integrated in one standard and expanded the disclosures which the Bank must provide in respect of its interests in subsidiaries, associates and unconsolidated structured entities. The initial adoption of IFRS 12 has resulted in more extensive disclosures provided by the Bank in its consolidated financial statements in respect of its interests in subsidiaries (see Note 38) and associates (see Note 36).

c) IAS 28 Investments in Associates and Joint Ventures (as amended in 2011) prescribes the accounting for investments in associates and sets out the requirements for the application of the equity method when accounting for investments in associates and joint ventures. The initial application of IAS 28 (2011) did not have a material effect on the consolidated financial statements of the Bank.

34. New standards and amendments to standards adopted in advance by the Bank

The Bank did not early adopt any standards or amendments to standards which become effective after 1 January 2014.

35. New standards and amendments to standards which become effective for the Bank for annual periods beginning on or after 1 January 2015 and which have not been adopted in advance by the Bank

The following new standards and amendments to standards which are relevant for the Bank become effective for annual periods beginning on or after 1 January 2015 and have not been early adopted by the Bank:

a) IFRIC 21 Levies, which provides guidance on when to recognise in financial statements liabilities to pay levies imposed by governments, other than income taxes. IFRIC 21 clarifies that the obligating event that gives rise to a liability to pay a levy is the activity that triggers the payment of the levy, as identified by the relevant legislation. As such, a liability to pay a levy must be recognised progressively if the obligating event occurs over a period of time. However, if the obligating event is the reaching of a minimum activity threshold then the corresponding liability must be recognised when that minimum activity threshold is reached. IFRIC 21 clarifies that an entity does not have a present obligation to pay a levy that will be triggered by the entity operating in a future period. IFRIC 21 will become mandatory for the Bank starting with its consolidated financial statements for the year 2015, with retrospective application required. The Bank does not expect the initial application of IFRIC 21 to have a material impact on its consolidated financial statements.

b) Annual Improvements to IFRSs (2010-2012 and 2011-2013 cycles), which consist of various non-urgent but necessary amendments to nine international financial reporting standards. The amendments will become mandatory for the Bank starting with its consolidated financial statements for the year 2015, with prospective application generally required. The Bank does not expect the initial application of the amendments to have a material impact on its consolidated financial statements.

c) Annual Improvements to IFRSs (2012–2014 cycle), which consist of various non-urgent but necessary amendments to four international financial reporting standards. If endorsed by the EU, the amendments will become mandatory for the Bank starting with its consolidated financial statements for the year 2016, with some of them required to be applied prospectively but others retrospectively. The Bank does not expect the initial application of the amendments to have a material impact on its consolidated financial statements.

87. Cont'd

d) Amendments to IAS 16 and IAS 38 – Clarification of Acceptable Methods of Depreciation and Amortisation, which clarify that the use of revenue-based methods to calculate the depreciation of items of property, plant and equipment are not appropriate and that revenue is generally presumed to be an inappropriate basis for measuring the consumption of the economic benefits embodied in an intangible asset. If endorsed by the EU, the amendments will become mandatory for the Bank starting with its consolidated financial statements for the year 2016, with prospective application required. The Bank does not expect the initial application of the amendments to have a material impact on its consolidated financial statements.

e) Amendments to IFRS 10 and IAS 28 – Sale or Contribution of Assets between an Investor and its Associate or Joint Venture, which address an inconsistency between the requirements in IFRS 10 and those in IAS 28 in dealing with the sale or contribution of assets between an investor and its associate or joint venture. The main consequence of the amendments is that a full gain or loss must be recognised when a transaction involves a business but a partial gain or loss must be recognised when a transaction involves assets that do not constitute a business. If endorsed by the EU, the amendments will become mandatory for the Bank starting with its consolidated financial statements for the year 2016, with prospective application required. The Bank does not expect the initial application of the amendments to have a material impact on its consolidated financial statements.

f) Amendments to IAS 1 – Disclosure Initiative, which clarify existing requirements in IAS 1 and emphasise the need to apply professional judgement in determining the information required to be disclosed in financial statements. The amendments clarify that materiality applies to the whole of financial statements and that a specific disclosure required by an IFRS need not be provided if the information resulting from that disclosure is not material. Furthermore, the amendments clarify that when an entity decides the manner of presentation of the notes to the financial statements the entity must consider the effect on the understandability and comparability of the financial statements of the entity. The amendments also provide for specific criteria for presenting subtotals on the balance sheet and in the statement of profit or loss and other comprehensive income and require additional reconciliations. If endorsed by the EU, the amendments will become mandatory for the Bank starting with its consolidated financial statements for the year 2016, with retrospective application required. The Bank does not expect the initial application of the amendments to have a material impact on its consolidated financial statements.

g) IFRS 15 Revenue from Contracts with Customers, which establishes a single comprehensive framework for reporting to users of financial statements information about the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. IFRS 15 does not apply to revenue arising from financial instruments and lease contracts but it may apply to the fees charged by the Bank which are not part of effective interest rate calculations. The core principle of IFRS 15 is that revenue must be recognised so as to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Revenue must be recognised in accordance with that core principle by applying a five-step model to determine when to recognise revenue and at what amount. If endorsed by the EU, IFRS 15 will become mandatory for the Bank starting with its consolidated financial statements for the year 2017. The Bank will have a range of options on how to account for any changes in accounting policies which might result from the initial application of IFRS 15. The Bank does not plan to early adopt IFRS 15 and it is currently in the process of evaluating the possible effect of the initial application of IFRS 15 on its consolidated financial statements. More disclosures are however already anticipated.

h) IFRS 9 Financial Instruments replaces the existing rules in IAS 39 Financial Instruments: Recognition and Measurement and introduces consequential amendments to other standards, such as IAS 1 Presentation of Financial Statements and IFRS 7 Financial Instruments: Disclosures. The key features of IFRS 9 are the following:

- Financial assets are required to be classified into one of three measurement categories, i.e. measured subsequently at amortised cost, measured subsequently at fair value through other comprehensive income or measured subsequently at fair value through profit or loss. The assessment as to how an asset should be classified is to be made at initial recognition. Reclassification between measurement categories is required if the objective of the business model in which the financial assets are held changes after initial recognition and if the change is significant to the entity's operations.

- A financial asset is classified as being subsequently measured at amortised cost if the contractual terms of the financial asset give rise to cash flows that are solely payments of principal and interest and the asset is held within a business model whose objective is to collect contractual cash flows.

- A financial asset is classified as being subsequently measured at fair value through other comprehensive income if the contractual terms of the financial asset give rise to cash flows that are solely payments of principal and interest and the asset is held in a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets.

87. Cont'd

• All other financial assets are classified as being subsequently measured at fair value through profit or loss. In addition, there is an option at initial recognition to irrevocably designate a financial asset as at fair value through profit or loss if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise.

• All investments in equity instruments are to be measured subsequently at fair value. Equity instruments that are held for trading will be measured at fair value through profit or loss. For all other investments in equity instruments, an irrevocable election can be made at initial recognition, to recognise unrealised and realised fair value gains and losses, including any related foreign exchange component, in other comprehensive income rather than profit or loss. For such investments there will be no recycling of fair value gains and losses to profit or loss. This election may be made on an instrument-by-instrument basis. Dividends are to be presented in profit or loss, as long as they represent a return on investment.

• IFRS 9 retains the existing requirements in IAS 39 for embedded derivatives where the host is not a financial asset in the scope of IFRS 9, e.g. a financial liability or a lease receivable. However, derivatives embedded in financial assets that are within the scope of IFRS 9 are not to be separated. Instead, the whole hybrid financial instrument is to be assessed for classification in its entirety.

• IFRS 9 retains the existing requirements in IAS 39 for the classification of financial liabilities. For financial liabilities designated at fair value through profit or loss, the amount of change in fair value attributable to changes in the credit risk of those liabilities must, in general, be presented in other comprehensive income, with only the remaining amount of the total gain or loss being included in profit or loss. The amounts presented in other comprehensive income may not be subsequently reclassified to profit or loss but may be transferred within equity. However, if the recognition of gains and losses in other comprehensive income creates or enlarges an accounting mismatch in profit or loss, then the whole fair value change must be presented in profit or loss. Additionally, all fair value gains and losses continue to be included in profit or loss for loan commitments and financial guarantee contracts designated as fair value through profit or loss.

• IFRS 9 replaces the incurred loss model in IAS 39 with an expected credit loss model for calculating impairment on financial assets. The expected credit loss model in IFRS 9 will not apply to investments in equity instruments and financial assets classified as being subsequently measured at fair value through profit or loss. The expected credit loss model in IFRS 9 uses a dual measurement approach, under which the loss allowance for expected credit losses is measured at each reporting date as either 12-month expected credit losses or lifetime expected credit losses, depending on whether there has been a significant increase in credit risk of the financial instrument since initial recognition. Special rules will apply to financial assets that are credit-impaired at initial recognition.

• IFRS 9 includes a new general hedge accounting model, which aligns hedge accounting more closely with risk management. The new model does not fundamentally change the types of hedging relationships or the requirement to measure and recognise ineffectiveness under IAS 39. However, under the new model more hedging strategies that are used for risk management may qualify for hedge accounting. In addition, the effectiveness test has been overhauled and replaced with the principle of economic relationship. Retrospective assessment of hedge effectiveness will also no longer be required. IFRS 9 carries forward guidance from IAS 39 on portfolio fair value hedges of interest rate risk and also allows entities to continue to apply all of the hedging requirements in IAS 39 rather than applying the new general hedge accounting model.

• IFRS 9 introduces new presentation requirements and extensive new and amended disclosure requirements, including requirements for disclosures about transition from IAS 39 to IFRS 9.

If endorsed by the EU, IFRS 9 will become mandatory for the Bank starting with its consolidated financial statements for the year 2018, with retrospective application generally required but subject to specific exceptions. The Bank does not plan to early adopt IFRS 9 but has initiated a formal implementation project to ensure that the Bank will be ready for parallel run in 2017 and for full disclosures with comparatives in 2018. The Bank is currently in the process of evaluating the potential effect of the initial application of IFRS 9 on its consolidated financial statements. Given the nature of the Bank's operations, if endorsed by the EU, the standard is expected to have a pervasive impact on the consolidated financial statements of the Bank in the period of initial application.

Unaudited Appendix: Corporate Governance Statement

The Board of Directors of Íslandsbanki is committed to excellence in corporate governance complying with the applicable regulatory standards and best international practices in the field of corporate governance.

Íslandsbanki's governance practises are consistent with general corporate governance guidelines for entities regulated by official supervisors and regulatory instruments. The regulatory framework for corporate governance practices within Íslandsbanki consists of the law applicable to entities subject to the supervision of the Financial Supervisory Authority (FME) as well as other applicable law and regulations, including those imposed by the FME and the NASDAQ OMX Nordic Exchange in Iceland, available at their websites.[1] The applicable law includes, inter alia, the Act on Financial Undertakings No. 161/2002, the Act on Securities Transactions 108/2007, the Act on Competition No. 44/2005 and the Act on Public Limited Companies No. 2/1995, which along with the Íslandsbanki's Articles of Association lay the foundation for the Bank's existence and activities. The relevant law is available on the Icelandic legislature's website.[2]

Exemplary in Corporate Governance

Íslandsbanki is committed to maintaining high standards of governance complying with best governance practices. Íslandsbanki was recognized as "Exemplary in Corporate Governance" in March 2014 by the Center of Corporate Governance at the Institute for Business Research, University of Iceland. The recognition was awarded following a comprehensive review of the practices of the Board, Board subcommittees and management.

Íslandsbanki has a good governance policy, the Decision Making Matrix, which outlines all major decisions that the Bank may wish to take under given circumstances. The policy is a part of the bank's effort to improve its material actions and enhance stakeholders trust. The Decision Making Matrix sets specific conditions to all major decision making. Furthermore, it sets the requirement that all such decisions are taken with the input of the best qualified parties within the Bank and on the basis of the best available information at the time.

Compliance to Corporate Governance Guidelines

In accordance with Paragraph 3 of Article 19 of the Act on Financial Undertakings No. 161/2002, the Bank is required to comply with accepted guidelines on the governance of financial undertakings. The Board of Directors follows the Corporate Governance guidelines issued in March 2012 (4th ed.) by the Iceland Chamber of Commerce, NASDAQ OMX Iceland and SA-Business Iceland (former Confederation of Icelandic Employers). The guidelines are available on the website of Icelandic Chamber of Commerce.[3]

Governance practices of the Bank are consistent with the guidelines. Íslandsbanki complies with them in all respects except for certain items in Articles 1.2., 2.10., 5.1. and 5.2.C.1. The following discussion explains the reasons behind these exceptions as well as measures taken in relation to them;

In accordance with Article 1.2. of the guidelines the Chairman of the Board and a required majority of the Board should preferably be present at a shareholders' meeting, together with the CEO. According to the said Article it is also preferable that auditors and not less than one member of the Bank's subcommittees be present, when appropriate. Íslandsbanki has followed this in detail in regards to the Annual General Meeting (AGM), but not in other shareholders' meetings because the bank has not considered it necessary since there are only two shareholders.

According to Article 2.10. of the guidelines it is preferred that the Board establishes a policy of social responsibility and code of ethics. The Executive Board of the Bank adopted a code of conduct for the Bank in January 2011. The Board of Directors has approved of a road map outlining a new Corporate Social Responsibility (CSR) Policy and strategic developmental projects are in progress. Subsequently, the Board will adopt a new CSR Policy.

Article 5.1. of the guidelines stipulates that the rules of procedure of all of the Board's subcommittees shall be posted on the Bank's website. Each subcommittee of the Board of Íslandsbanki operates under the terms of a mandate letter from the Board as well as the Rules of Procedure of the Board which are available on the Bank's website. Furthermore, a description of the role and responsibilities of the Board's subcommittees is provided on the Bank's website which the Board has considered sufficient in this respect.

In accordance with Article 5.2.C.1 of the guidelines the Board may decide to establish a Nomination Committee. Íslandsbanki's Board has not deemed it necessary to appoint a nomination committee.

Main aspects of Risk Management and Internal Control

The Board of Directors has a supervising role monitoring the execution of set policies, the sound control of accounting and financial management and ensures that group internal audit, compliance and risk management are effective at all times.

The management committees; The Executive Board, Risk Committee, Asset and Liability Committee and Investment Committee, are responsible for implementing risk management practises and internal monitoring in accordance with Board authorisation. Under this authorisation, these committees issue detailed guidelines for risk assessment and individual risk thresholds in accordance with the Bank's defined risk appetite.

[1] www.fme.is and www.nasdaqomxnordic.com
[2] www.althingi.is
[3] www.vi.is

Group Internal Audit operates independently from other departments in accordance with Article 16 of the Act on Financial Undertakings No. 161/2002. The department provides Íslandsbanki with independent, objective, assurance over the effectiveness of risk management, control and governance processes. The Chief Audit Executive is appointed by the Board and is responsible for internal audit on a group basis.

As a financial undertaking licensed to conduct securities trading and an issuer of listed financial instruments, Íslandsbanki operates a compliance department. The Bank's Compliance Officer is appointed by the CEO, subject to Board confirmation, conferring the department's mandate, in accordance with Article 130 of the Act on Securities Transactions No. 108/2007. The Compliance officer maintains an independent position within the Bank's organisation and is responsible for monitoring and assessing regularly whether the Bank's operations, regarding securities transactions, are in compliance with applicable law. Furthermore, the Compliance Officer is the Bank's responsible officer under the US Foreign Account Tax Compliance Act (FATCA) and is also responsible for compliance with Act on measures against money laundering and terrorist financing No. 64/2006.

As provided for in the Bank's Articles of Association and the Act on Financial Undertakings, the Bank's audit firm shall be elected at the AGM for a term of five years. Deloitte hf. was elected to serve as Íslandsbanki's independent external auditing firm at the 2010 AGM and a new audit firm will be elected at the 2015 AGM.

Further information on risk management and internal control can be found in the bank's annual risk report which is published on its website.

In 2014 Íslandsbanki was found, by the Icelandic Consumer Agency, to be in violation of certain Articles of the expired Act on Consumer Credit no. 121/2014 and Act on Supervision of Commercial Practices and Transparency of the Market No. 51/2007. The Bank disagrees with the agency's decisions and has appealed both cases to the Consumer Appeals Committee. Further information on this, and other legal cases relating to Íslandsbanki, can be found in the notes to the consolidated financial statements.

Íslandsbanki Values, Code of Conduct and Social Responsibility

Íslandsbanki's values are the pillars of the Bank's corporate culture, shaping the conduct and attitudes of its employees. The values insist on employees being professional, disciplined in their working procedures, and following matters through – professional, positive and progressive.

In order to maintain and strengthen the credibility and the reputation of the Bank, all employees were involved in formulating the Bank's Code of Conduct which is available on the Bank's website. The aim of the code is to promote good operational and business practices, increase trust and guide employees in their daily work.

Íslandsbanki seeks to work in harmony with the communities in which it operates, delivering support for its immediate environment in the areas of culture, sports, community affairs as well as entrepreneurship and innovation. This participation in community programmes rests on Íslandsbanki's Corporate Social Responsibility Policy set by the Executive Board. The policy covers five key areas: business, education, environment, human capital, and society. Furthermore, the Bank produces an annual report, Íslandsbanki in the Community: Global Compact, which can be accessed on the Bank's website. For the last six years Íslandsbanki has been a signatory to the UN Global Compact on social responsibility. The compact is a guide for companies on how to be socially responsible in practice. The Board has approved of a road map that outlines a new Corporate Social Responsibility (CSR) Policy and strategic developmental CSR projects are in progress. Subsequently, the Board will adopt a new CSR Policy.

Board of Directors

The Board of Directors comprises seven non-executive directors, and three alternates, elected at each AGM for a term of one year. The Chairman of the Board is elected at a shareholders' meeting. There are no limitations on duration of Board membership.

The Board undertakes the Bank's affairs in between shareholders' meetings unless otherwise provided by law or the Articles of Association. The Board is responsible for the formulation of the Bank's general strategy and instructs the CEO on its further implementation and execution. The Board has a supervisory role in that it oversees that the Bank's organisation and activities are at all times in accordance with the relevant law, regulations and good business practices. The Board appoints the CEO and Chief Audit Executive.

The Rules of Procedure of the Board are adopted in accordance with Article 70 of the Act on Public Limited Companies No 2/1995 and Article 54 of the Act on Financial Undertakings No 161/2002. The Board's current rules of Procedure, adopted 27 August 2013, are available on the Bank's website. According to its Rules of Procedure, at meetings of the Board the presence of at least five members of the Board is required to constitute a quorum. The Board met 13 times in 2014, constituting a quorum each time.

In accordance with the rules governing its activities, the Board appoints subcommittees. Each subcommittee operates under the terms of a mandate letter from the Board as well as the Rules of Procedure of the Board. There are four Board appointed subcommittees:

The Board Audit Committee, comprising three Board members, assists the Board in fulfilling its oversight responsibilities concerning the financial reporting process, the system of internal control, the audit process and the bank's process for monitoring compliance with laws and regulations and its code of ethics. The committee met 11 times in 2014, all of which were valid.

The Board Risk Management Committee, which comprises three Board members, is responsible for assisting the Board in providing oversight of senior management's activities in managing risk relevant to the Bank's operations. It is also responsible for reviewing the Risk Management and Internal Control Policy set by the Board. The committee met 7 times in 2014, all of which were valid.

The Board Strategy Committee, which comprises of four Board members, oversees and approves key issues related to the strategy of the Bank and formulates general policies to effectively implement that strategy. The Committee sets out strategic and financial targets and monitors their progress. The committee met 7 times in 2014, all of which were valid.

The Board Corporate Governance, Compensation and Human Resource Committee, which comprises four Board members, assists the Board in overseeing the development and the regular assessment of the Bank's approach to corporate governance issues and board effectiveness. Furthermore it is responsible for providing oversight regarding compensation and human resource issues. The committee met 7 times in 2014, all of which were valid.

Structure and composition of Board subcommittees is as follows:

	The Board Audit Committee	The Board Risk Management Committee	The Board Strategy Committee	The Board Corporate Governance, Compensation and HR Committee
Fridrik Sophusson			Member	Chair
John E. Mack			Chair	Member
Árni Tómasson	Member	Member		
Helga Valfells		Member		Member
Marianne Økland	Member	Chair		
Neil Graeme Brown	Chair		Member	
Dr. Thóranna Jónsdóttir			Member	Member

Member Chair

Members of the Board

Friðrik Sophusson, chairman of the Board, born in 1943 and is an Icelandic national. He holds a Cand. Jur. degree in Law from the University of Iceland. He joined the Board in January 2010. He also serves as board chairman of Hlíðarendi ses. and as an alternative board member of Fondament ehf.

John E. Mack, vice-chairman of the Board, born in 1947 and is a United States national. He has a MBA degree from the University of Virginia, Darden School of business and a B.A. degree in economics from Davidson College. He joined the Board in January 2010. He also serves as board member of Flowers National Bank, Incapital Holdings, Medley Capital Corporation, and Search Light Minerals (SRCH).

Neil Graeme Brown, born in 1959 and is a British national. He has an M.A. degree in classics from Emmanuel College, Cambridge and is an associate at of the Institute of Chartered Accountants (ACA). He joined the Board in January 2010. He is a founding partner of Subito Partners, a London based board advisory and investment business, specialising in private investments and restructuring. He also serves as board member of Gate Group AG, Magma Finance, AVC NEXT-GEN and Euro Car Parts Limited.

Árni Tómasson, born in 1955 and is an Icelandic national. He has a Cand. Oecon degree in business from the University of Iceland and is a state authorized public accountant. He joined the Board in January 2010. He runs his own consulting firm, AT ráðgjöf ehf. and serves as a board member of Reviva Capital S.A., AT Ráðgjöf ehf., Skjaldborg kröfuhafafélag 15 ehf., Skjaldborg Kröfuhafafélag 10 ehf. and Kaffitár hf.

Marianne Økland, born in 1962 and is a Norwegian national. She has a M.Sc. degree in finance and economics from the Norwegian School of Economics and Business Administration. She is the managing director of Avista Partners. She joined the Board in January 2010. She also serves as board member of IDFC and Scorpio Tankers Inc.

Dr. Þóranna Jónsdóttir, born in 1968 and is an Icelandic national. She has a Doctorate Degree in Business Administration from Cranfield University, UK, an MBA degree from IESE Barcelona and a MSc degree in Pharmaceuticals, and is chartered stockbroker. She joined the Board in September 2013. She is the Dean of Reykjavík University's School of Business, managing director and board member of Kaliber ehf., Ísarn ehf., Festi ehf. and Kaupás ehf. An alternate board member of Klak Innovit ehf. and Grunnstöð ehf.

Helga Valfells, born in 1964 and is an Icelandic national. She has a MBA degree from London Business School, UK, and a B.A. degree in Economics and English Literature from Harvard University. She joined the Board in September 2013. She is managing director of NSA Ventures, owner and managing director of Árhólmi ehf., owner and alternate board member of Uggi ehf. Board member of Mentor ehf., Klak Innovit ehf., Transmit ehf., Vesturgarður ehf., Frumtak GP hf. and Azazo hf. An alternate board member of AMP ehf., InfoMentor ehf., Norrænar myndir ehf., Akthelia ehf., FSÍ (Framtakssjóður Ísl) GP hf., Greenqloud ehf. and Íslensk nýsköpun ehf.

Alternate members of the Board are three; **Margrét Kristmannsdóttir**, since September 2014, **Gunnar Fjalar Helgason,** since September 2013, and **Jón Eiríksson** since January 2011.

All members of the Board are considered independent from the Bank and large shareholders of the Bank except for Árni Tómasson who is not considered independent from the largest shareholder in the Bank on account of his work for the shareholder during the course of the past three years.

Board Performance Assessment

At least once a year, as provided for in the Board's Rules of Procedure, the Board shall assess its work, procedures and practices. This performance assessment is intended to improve working methods and increase efficiency of the Board. The assessment entails the evaluation of the strengths and weaknesses of the Board's work and practices. This is i.a. based on Board members' self-assessment on whether the Board rules of procedure have been complied with in all respects, status taken of the specific priorities set by the Board regarding risk management and internal control within the Bank as well as a follow up on how certain decisions of the Board have been implemented.

Executive Management

The Chief Executive Officer (CEO) is responsible for overseeing the Bank's daily operations in accordance with set policy and Board decisions. The CEO is also to ensure that the Bank's operations are in compliance with the law and the Articles of Association at all times. The CEO appoints the Bank's Compliance Officer, members of the Executive Board and members of other management committees.

Birna Einarsdóttir is the CEO of Íslandsbanki, born in 1961 and is an Icelandic National. She has a Cand. Oecon. degree in business administration from the University of Iceland and a MBA degree from the University of Edinburgh. Birna has been with Íslandsbanki and its predecessors in various divisions for over 19 years. Previously she was a senior product manager at Royal Bank of Scotland and has worked as a marketing manager for Íslenska útvarpsfélagið and Íslensk Getspá.

Together with the CEO, the Executive Board manages the daily activities of the Bank according to the strategy set out by the Board. It consists of 9 people, including the CEO: **Birna Einarsdóttir,** CEO since October 2008, **Björgvin Ingi Ólafsson**, Managing Director of Relationship Banking since September 2014, **Elín Jónsdóttir**, Managing Director of Asset Management since July 2014, **Jón Guðni Ómarsson**, Chief Financial Officer since October 2011, **Sigríður Olgeirsdóttir**, Chief Operating Officer since September 2010, **Sverrir Örn Þorvaldsson**, Chief Risk Officer since November 2010, **Tryggvi Björn Davíðsson,** Managing Director of Markets since September 2011, **Una Steinsdóttir,** Managing Director of Retail Banking since October 2008 and **Vilhelm Már Þorsteinsson** Managing Director of Corporate Banking since October 2008.

The CEO and management committees are responsible for implementing risk management practices and internal monitoring in accordance with Board authorization. The committees are appointed by the CEO, and their letters of mandate and rules of procedure are approved by the Board:

The Executive Board sets the Bank's policy for operational risk at the group level and supervises reputational risk, business risk and strategic risk as well as the Bank's formal product approval policy.

The Risk Committee manages and supervises lending issues and other counterparty risk, in accordance with the Bank's credit policy and lending rules.

The Asset and Liability Committee monitors other financial risks, such as market risk, liquidity risk, and interest rate risk in the Bank's non-trading portfolio.

The Investment Committee makes decisions on the purchase or sale of equity holdings in companies, as well as other types of investments, including investment funds and real estate.

Further to this three other departments report directly to the CEO; Legal department, Human Resources, and Compliance.

Arrangement of communications between shareholders and the Board

The Board communicates with shareholders in accordance with the relevant laws, the Bank's Articles of Association and the Board's Rules of Procedure. Members of the Board of Directors shall, in their duties and decision-making, safeguard the interests of the Bank and shareholders in accordance with the provisions of Act No. 2/1995, on Public Limited Companies, Act No. 161/2002, on Financial Undertakings, and other current rules and guidelines about the activities of financial undertakings.

Glitnir Bank hf. holds 95% of the share capital in Íslandsbanki through its subsidiary ISB Holding ehf. The remaining 5% is held by the Icelandic government and is administered by Icelandic State Financial Investments (ISFI). Shareholder meetings are the general forum for informing and communicating with shareholders. In between meetings of the Bank's shareholders the Chairman of the Board, on behalf of the Board of directors, is responsible for communications with shareholders.

Shareholders can at any time express their views in relation to the operations of the Bank to the Board of Directors and submit queries to the Board for discussion.

This Corporate Governance Statement was approved by the Board Corporate Governance, Compensation and Human Resource Committee and the Board of Directors on 23 February 2015.